Deep Down, Inc.
Form 10-Q
November 14, 2017

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, 2017

OR

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

Commission File No. 000-30351

DEEP DOWN, INC.

(Exact name of registrant as specified in its charter)

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

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

Not applicable

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

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

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

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

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨	Smaller reporting company þ
Emerging growth company ¨	

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

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

At November 14, 2017, there were 13,436,243 shares outstanding of Common Stock, par value $0.001 per share.

IMPORTANT INFORMATION REGARDING THIS FORM 10-Q

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

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

Our current operations are primarily conducted under Deep Down Delaware. 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; and
- 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, 2016, other periodic and current reports we have filed with the SEC or this Report.

Access to Filings

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

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

DEEP DOWN, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share and par value amounts)

	September 30, 2017 Unaudited	December 31, 2016
ASSETS		
Current assets:		
Cash	$ 5,693	$ 8,203
Short term investment (certificate of deposit)	1,015	1,005
Accounts receivable, net of allowance of $10	3,647	5,945
Costs and estimated earnings in excess of billings on uncompleted contracts	298	1,077
Prepaid expenses and other current assets	909	864
Total current assets	11,562	17,094
Property, plant and equipment, net	8,737	7,938
Intangibles, net	64	69
Long term asset - Carousel	3,117	3,117
Other assets	326	211
Total assets	$ 23,806	$ 28,429
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$ 1,466	$ 1,778
Billings in excess of costs and estimated earnings on uncompleted contracts	604	3,349
Total current liabilities	2,070	5,127
Total liabilities	2,070	5,127
Commitments and contingencies (Note 8)		
Stockholders' equity:		
Preferred stock, $0.001 par value, 10,000,000 shares authorized, 0 shares issued	–	–
Common stock, $0.001 par value, 24,500,000 shares authorized, 15,438,660 and 15,408,660 shares issued, respectively	15	15
Treasury stock, 2,002,417 and 587,847 shares at cost, respectively	(2,041)	(567)
Additional paid-in capital	73,213	73,112
Accumulated deficit	(49,451)	(49,258)

Total stockholders' equity	21,736	23,302
Total liabilities and stockholders' equity	$ 23,806	$ 28,429

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

(In thousands, except per share amounts)	Three Months Ended September 30, 2017	Three Months Ended September 30, 2016	Nine Months Ended September 30, 2017	Nine Months Ended September 30, 2016
	Unaudited			
Revenues	$3,470	$9,165	$14,458	$19,489
Cost of sales:				
Cost of sales	2,103	5,498	7,151	11,835
Depreciation expense	333	370	966	982
Total cost of sales	2,436	5,868	8,117	12,817
Gross profit	1,034	3,297	6,341	6,672
Operating expenses:				
Selling, general and administrative	2,264	2,210	6,995	7,376
Depreciation and amortization	79	113	238	313
Total operating expenses	2,343	2,323	7,233	7,689
Operating income (loss)	(1,309)	974	(892)	(1,017)
Other income (expense):				
Interest income (expense), net	21	10	46	(51)
Equity in net income of joint venture	–	–	94	–
Gain on sale of assets	559	–	574	1,070
Total other income (expense)	580	10	714	1,019
Income (loss) before income taxes	(729)	984	(178)	2
Income tax expense	(5)	(5)	(15)	(16)
Net income (loss)	$(734)	$979	$(193)	$(14)
Net income (loss) per share:				
Basic	$(0.05)	$0.06	$(0.01)	$–
Fully diluted	$(0.05)	$0.06	$(0.01)	$–
Weighted-average shares outstanding:				
Basic	14,695	15,493	15,074	15,534
Fully diluted	14,695	15,493	15,074	15,534

