

FINAL TRANSCRIPT

CCBNStreetEventsSM



Event Transcript

IO - Q1 2004 Input/Output Inc. Earnings Conference Call

Event Date/Time: Apr. 29. 2004 / 10:30AM ET

CCBNStreetEventsSM

streetevents@ccbn.com

617.603.7900

www.streetevents.com



FINAL TRANSCRIPT

IO - Q1 2004 Input/Output Inc. Earnings Conference Call

CORPORATE PARTICIPANTS

Jack Lascar

Input/Output, Inc. - Investor Relations

Bob Peebler

Input/Output, Inc. - Pres. CEO, Director

Mike Kirksey

Input/Output, Inc. - CFO, Exec. V.P.

CONFERENCE CALL PARTICIPANTS

Paul Chow (ph)

Steadfast Financial - Analyst

Joe Aguilar

Johnson Wright - Analyst

John Morisani (ph)

IMG Investment Management - Analyst

Chris Toomfield (ph)

Siemens & Company - Analyst

Scott Gill (ph)

Siemens & Company - Analyst

PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Input/Output first quarter earnings conference call. At this time, all participants are in a listen-only mode. Following today's presentation, instructions will be given for the question and answer session. If anyone needs assistance at any time during the conference, please press the star followed by the zero. As a reminder, this conference is being recorded today, Thursday, April 29, of 2004. I would now like to turn the conference over to Jack Lascar. Please go ahead sir.

Jack Lascar - Input/Output, Inc. - Investor Relations

Thank you, Eileen. Good morning and welcome to Input/Output's first quarter conference call. We appreciate your joining us today. Your hosts today are Bob Peebler, President and Chief Executive Officer, and Mike Kirksey, Executive Vice President and Chief Financial Officer. Before I turn the call over to management, I have a few items to go over. If you would like to be on an e-mail distribution or fax list to receive future news releases or experienced a technical problem and did not receive yours yesterday, please call DRG&E and relay that information. That number is 713-529-6600. If you would like to listen to a replay of today's call, it is available via webcast by

going to the Investor Relations section of the company's website at www.i-o.com or via recorded instant replay until May 6, 2004.

To use the replay feature call area code 303-590-3000 and use the pass code 576585. Information reported on this call speaks only as of today April 29, 2004 and therefore, you are advised that time sensitive information may no longer be accurate as of the time of any replay. Management is going to discuss today, certain topics that will contain forward-looking information data based on management's beliefs as well as assumptions made by and information currently available to management. Forward-looking information includes statements regarding expected revenues, gross margins, EBITDA, and earnings per share for the second quarter and full year of 2004. Although the company believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to have been correct.

Furthermore, as we start this call, please refer to the statement regarding forward-looking statements incorporated in our press release issued yesterday. Please note that the contents of our conference call this morning are covered by this statement. Risks that the company faces are discussed in greater detail in the company's filings with the Securities and Exchange Commission including the company's report on Form 10 K for the year ended December 31, 2003. Please also note that you can find the reconciliation for reported numbers for non-GAAP measures that we will discuss on this call in our press release. I would like to turn the call over now to Bob Peebler.

Bob Peebler - Input/Output, Inc. - Pres. CEO, Director

Good morning and thank you for joining us. The agenda this morning will include highlights of the first quarter, a review of the first quarter results, an update on progress against our strategy, a preliminary look at the remainder of 2004, followed by a question and answer period. First of all, we're all pleased by the positive events at I/O during the first quarter. Our mix of sales trended toward our higher margin products including new product sales and sales of software from Concept systems resulting in an overall gross margin of 34% compared to 20.5% in the first quarter of last year. A major milestone was the first commercial sale of VectorSeis Ocean to a new Norwegian based acquisition company, Terra Seismic services. We also completed the strategic acquisition of Concept Systems, a software and services business based out of Edinboro, Scotland.

FINAL TRANSCRIPT

IO - Q1 2004 Input/Output Inc. Earnings Conference Call

All of these accomplishments were targets we set out to achieve during the first quarter and we were successful. The combination of higher margins in our marine business, both from VectorSeis Ocean and our positioning products, as well as follow on cells of System Four VectorSeis, demonstrated the margin potential that these new products take hold in the marketplace. VectorSeis Ocean is an exciting new system that unleashes the benefits of our VectorSeis sensor technology when placed on the seabed. All companies have been reprocessing 3D marine seismic data, spec data, over the last few years but are starting to realize that there are limits to this approach and that new data is needed to further unlock oil and gas from more complex reservoirs such as the deep shelf in the Gulf of Mexico.