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

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DEEP DOWN, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)	Nine Months Ended September 30, 2017	2016
	Unaudited	
Cash flows from operating activities:		
Net loss	$(193)	$(14)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Share-based compensation	101	309
Depreciation and amortization	1,204	1,295
Gain on sale of assets	(574)	(1,070)
Write-off of deferred financing fees	–	23
Equity in net income of joint venture	(94)	–
Changes in assets and liabilities:		
Accounts receivable, net of allowance	2,298	551
Costs and estimated earnings in excess of billings on uncompleted contracts	779	(848)
Prepaid expenses and other current assets	(45)	(56)
Other assets	(161)	37
Accounts payable and accrued liabilities	(362)	217
Billings in excess of costs and estimated earnings on uncompleted contracts	(2,745)	2,209
Net cash provided by operating activities	208	2,653
Cash flows from investing activities:		
Purchases of property, plant and equipment	(2,306)	(1,105)
Proceeds from sale of assets (net of $60 cash paid for costs to sell)	958	3,800
Repayments received on employee receivable	20	11
Other investing activity	(10)	–
Cash distribution received from joint venture	94	161
Net cash provided by (used in) investing activities	(1,244)	2,867
Cash flows from financing activities:		
Cash paid for purchase of our common stock	(1,474)	(305)
Proceeds from bank loans	–	300
Cash paid for deferred financing costs	–	(15)
Release of compensating balance	–	3,900
Repayments of long-term debt	–	(3,047)
Net cash provided by (used in) financing activities	(1,474)	833
Change in cash	(2,510)	6,353
Cash, beginning of period	8,203	374
Cash, end of period	$5,693	$6,727

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

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands except per share amounts)

NOTE 1: BASIS OF PRESENTATION

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Deep Down, Inc. and its directly and indirectly wholly-owned subsidiaries ("Deep Down," "we," "us" or the "Company") were prepared in accordance with the rules and regulations of the Securities and Exchange Commission ("SEC" or the "Commission") pertaining to interim financial information and instructions to Form 10-Q. As permitted under those rules, certain footnotes or other financial information that are normally required by United States generally accepted accounting principles ("US GAAP") can be condensed or omitted. Therefore, these statements should be read in conjunction with the audited consolidated financial statements, and notes thereto, included in our Annual Report on Form 10-K for the year ended December 31, 2016, filed on March 31, 2017 with the Commission.

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

Principles of Consolidation

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

Segments

For the quarters ended September 30, 2017 and 2016, we had one operating and reporting segment, Deep Down Delaware.

Recently Issued Accounting Standards Not Yet Adopted

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers" ("ASU 2014-09"). This update provides a five-step approach to be applied to all contracts with customers and requires expanded disclosures about the nature, amount, timing and uncertainty of revenue (and the related cash flows) arising from customer contracts, significant judgments and changes in judgments used in applying the revenue model and the assets recognized from costs incurred to obtain or fulfill a contract. The effective date for this standard was deferred in July 2015 and will now be effective for us beginning January 1, 2018. The standard provides for different application methods during adoption. We are currently in the process of evaluating the potential impact this new pronouncement will have on our financial statements. We are reviewing our existing contracts to identify any that may be impacted by this standard, and evaluating new contracts we are negotiating to ensure compliance with this standard. We have not completed our full evaluation and therefore cannot conclude whether the pronouncement will have a significant impact on our financial statements at this time, but we expect requirements of this standard to significantly enhance our revenue disclosures. We currently anticipate that we will utilize the modified retrospective method of adoption, however, this expectation may change following the completion of our evaluation of the impact of this pronouncement on our financial statements.

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

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands except per share amounts)

In October 2016, the FASB issued ASU No. 2016-16, "Intra-Entity Transfers of Assets Other Than Inventory." This update requires that income tax consequences are recognized on an intra-entity transfer of an asset other than inventory when the transfer occurs. The amendments in this ASU are effective for us on January 1, 2018. We are currently evaluating the impact of this ASU on our consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-01, "Business Combinations." This new ASU clarified the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The new standard is effective for us January 1, 2018 and will be applied prospectively. We are currently evaluating the impact of our pending adoption of the new standard, but do not expect it to have a material impact on our consolidated financial position or results of operations.

In February 2017, the FASB issued ASU No. 2017-05, "Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets" ("ASU 2017-05"). This update clarifies the scope of accounting for the derecognition or partial sale of nonfinancial assets to exclude all businesses and nonprofit activities. ASU 2017-05 also provides a definition for in-substance nonfinancial assets and additional guidance on partial sales of nonfinancial assets. We are currently evaluating the effect of ASU No. 2017-05 on our consolidated financial statements and will adopt ASU 2017-05 in conjunction with ASU 2014-09 on January 1, 2018.

In May 2017, the FASB issued ASU No. 2017-09, "Scope of Modification Accounting" ("ASU 2017-09"), which amends the scope of modification accounting for share-based payment arrangements. This update clarifies when a change to the terms or conditions of a share-based payment award should be accounted for as a modification. An entity should account for the effects of a modification unless the fair value, vesting conditions and classification, as an entity instrument or a liability instrument, of the modified award are the same before and after a change to the terms or conditions of the share-based payment award. The new standard is effective for us January 1, 2018. We do not expect ASU 2017-09 to have a material impact on our consolidated financial position or results of operations.

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, 2017	December 31, 2016
Costs incurred on uncompleted contracts	$ 8,525	$ 8,858
Estimated earnings on uncompleted contracts	9,266	6,777
	17,791	15,635
Less: Billings to date on uncompleted contracts	(18,097)	(17,907)
	$ (306)	$ (2,272)
Included in the accompanying condensed consolidated balance sheets under the following captions:		
Costs and estimated earnings in excess of billings on uncompleted contracts	$ 298	$ 1,077
Billings in excess of costs and estimated earnings on uncompleted contracts	(604)	(3,349)
	$ (306)	$ (2,272)

The balance in costs and estimated earnings in excess of billings on uncompleted contracts at September 30, 2017 and December 31, 2016 consisted primarily of earned but unbilled revenues related to fixed-price projects.

The balance in billings in excess of costs and estimated earnings on uncompleted contracts at September 30, 2017 and December 31, 2016 consisted primarily of unearned billings related to fixed-price projects.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands except per share amounts)

NOTE 3: PROPERTY, PLANT AND EQUIPMENT

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

	September 30, 2017	December 31, 2016	Range of Asset Lives
Buildings and improvements	285	5	7 - 36 years
Leasehold improvements	908	908	2 - 5 years
Equipment	15,372	16,360	2 - 30 years
Furniture, computers and office equipment	1,245	1,274	2 - 8 years
Construction in progress	1,938	586	–
Total property, plant and equipment	19,748	19,133	
Less: Accumulated depreciation and amortization	(11,011)	(11,195)	
Property, plant and equipment, net	$ 8,737	$ 7,938	

NOTE 4: LONG-TERM DEBT

From 2008 through June 30, 2016, we maintained a credit facility (the “Facility”) with Whitney Bank. In March 2016, we paid all borrowings under the Facility with proceeds received from the sale of our Channelview location. Following the expiration of the Facility on June 30, 2016, we no longer have any credit facilities available to us.

NOTE 5: SHARE-BASED COMPENSATION

Share-based Compensation Plan

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. Share-based compensation expense related to awards is based on the fair value at the date of grant, and is recognized over the requisite expected service period, net of estimated forfeitures. Under the Plan, the total number of options permitted is 15 percent of issued and outstanding common shares.

Summary of Nonvested Shares of Restricted Stock

On May 2, 2017, we granted 30 shares of restricted stock to an independent director. These shares have a fair value grant price of $1.15 per share, based on the closing price of our common stock on that day. These shares vest over three years in equal tranches on the grant date anniversary, subject to continued service on our Board of Directors. We are amortizing the related share-based compensation of $33 over the three-year requisite service period.

For the nine months ended September 30, 2017 and 2016, we recognized a total of $101 and $309, respectively, of share-based compensation expense related to restricted stock awards, which is included in selling, general and administrative expenses in the accompanying unaudited condensed consolidated statements of operations. The unamortized estimated fair value of nonvested shares of restricted stock awards was $73 at September 30, 2017. These costs are expected to be recognized as expense over a weighted-average period of 0.30 years.