Acquiring data on the seabed versus coast streamer has the benefits of higher fidelity measurements, wider coverage called White asthma, and importantly being able to record not only the pressure but also the sheer waves. Up to this point, the industry has been slow to utilize ocean bottom measurements due to practical issues including high costs. But this is about to change. Our redeployable seabed system, VectorSeis Ocean has been designed with numerous proprietary features to bring significant productivity gains in acquiring the data and to improve the image quality for the end user.

We believe that the combination of these positive factors will significantly increase the market share of seabed systems and we expect good growth over the next few years. Also by shifting the mix of acquisition expenditures from logistics to value-added technologies, contractors can possibly change the traditional economic model of the seismic business which benefit both them and the oil company customers. On the land side of our business, our strategic relationship with Apache continues to progress very well as we are seeing better than expected productivity with our System Four. With up to two X field performance, measured by the number of shots per day. We're also getting reports back from Apache executives, senior geoscientists and field observers that the quality of both the pressure and the sheer wave are exceptional.

We're now in the early stages of processing some of the first surveys and look forward to seeing results of the final images. We're also seeing increasing interest in our VectorSeis Land Systems in Russia, China, and North America and look forward to several sales closing in Q2. In fact, several VectorSeis base sales were near completion at the end of Q1 and we now expect to finalize in the second quarter. We were also pleased to close the concept systems acquisition in February. It is a one-of-a-kind company that has been on our strategic acquisition list since last summer. Concept systems is a market leader in delivering

complex, integrated planning navigation and data managing solutions to seismic contractors and oil companies in both land and marine applications. The synergies between Concept and I/O are highly compelling across all of our product lines. We are already laying out project plans with the various R&D groups to take full advantage of them.

One significant area of potential growth for I/O is the 4-D technology which is used to monitor fluid flow in reservoirs. Concept is viewed as a technology and thought leader in this important new area of business. I am very happy to have Concept Systems as a new member of the I/O Technology family. As we said in late January, the market environment is improving and although we're not yet seen a robust seismic market we're starting to see pockets recovery. EMP companies continue to talk about the importance of seismic to their finding the development efforts and are starting to recognize it's important to better understand challenging areas such as the deep shelf in the Gulf of Mexico, deepwater and Russia.

One of the main drivers is the growing gap between supply and demand and it has not gone unnoticed that on the supply side reserves are not as robust as once thought. The pressure is growing for oil companies to return to the drill bit to increase reserves versus just reshuffling the deck via acquisitions. It is also even more important to get every drop of oil and gas out of existing reservoirs and production enhancement technologies including 4-D Seismic have a robust future. We believe that 2004 is the turnaround year for the overall industry activity and I/O should benefit along with our other services and technology callings in the industry. Mike will now cover the financial results.

Mike Kirksey - *Input/Output, Inc. - CFO, Exec. V.P.*

Thank you, Bob. As indicated in our press release, first quarter sales were \$36 million. As mentioned in our last quarter conference call, we expected that revenues would be lower than last year's \$41 million mainly due to vibrator vehicle sales being shifted out of the second and third quarters due to supply change issues and a product transition from our last generation image system to the new system Four analog. One important highlight of the quarter is that the mix of sales reflects the gross margin potential of our leading product lines and takes us toward our 2004 goal of a gross profit margin of approximately 30%. Both marine and land division sales had a higher margin product mix than was the case last year. The marine division had revenues of \$11.5 million including \$3.5 million of the VectorSeis Ocean. This was the first part of a contract which is expected to have

FINAL TRANSCRIPT

IO - Q1 2004 Input/Output Inc. Earnings Conference Call

deliveries for the next 12 to 18 months with a total value in excess of \$15 million.

Last year's first quarter marine revenues were \$8.6 million. However, the first quarter of this year had a better mix of products yielding higher gross margins. Marine division gross margins this year were 41% compared to 25% last year. In our land division sales were \$21 million compared to \$31 million last year. While sales were lower, gross margin dollars were actually slightly better this year with a gross margin of 24%. Follow on sales of system for VectorSeis and other higher-margin products and the absence of high volumes of low-margin vibrator vehicles yielded more attractive gross margins. The weak dollar impacted our gross margin in our foreign operations reducing earnings by approximately one cent per share. We're making simple progress in VectorSeis Land sales in Q1 but as Bob mentioned, due to timing issues related to financing, two large deals moved into the second quarter. Our processing business was about the same as last year but with a building pipeline that supports our growth plans. We are very encouraged with concepts partial quarter results which added 1 cent per share to our results.

Operating expenses were \$12.1 million, down 11% from last year. We continue to invest in focused R&D projects and improve our marketing and sales function in support of all of our new products. Lastly, including in other income, is a gain of about \$600,000 on the sale of some excess real estate and the tax line includes a refund of approximately \$1.1 million. Our income from operations this quarter was \$200,000 compared to last year's loss from operations of \$5 million. Adjusted EBITDA this quarter was positive \$3.5 million compared to a negative \$1.2 million last year. You can find a reconciliation of adjusted EBITDA to our reported earnings in our press release we issued yesterday after the market close. Capital expenditures during the fourth quarter were \$1.3 million. Our balance sheet finished with approximately \$26 million in cash. We used approximately \$37 million in the Concept acquisition. Accounts receivable were about flat while inventories increased by \$4 million as several systems sales were approaching delivery but did not ship in Q1. We expect cash to build in Q2 with collections from several systems sales including the recent VectorSeis Ocean. I will now turn it back to Bob for some closing comments.

Bob Peebler - *Input/Output, Inc. - Pres. CEO, Director*

Thanks Mike. I want to take this opportunity to remind everyone of the key elements of our strategic plan that we outlined last quarter and how we are progressing toward our

strategic objectives. Four key elements of our strategy are one, to reposition ourselves as a seismic imaging solutions company, versus a seismic equipment manufacturer. Seismic service contractors and oil companies are both important players within the EMP business. We do not view our contractor customers as any less important to our business with this strategy but believe that by focusing on the entire \$6 billion per year seismic imaging value chain we can expand our business leveraging our current technology and services base.

For example, the acquisition of Concept Systems adds to our product offering with marine and land service contractors, but they also expand our business with oil companies in the emerging permanent monitoring 4-D markets where they already have a strategic presence. We're also convinced that we can and should play an important role in VectorSeis full-wave processing since we can already have the unique position of leadership and sensor technology including understanding the algorithm required to turn the raw signals into meaningful seismic information. It's a natural extension for I/O to expand into processing the VectorSeis sensor output into full wave images and we plan to obtain the leadership position in that endeavor. Closer involvement in survey planning and processing gives us a much closer and ongoing relationship with oil companies as direct customers. Their input on the geological problems they face help our ND people better design future technologies to solve their problems.

Two, to lead in the emerging 3-D wave of seismic technology called full wave digital imaging. We believe full wave is a critical breakthrough technology that will enable finding oil and gas when it cannot be found with traditional methods. Related to this our VectorSeis Ocean products line should take I/O into a leadership position for seabed acquisition and our first multimillion-dollar sale to Terra's Seismic Services is a major milestone towards that goal. We are also on a firm track to achieve 40 plus million in VectorSeis Bay system sales in 2004 which reflects the market's vote of confidence for a new imaging technology.

Three, to reduce full cycle seismic energy costs by shortening cycle times and reducing logistics' cost with new technologies and services. Related to this goal, our system Four VectorSeis was designed to substantially to improve productivity. The combination of replacing geophone rays with point receivers, less weight of the field equipment, and multiple improvements in the operating system has even exceeded our expectations of field performance. We're getting early reports back from crews in Canada that they are seeing productivity improvement measurements, measured in shocks per day as great as 2X or

FINAL TRANSCRIPT

IO - Q1 2004 Input/Output Inc. Earnings Conference Call

more. In addition, these crews achieved these results with half the manpower of the traditional crew. We're excited and our customers are delighted with these early results. We also expect that our VectorSeis Ocean system compared to standard ocean-bottom cable acquisition approaches will change the game in seabed recording. We are looking forward to working with our first VectorSeis Ocean customer, Terra Seismic Services to start changing the game in marine acquisition.

Four, to form closer relationships with the ultimate end user of seismic imaging the oil company. Apache is our first tangible example of the power of a close alliance and as Steve Ferris Apache's CEO recently stated to me, full wave is extremely important to EMP's future and we are just starting to fully understand all of its future benefits. We are restructuring our marketing and sales organization to routinely include oil companies in our business development mix. We're learning that if we handle this relationship properly, it's a win for the oil company, our contractor customers and I/O. Our first North American contractor Trace is a good example of a company that has benefited by being an early provider of our VectorSeis base system. The Q1 expansion of the VectorSeis platform to meet their growing business is a good example of a win/win.

Now for a preliminary outlook of 2004. Looking at 2004, we expect a challenging and exciting year in terms of product transition and new product introductions. In our land imaging division, we are on plan to introduce our new System Four analog offering in late Q2 or early Q3. This product is based on a System Four platform that has been proven by contractors around the world and as already mentioned are benefiting by significant productivity improvements in the field operations. System Four AC takes the functionality to the next level by giving seismic contractors the flexibility to use traditional analog geophone sensors or digital full wave exercise sensors even on the same survey. The introduction of System Four AC begins the replacement of our older image product line and makes us much more competitive in the analog market segment. On the marine side, we have new products in our Digi line that are gaining traction in the market. We also expect to deliver additional cables against our contract with Terra Seismic services over the balance of the year.