NOTE 6: TREASURY STOCK

On May 23, 2016, our Board of Directors authorized a repurchase program (the "Repurchase Program") under which we were originally authorized to repurchase up to $1,000 of our outstanding stock. Subsequently, on March 29, 2017, our Board of Directors authorized a renewal and extension of the Repurchase Program for an additional $1,000 until March 31, 2018. The purchases could be made from time to time in the open market, through privately negotiated transactions and Rule 10b5-1 trading plans in accordance with applicable laws, rules and regulations. The Repurchase Program was funded from cash on hand and cash provided by operating activities. As of September 30, 2017, we had exhausted the Repurchase Program. As of the date of this report no decisions have been made on any further stock repurchases. The average price per share of treasury stock through September 30, 2017 was $1.02. Treasury shares are accounted for using the cost method.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands except per share amounts)

NOTE 7: INCOME TAXES

Income tax expense during interim periods is based on applying the estimated annual effective income tax rate to interim period operations. The estimated annual effective income tax rate may vary from the statutory rate due to the impact of permanent items relative to our pre-tax income, as well as by any valuation allowance recorded. We employ an asset and liability approach that results in the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the financial basis and the tax basis of those assets and liabilities. A valuation allowance is established when it is more likely than not that some of the deferred tax assets will not be realized. 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, 2017 and December 31, 2016 management has recorded a full deferred tax asset valuation allowance.

NOTE 8: COMMITMENTS AND CONTINGENCIES

Litigation

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

NOTE 9: EARNINGS PER COMMON SHARE

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

At September 30, 2017 and 2016, there were potentially dilutive securities outstanding, but they were not taken into consideration in calculating diluted EPS because there were losses, so including them would have been anti-dilutive.

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

The following discussion and analysis provides information that management believes is relevant for an assessment and understanding of our results of operations and financial condition. This information should be read in conjunction with our audited historical consolidated financial statements, which are included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2016, filed with the Securities and Exchange Commission (“SEC”) on March 31, 2017 and our unaudited condensed consolidated financial statements, and notes thereto, included with this Quarterly Report on Form 10-Q (“Report”) in Part I. Item 1. “Financial Statements.” and is available on the SEC’s website.

General

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

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, respectively, unless otherwise indicated.

Industry and Executive Outlook

Three years into the downturn in oil prices, the industry has largely come to terms with the lower prices, and adjusted accordingly. So much so, that the recent slight uptick in prices is giving rise to optimism about the future. However, even without increases in prices, oil companies have modified their strategies to manage their operations with the lower prices, with projects being executed at breakeven prices as low as $50 a barrel.

One key strategy being employed across the industry is the increased use of strategic partnerships. Whether between oil and gas operators and their suppliers, or between suppliers who serve different steps along the value chain, these partnerships are realizing increased value due to the alignment of incentives, while spreading project risks.

While we are disheartened by delays in some key projects we expect to be working on, and the resulting disappointing results, we are cautiously optimistic that partnerships we are pursuing will provide material benefits for us in 2018 and beyond, even as we continue to engage with our existing and new customers on their projects. We are especially looking to take advantage of such partnerships to pursue opportunities in international markets, where there is an increase in the focus on local content regulations, in order to enhance local capacity.

We are continuing to engage in more discussions with different customers on what is commonly referred to as brownfield work, which is where operators seek to derive further benefit from their existing infrastructure, rather than develop new fields. We continue to view this as a growth opportunity for us, especially as a mitigation for continued delays in new projects, and are making concerted efforts to enhance our market position in this area.

Our balance sheet continues to be strong, we continue to evaluate opportunities to optimize our cost structure, and we are continuing to engage with our customers as they make plans for their projects in 2018 and beyond. Through these efforts we remain strongly committed to creating the most value for our customers, shareholders and employees.

Results of Operations

Three Months Ended September 30, 2017 Compared to Three Months Ended September 30, 2016

Revenues. Revenues for the three months ended September 30, 2017 were $3,470 compared to revenues of $9,165 for the three months ended September 30, 2016. The $5,695, or 62 percent, decrease was primarily the result of delays in the commencement of certain customer projects, and fewer projects in process in 2017, coupled with the commencement of procurement and manufacturing activities on certain customer orders that resulted in higher than normal revenues in the three month period ended September 30, 2016.