Looking ahead, based on our current pipeline of business, the addition of concept systems our improved cost structure, and the impact of our new product introductions we expect 2004 revenues to be in the 190 to \$210 million range. Up from the 175 to \$195 million range that we provided during the last conference call. We expect a slight strengthening of our business from our more traditional markets and continued growth

internationally mainly in the CIS and Middle East. Much of our expected topline growth should come from our new product offerings. The pipeline of VectorSeis System sales in Q2 looks very promising and as previously stated, we feel confident that we're on track towards our goal of VectorSeis sales of 40 plus billion for 2004.

We expect consolidated gross margins to be in the low 30s. Based on the expected level of revenues and gross margins, EBITDA should be 25 to \$30 million with earnings per share range of 10 to 20 cents, up from 5 to 15 cents from our guidance last quarter. Our second quarter is unfolding fairly close to our original 2004 plan with continued growth in sales of VectorSeis based systems. As a result, we expect second quarter revenue to be in the 45 to \$55 million range and earnings per share to range between 2 to 5 cents. In summary, we had a solid quarter and continue to make our critical milestones related to profitability and new product sales. We remain confident about 2004 and believe we are off to a very good start. We will now open for questions.

QUESTIONS AND ANSWERS

Operator

Thank you, sir. Ladies and gentlemen, at this time we will begin the question and answer session. If you have a question, please press the star followed by the one on your push button phone. If you would like to decline from the polling process, press the star followed by the two. You will hear a 3-tone prompt acknowledging your selection. If you're using speaker equipment you will need to lift the handset before pressing the numbers. One moment please for the first question. Our first question comes from Paul Chow with Steadfast Financial. Please go ahead.

Paul Chow - *Steadfast Financial - Analyst*

Hi. Can you hear me?

Bob Peebler - *Input/Output, Inc. - Pres. CEO, Director*

We sure can.

Paul Chow - *Steadfast Financial - Analyst*

I just have a question on the guidance. I know that when you announced the Concept acquisition, you did say that was going

FINAL TRANSCRIPT

IO - Q1 2004 Input/Output Inc. Earnings Conference Call

to be accretive to earnings. I'm just sort of curious is it possible to break out how much of your increasing guidance is due to Concept versus sort of an improved outlook in VectorSeis and general equipment sales?

Bob Peebler - *Input/Output, Inc. - Pres. CEO, Director*

Concept is accretive as we've mentioned before but we don't make a practice of breaking out pieces like that. Concept is part of our processing and software group, but it is accretive. I think that we mentioned in our conversations when we acquired Concept that it would be accretive in the single digits and that continues to be the case.

Paul Chow - *Steadfast Financial - Analyst*

Single-digit growth, right?

Bob Peebler - *Input/Output, Inc. - Pres. CEO, Director*

Yes.

Operator

Our next question comes from Ray Albert with Chatfield Asset Management. Please go ahead.

Craig (UNIDENTIFIED) - *Chatfield Asset Management - Analyst*

Hi, this is Craig. I must have missed you, I apologize. You mentioned something when you were talking about the Q1 sales being down year-over-year. There were some timing issues. Could you just repeat what those are?

Bob Peebler - *Input/Output, Inc. - Pres. CEO, Director*

Yeah. We had -- there's really two main things that we talked about last quarter and in fact, it was even reflected in our look forward plan. That was, one, that we have what is called viber size trucks which are large trucks that are used to create sound sources. They're actually one of our lower margin products. But it requires substantial inventory to build and we keep that fairly close because of the size of the inventory and the low margins. So effectively, we ended up with some supply chain issues where we couldn't get them built against the order in the first quarter so it really got moved into Q2 and Q3. So the orders are, we

feel confident that those orders are there. In fact, we are filling them as we can build the trucks. So those are sort of high revenue, but fairly low-margin products. And in the second piece on the first quarter, mainly in land, was we're in a product transition.

Our older system called image, we have really stopped taking orders with the exception of just a few exceptions. So we are winding down the image to make room for a new system for analog version. Which really starts in the latter part of Q2, this quarter. So we had by plan that that was going to happen. So we have a little bit of a lull in our traditional, if you want to call it analog sales in our land systems, which we had both of those in Q1 of last year. That is why we're very confident that that really is a transition and we're already seeing the effects of that in Q2 and going forward.

Craig (UNIDENTIFIED) - *Chatfield Asset Management - Analyst*

Great. Regarding that old system and the new AC, the analog cable system that allows the user the flexibility to choose between VectorSeis or not, if they choose to go with the analog version, is that sort of a comparable product to the 408 sort of sell product and then the VectorSeis is a step up?

Bob Peebler - *Input/Output, Inc. - Pres. CEO, Director*

Yeah. We would argue that it is an improved product over the 408. The one that is known to the company well, we have not been as competitive as we need to be in that space, but we feel very good about the competitiveness. Now with the 408. One of the even greater advantages that we knew we had but we didn't prove it in the field, it is the new System Four it brings some real productivity to the operations both for our VectorSeis option and also now for our analog options. So we fill, frankly, excited ,about getting it into the market.

Craig (UNIDENTIFIED) - *Chatfield Asset Management - Analyst*

So someone who buys that product, they're choosing at the outset whether to buy a digital sensor or not? Or is that something where they can just buy the analog product and then change as they go on?

FINAL TRANSCRIPT

IO - Q1 2004 Input/Output Inc. Earnings Conference Call

Bob Peebler - *Input/Output, Inc. - Pres. CEO, Director*

It is completely their option. If you want to think of a System Four as the software platform that is really the operating system, and then you have the option of either using digital or analog. Effectively, it is sort of an A to B converter that is out at the field unit. So there are some changes, there's basically an option they have to buy to give them that flexibility. So they can start out with the System Four with the analog option, and later on add the digital or they can start with the digital and later on add the analog or they can start out with both the capability for both.

Craig (UNIDENTIFIED) - *Chetfield Asset Management - Analyst*

Got it. And if they choose just to stick with the analog for right now, how is that product priced relative to the 408?

Bob Peebler - *Input/Output, Inc. - Pres. CEO, Director*

It will be very competitive.

Craig (UNIDENTIFIED) - *Chetfield Asset Management - Analyst*

Okey doke. Thank you very much.

Operator

Our next question comes from Joe Aguilar with Johnson Wright. Please go ahead.

Joe Aguilar - *Johnson Wright - Analyst*

Thanks, good morning. Nice quarter. I was hoping if I could maybe spend a second on the VectorSeis Ocean announcement. To maybe get you to sort of clarify the expectations of revenue over the next year to year and a half with \$15 million. What that would relate to just sort of the overall, how much -- I don't know if you want to tell us how much was in Q1, but just generally if you could explain what you meant by that.

Bob Peebler - *Input/Output, Inc. - Pres. CEO, Director*

I think we did say what was in Q1. Yes. We did say in Q1 it was slightly over \$3 million. I think it was \$3.5 million in Q1. That was against a shipment of effectively the first cable. They

are looking at doing a simple floor 2-D line, sort of shaking out the system, and then they will be increasing at the end of this quarter, they should be increasing to having a vessel in the water which will be 2 cables, I believe. Two additional cables, and then they will be expanding that in Q3, Q4. We can't predict it exactly because they have some of their own logistic issues of getting the boats in the water, they are marching to some contractor contracts. I'm not sure that they already have in hand, so they have some clear business needs to get the system in the water and up and running. They will, I believe, end up with two vessels equipped which they can typically use on one survey. They can do a survey with one vessel, but two vessels really gives them more productivity. Did that answer your question?

Joe Aguilar - *Johnson Wright - Analyst*

Yeah. Well, Bob, I guess, so the \$3 million initial sales would that have included the, what I guess is referred to as essential electronics unit?

Bob Peebler - *Input/Output, Inc. - Pres. CEO, Director*

It does, except it's fairly simple. The nature of the recording device, the way the system works is that you put the cables in the water and rather than the boat sitting there recording. The recording device is in a buoy. Then obviously if you have a recording device in the buoy then you have to have a way of moving the data from the buoy into a recording system. So it does have a recording system, but that is sort of bundled into that first -- into that first price.

Joe Aguilar - *Johnson Wright - Analyst*

Right. So they are going to be adding cable over time?

Bob Peebler - *Input/Output, Inc. - Pres. CEO, Director*

Yes. They will be adding cables and buoys so that is a full system. And then if they expand into other vessels, if they want to add additional crews and probably typically a crew may be made up of two vessels and they would be doing the whole thing again as they go forward, it is also over time we're not starting out I don't believe right at the beginning but I think fairly quickly they will be also be using what is called Gator software from Concept. Which is integrated into this offering to help them better position, have better positioning technology on the job. So this also bring efficiencies.

FINAL TRANSCRIPT

IO - Q1 2004 Input/Output Inc. Earnings Conference Call

Joe Aguilar - *Johnson Wright - Analyst*

Now as opposed to your deal with Apache, where you all sort of helped push along VectorSeis plan technology, how are they, how did this sort of, they have a contract with a major oil company to use this? Were you all involved with that oil company in terms of demonstrating that technology?