Gross profit. Gross profit for the three months ended September 30, 2017 was $1,034, or 30 percent of revenues, compared to $3,297, or 36 percent of revenues, for the three months ended September 30, 2016. The $2,263 decrease in gross profit, or 6 percent decrease in gross profit percentage respectively, was due to lower revenues in the three months ended September 30, 2017.

Selling, general and administrative expenses. Selling, general and administrative ("SG&A") expenses were $2,264, or 65 percent of revenues, for the three months ended September 30, 2017 compared to $2,210, or 24 percent of revenues, for the three months ended September 30, 2016. The $54 increase in 2017 resulted primarily from labor costs directed to SG&A activities due to lower manufacturing and/or service activities.

Other income (expense). During the three months ended September 30, 2017, we recognized a gain on the sale of property, plant and equipment of $559 related to the sale of one of our ROVs. There was no gain or loss on the sale of property, plant and equipment during the three months ended September 30, 2016.

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 unaudited condensed consolidated statements of operations.

We believe Modified EBITDA is useful to investors in evaluating our operating performance because it is widely used to measure a company's operating performance, which can vary substantially from company to company depending upon accounting methods and book value of assets, financing methods, capital structure and the method by which assets were acquired. It helps investors more meaningfully evaluate and compare the results of our operations from period to period by removing the impact of our capital structure (primarily interest); asset base (primarily depreciation and amortization); actions that do not affect liquidity (share-based compensation expense, 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 (loss) to Modified EBITDA (EBITDA loss) for the three months ended September 30, 2017 and 2016:

	Three Months Ended September 30,	
	2017	2016
Net (loss) income	$(734)	$979
Less gain on sale of assets	(559)	–
Deduct interest income, net	(21)	(10)
Add back depreciation and amortization	412	483
Add back income tax expense	5	5
Add back share-based compensation	34	35
Modified (EBITDA loss) EBITDA	$(863)	$1,492

Modified EBITDA loss was ($863) for the three months ended September 30, 2017 compared to Modified EBITDA of $1,492 for the three months ended September 30, 2016. The $2,355 decrease in Modified EBITDA was due primarily to the decrease in net income, which was driven by the previously discussed decreased revenues, as well as the gain on sale of assets during the 2017 period.

Nine Months Ended September 30, 2017 Compared to Nine Months Ended September 30, 2016

Revenues. Revenues for the nine months ended September 30, 2017 were $14,458 compared to revenues of $19,489 for the nine months ended September 30, 2016. The $5,031, or 26 percent, decrease was primarily a result of project delays and fewer projects in process in 2017, coupled with the previously discussed above average activity levels in the same period in 2016.

Gross Profit. Gross profit for the nine months ended September 30, 2017 was $6,341, or 44 percent of revenues, compared to gross profit of $6,672, or 34 percent of revenues, for the nine months ended September 30, 2016. Though we had a slight decrease of $331 in gross profit, we maintained higher margins as a percentage of revenues, due to a larger proportion of higher margin service work, as well as the resolution of an outstanding customer issue, during the nine months ended September 30, 2017.

Selling, general and administrative expenses. SG&A expenses for the nine months ended September 30, 2017 were $6,995, or 48 percent of revenues, compared to $7,376, or 38 percent of revenues, for the nine months ended September 30, 2016. The $381 decrease in 2017 resulted primarily due to a reduction in certain SG&A salaries and rent expense incurred in 2016, related to the sale and move from our Channelview location in 2016, as well as a decrease in our legal expenses.

Equity in net income of joint venture. During the nine months ended September 30, 2017, we recorded $94 of equity in net income of joint venture, related to net income, for the year ended December 31, 2016, of Cuming Flotation Technologies, LLC, in which we previously owned a 20 percent interest.

Other income (expense). During the nine months ended September 30, 2017, we recognized a gain on the sale of property, plant and equipment of $574 primarily related to the sale of one of our ROVs, while during the nine months ended September 30, 2016, we recognized a gain on the sale of property, plant and equipment of $1,070 related to the sale of our Channelview location.