Bob Peebler - *Input/Output, Inc. - Pres. CEO, Director*

Only, we were in a sense that we've been educating, we can't speak to the oil company because this has not been released this is really Terra's deal but we do know the oil company and we have been working with Terra to help people understand the value of VectorSeis particularly on the seabed. The other thing we have is that Terra was involved with us, with putting the first VectorSeis seabed our first prototype with Conoco-Phillips in the Ecofish field in the North sea. It was really that first job that has really got people excited. We're getting lots of feedback. It's a best full wave or multicomponent data that anyone has seen on the seabed. We think we have a compelling advantage with the way our digital full wave is architected for Ocean. And really do see this as just really the beginning of a quite an exciting journey for us on seabed acquisition.

Joe Aguilar - *Johnson Wright - Analyst*

I would guess that you all might take issue with, there's a press release out today from Western GECO regarding a Cue Technology sale that they made I guess. You know, I guess you all may take issue with their claiming of being the superior 4-D solution.

Bob Peebler - *Input/Output, Inc. - Pres. CEO, Director*

Well, Cue, if I, I haven't seen the press release. I'm assuming they're talking about code streamer Q which is quite a different animal than recording on the seabed. One thing -- I'm not going to get into the Cue versus our seabed system at this moment, but the thing I can assure you is that they cannot record full wave behind closed streamer. Sheer wave do not travel through water. Over time, as people find more and more utility in the full wave, using the sheer in addition to the pressure wave, then that is going to ease and create a more compelling reason to get to the seabed. Another important reason for seabed, is the utility of White Asthma. It's a much more difficult problem to try to do White Asthma shooting with code streamer whereas the seabed you can do White Asthma fairly routinely. And then,

obviously, also when you get into places where 4-D may be applicable, you have the issues of platforms and obstructions. So you may be forced to go to the seabed just to manage that. There is going to be plenty of opportunity for code streamer. Particularly in deeper waters. And there is going to be plenty of opportunities for seabed. We just happen to believe that there's many geological problems that only can be best solved by using our system.

Joe Aguilar - *Johnson Wright - Analyst*

Great. Thank you very much.

Operator

Ladies and gentlemen, if there any additional questions, please press the star followed by the one at this time. As a reminder, if you're using speaker equipment, you will need to lift the handset before pressing the number. Our next question comes from John Morisani with IMG Investment Management. Please go ahead.

John Morisani - *IMG Investment Management - Analyst*

Good morning guys. Two questions here. The first one is sort of a follow-up to what Joe was just asking about. I gather you're not comfortable talking about the oil company that is going to be doing this shoot?

Bob Peebler - *Input/Output, Inc. - Pres. CEO, Director*

I can't yet. Mainly because its under an MBA and it will have to really be released through either the oil company or through Terra.

John Morisani - *IMG Investment Management - Analyst*

Can you just say sort of what you think they're looking for? Is this a deep shelf? Is this something in relatively shallow water looking deep? What is your sense of why they're going to your technology versus going to a multi-client or something else?

Bob Peebler - *Input/Output, Inc. - Pres. CEO, Director*

I will speculate because I have not been privy to the survey designs or exactly their objectives, but it is on the shelf as I understand it. It would be in the deeper -- there is sort of water

FINAL TRANSCRIPT

IO - Q1 2004 Input/Output Inc. Earnings Conference Call

depths on the shelf and then there is reservoir depth on the shelf. I believe that they do have an interest in the deeper reservoirs on the shelf which people call the deep shelf. I think they also have some shallower issues they want to deal with. I think they're also very interested in the sheer part of the survey. The full wave. Beyond that, I'm afraid that if I told you the things I know I would be getting way too close to the MBA.

John Morisani - *IMG Investment Management - Analyst*

Gotcha. Then the question just really has to do with certain guidance on the R&D, the G&A, the sales expenses. Do you expect those to be relatively flat as we go forward in revenues growing? What should we be kind of modeling?

Bob Peebler - *Input/Output, Inc. - Pres. CEO, Director*

I will let Mike speak to that.

Mike Kirksey - *Input/Output, Inc. - CFO, Exec. V.P.*

Yeah. If we look out in our plan for the year, those will be relatively flat and I am including kind of Concept in there, so we were -- our current quarter was in the 9 to \$10 million range and that will be pretty much where it is going forward.

John Morisani - *IMG Investment Management - Analyst*

Okay. If you go out a couple of years, do you see that -- has your expense level been basically right size so that if we were to see a real scale up in revenue, we would continue to see margins getting better as we go forward?

Bob Peebler - *Input/Output, Inc. - Pres. CEO, Director*

Yes. Yeah, you'll see -- John, I think the one number--we're right now using R&D go forward is about 10% of revenues assuming that we are in that out years. We're in that mid 30's gross product margin. The rest of the expense that we get leverage on. In other words, we don't see our G&A base increasing linearly with the increase in revenues. So I would say marketing sales, would be putting more dollars in marketing sales but again it won't be at the same rate as the revenue growth. We come out and back around, Mike can help people with the models a little bit.

Mike Kirksey - *Input/Output, Inc. - CFO, Exec. V.P.*

Yeah. You see in this quarter about \$12 million of expenses. It varies up and down each quarter depending on what R&D projects are ongoing and what enhancements we make in marketing sales. But that is not out of line from kind of where we see as we go forward. There, it will be up some of quarters and down some. But again, as the leverage comes then revenue grows.

John Morisani - *IMG Investment Management - Analyst*

Okay. Just help me a little bit on the gross margin side. I guess I differ slightly with you because I think you used the -- you put the amortization of intangibles into the gross margin area or you deduct that before you get there. But I sort of had you in the low 30s and it sounds to me like you're heading -- you're sort of guiding to 30. Yet it seems like from what you're talking about that the kind of products you're going to be selling would be more of those higher-margin products than you might have had in the last quarter. What am I missing?

Mike Kirksey - *Input/Output, Inc. - CFO, Exec. V.P.*

Yes. We obviously try to be very prudent in those kinds of numbers. If you mix a lot of trucks in there, you start to get some dilution in the gross margin. But again, there's a bigger and bigger part of the sales as we go forward are the new products.

John Morisani - *IMG Investment Management - Analyst*

OK. Well, great quarter. Love to see those profits. Thank you.

Operator

Our next question comes from Chris Toomfield with Siemens and Company. Please go ahead.

Chris Toomfield - *Siemens & Company - Analyst*

Hi. Good morning guys. Just a quick kind of follow-up of the previous question. regarding the VectorSeis. You guys had mentioned a number, I think it was \$40 million in projected sales for FY '04?

FINAL TRANSCRIPT

IO - Q1 2004 Input/Output Inc. Earnings Conference Call

Bob Peebler - *Input/Output, Inc. - Pres. CEO, Director*

Yes.

Chris Toomfield - *Siemens & Company - Analyst*

Okay. Could you kind of give a little more color as how that breaks down between land and marine between the new Ocean seabed system and the land segment? Also kind of talk qualitatively in regards to kind of who is kind of showing interest in buying, showing interest, or showing interest towards buying. What kind of margins your expecting? And kind of projections for the Ocean system in and of itself?

Bob Peebler - *Input/Output, Inc. - Pres. CEO, Director*

We're going to keep those lumped. Mainly we also have -- we're walking the line of we would love to have the competitors breakdown by product line, their margins, and their expected revenue forecast, what I will say is that also the businesses are as you know are lumpy. There are big sales of -- you can see the size of the sales. We also have the same thing going on on land. So we really have been hesitant of saying exactly the \$40 million is going to be this much marine and this much land. We are really not planning on breaking those out like that. We'll let that unfold.

I will say that from an interest point of view the pipeline of opportunities in land really are in all of our markets. We have a very strong pipeline in, growing in Russia and other parts of Europe. But primarily in the Russia, CIS countries. We have a still growing interest in China. We also have -- we think we're going to see some repeat business and probably some additional business in North America. I would say in weight probably the Russia is the biggest part of our current look forward or CIS because that includes Poland and that part of the world. Followed by China then followed by North America. And the seabed, I think it's going to be really more the ability for it really takes a different service model. Our guess is that the beginning it will be mainly Terra expanding. Although, I think as people get experience, there's going to be analogs every place in the world. China Sea, Boja Bay, West Africa, the North Sea, there are lots of places in the world that have opportunities for this technology.

Scott Gill - *Siemens & Company - Analyst*

Bob, this is Scott Gill. Just a quick follow-up. Lot of interest in the CIS. Why is there more interest in the CIS then say for

example in the U.S. and Canada on land? Is it because there's a greater demand for new seismic equipment and therefore has the latest and greatest working off of existing equipment here in the U.S.

Bob Peebler - *Input/Output, Inc. - Pres. CEO, Director*

I think it is a couple of reasons. One, I hate to say this in some ways because this is a historical flip, but I will say it. Historically, our technology has not only, geophysical technology but new technology has typically started in the U.S. and spread out to the other parts of the world, and we're now seeing the sophistication and the interest in new technology actually stronger in some of the Eastern countries. For example, in Russia, they're quite skilled in geophysics. They are more advanced, we believe, in understanding full wave. Their ability to process the data and interpret the data seems to be further along and I will even say that is the same for the Chinese. So this is the case where the emerging areas are leading the traditional Western companies in applying the technology. So that is one. Just sort of a reversal. Maybe that is a sign of things to come.