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

The following is a reconciliation of net loss to Modified EBITDA for the nine months ended September 30, 2017 and 2016:

	Nine Months Ended September 30,	
	2017	2016

Net loss	$(193)	$(14)
Less gain on sale of assets	(574)	(1,070)
(Deduct) add back interest (income) expense, net	(46)	51
Add back depreciation and amortization	1,204	1,295
Add back income tax expense	15	16
Add back share-based compensation	101	309
Modified EBITDA	$507	$587

Modified EBITDA for the nine months ended September 30, 2017 was $507 compared to Modified EBITDA of $587 for the nine months ended September 30, 2016. The $80 decrease was primarily due to the decrease in gain on sale of assets, the decrease in share-based compensation, and the increase in net loss in 2017 as compared to 2016.

Liquidity and Capital Resources

Overview

Historically, we have supplemented the financing of our capital needs through debt and equity financings.

From 2008 through June 30, 2016, we maintained a credit facility (the “Facility”) with Whitney Bank. In March 2016, we paid all borrowings under the Facility with proceeds received from the sale of our Channelview location. Following the expiration of the Facility on June 30, 2016, we no longer have any credit facilities available to us.

As a result of cash we expect to generate from operations, we believe we will have adequate liquidity to meet our operating requirements for the foreseeable future.

Inflation and Seasonality

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

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Off-Balance Sheet Arrangements

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

Critical Accounting Estimates

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

Refer to Part II. Item 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, 2016 for a discussion of our critical accounting policies and estimates.

Recently Issued Accounting Standards

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

Share Repurchase Program

On May 23, 2016, our Board of Directors authorized a repurchase program (the "Repurchase Program") under which we may repurchase up to $1,000 of our outstanding stock. Subsequently, on March 29, 2017, our Board of Directors authorized a renewal and extension of the Repurchase Program for an additional $1,000 until March 31, 2018. The purchases may be made from time to time in the open market, through privately negotiated transactions and Rule 10b5-1 trading plans in accordance with applicable laws, rules and regulations. The Repurchase Program was funded from cash on hand and cash provided by operating activities.

As of September 30, 2017, we had exhausted the Repurchase Program. As of the date of this Report no decisions have been made on any further stock repurchases.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Not Applicable

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures. The Company's disclosure controls and procedures are designed to ensure that such information required to be disclosed by the Company in reports filed or submitted under the Exchange Act, 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, 2017, 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, 2017.

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, 2017, based on criteria issued in 2013 by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) entitled *"Internal Control-Integrated Framework."* Upon evaluation, the Company's management has concluded that the Company's internal controls over financial reporting were effective as of September 30, 2017.

Changes in Internal Control Over Financial Reporting. The Company's management, with the participation of the principal executive and principal financial officer, have concluded there were no changes in internal control during the fiscal quarter ended September 30, 2017.

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PART II. – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The table below summarizes information about our purchases of common stock, based on trade date, during the quarter ended September 30, 2017:

ISSUER PURCHASES OF EQUITY SECURITIES

	Total Number of Shares Purchased		Average Price Paid per Share (1)	Total Number of Shares Purchased as Part of Publicly Announced Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Programs (2)
July 1 - July 31	79,380		$1.0439	79,380	$ 783,002
August 1 - August 31	328,300		1.0068	328,300	454,702
September 1 - September 30	509,982	(3)	0.9602	454,702	–
Total activity for the three months ended September 30, 2017	917,662		$0.9841	862,382	$ –

(1) Does not include commissions.

(2) On May 23, 2016, we announced our Board of Directors authorized a repurchase program (the “Repurchase Program”) under which we were originally authorized to repurchase up to $1,000 of our outstanding stock. The Repurchase Program was scheduled to expire as of the close of business on March 31, 2017. On March 29, 2017, our Board of Directors authorized a renewal and extension of the Repurchase Program for an additional $1,000 until March 31, 2018.

(3) On September 27, 2017, we repurchased 490,231 shares, in connection with our transition agreement with Mr. Eugene L. Butler, our now former Executive Chairman and Chief Financial Officer dated September 25, 2017, for a fair market value of $0.96 per share, based on the median closing price, quoted by the OTCQX market, for the ten day trading period immediately prior to September 25, 2017.

ITEM 6. EXHIBITS

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

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 14, 2017

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

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

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

INDEX TO EXHIBITS

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

* Filed or furnished herewith.

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