After all, that is where most of the oil and gas reserves are in the world. I think in the U.S. people -- there has been so much spectator shot and people have gotten sort of hooked on cheap data and basically have reprocessed the reprocessed data to the point now they are out on the what I call the second derivative looking for, sort of processing noise, looking for opportunities and I think they're only now starting to realize that they're coming to the end of life for that approach. And are going to have to start reshooting. I think it will be driven as people start having success, geological success. You'll start seeing on land a little bit of the heat up where people will start shooting. So I think it's really sort of those two factors as the main reasons.

Scott Gill - *Siemens & Company - Analyst*

Okay. And Bob, last question on VectorSeis. How fast could you ramp up system production there?

Bob Peebler - *Input/Output, Inc. - Pres. CEO, Director*

Well, there is two on the VectorSeis land. We have plenty of capacity in our sensor facility. So there will be no problems of expanding including if we had to go to, you know, multiple shifts. So we just don't see any capacity issue with our built-in create to sensors. Because we've outsourced much of our

FINAL TRANSCRIPT

IO - Q1 2004 Input/Output Inc. Earnings Conference Call

manufacturing, and we're with very strong outsource providers, they can ramp up fast also. So I don't think any kind of manufacturing issues we would have would be fairly short-term in nature. Obviously, you get in to lead times on ordering parts and those kinds of things. On the ocean system, we are, I won't say limited, but we, because it's our first new commercial system we will be in a shakeout period and learning from that. So I would suspect that we have some capacity above what we've committed to Terra, but we don't have a lot of capacity in the short term.

Scott Gill - *Siemens & Company - Analyst*

Would you care to venture an estimate as to what your revenue from VectorSeis would be in 2005?

Bob Peebler - *Input/Output, Inc. - Pres. CEO, Director*

We will probably be doing that towards the end of this year.

Mike Kirksey - *Input/Output, Inc. - CFO, Exec. V.P.*

More.

Bob Peebler - *Input/Output, Inc. - Pres. CEO, Director*

Yeah. It'll more. Yeah.

Scott Gill - *Siemens & Company - Analyst*

Very good. Thanks.

Operator

Our next question comes from Joe Aguilar with Johnson Wright. Please go ahead.

Joe Aguilar - *Johnson Wright - Analyst*

Thanks. Just a couple follows if I could. The revenue in the quarter you gave for land and marine, I would assume that the difference there around \$3.8 million is now processing revenue?

Mike Kirksey - *Input/Output, Inc. - CFO, Exec. V.P.*

That would be correct. And a little bit of Concept.

Joe Aguilar - *Johnson Wright - Analyst*

That's what I was going to ask. The Concept is going to go into processing?

Mike Kirksey - *Input/Output, Inc. - CFO, Exec. V.P.*

That's why we're going to disclose it. Right.

Joe Aguilar - *Johnson Wright - Analyst*

Okay. Great. And Mike, I was curious in terms of your forward guidance for the rest of this year, tax rate that you are assuming?

Mike Kirksey - *Input/Output, Inc. - CFO, Exec. V.P.*

We put in our flash just \$1 million or so of taxes it's foreign in nature but it's a couple of percent.

Joe Aguilar - *Johnson Wright - Analyst*

Okay. So that would be for the full year?

Mike Kirksey - *Input/Output, Inc. - CFO, Exec. V.P.*

Yes.

Joe Aguilar - *Johnson Wright - Analyst*

So you had a benefit of about a half a million so it would be about million and a half in taxes paid over the remaining three quarters?

Mike Kirksey - *Input/Output, Inc. - CFO, Exec. V.P.*

That's right.

Joe Aguilar - *Johnson Wright - Analyst*

OK. Great. Thank you.

FINAL TRANSCRIPT

IO - Q1 2004 Input/Output Inc. Earnings Conference Call

Operator

Ladies and gentlemen, this concludes today's question-and-answer session. I would now like to turn the conference back over to Mr. Peebler for any closing comments.

Bob Peebler - *Input/Output, Inc. - Pres. CEO, Director*

Well, we would just like to thank you for taking the time to attend this conference call and look forward to speaking again next quarter. Thanks.

Operator

Ladies and gentleman, this concludes the Input/Output first quarter earnings conference call. If you would like to listen to a replay of today's conference, you may dial 303-590-3000 and enter the access number of 576585. Once again, if you would like to listen to a replay of today's conference you may dial 303-590-3000 and enter the access number of 576585. Thank you for participating. You may now disconnect.

DISCLAIMER

CCBN reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES CCBN OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2004, CCBN, Inc. All Rights Reserved.