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Event Transcript

IO - Q2 2003 Input/Output Inc. Earnings Conference Call

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IO - Q2 2003 Input/Output Inc. Earnings Conference Call

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Brad Eastman

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Simmons and Company - Analyst

Allen Brooks

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Ben Atkinson

Gagnon Securities - Analyst

John Morosani

ING - Analyst

Ann Sockvitz

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Frank Perese

Stifel Nicolaus - Analyst

David Snow

Energy Equities - Analyst

PRESENTATION

Operator

Thank you for standing by, today's teleconference call is beginning. Hello and welcome to the Input/Output, Inc. Second Quarter Earnings Release. Following today's presentation there will be a formal question and answer session and instructions will be given at that time. Until then all lines will remain in a listen-only mode. At the request of the Company today's conference is being recorded. If anyone has any objections you may disconnect at this time. I would now like to introduce today's conference host Mr. Ken Dennard. Sir you may begin.

Ken Dennard - *Input/Output Inc - Representative*

Thank you Jackie and good afternoon everyone and welcome to Input/Output second quarter conference call. We appreciate you joining us to review these quarterly results. Your hosts today are Bob Peebler, President and Chief Executive Officer; Jorge Machnizh, Executive Vice President and Chief Operating Officer; and Brad Eastman, Chief Administrative Officer. Before

I turn the call over to management I have a few housekeeping details to run through. If you would like to be on an e-mail distribution or fax list to receive future news releases or if you experience a technical problem today and didn't receive your press release this afternoon, please call Elisa Smith at Input/Output and relay her that information; her number is 281-879-3593. Also if you like to listen to a replay of today's call, it is available via web cast by going to the investor relations section of the Company's website at www.i-o.com or via a telephonic recorded instant replay that will be available until August 6th. To use the telephonic replay feature please call 800-925-4670.

Information reported on this call speaks only as of today July 30, 2003 and therefore you are advised that time-sensitive information may no longer be accurate at the time of any replay. As well as you know management is going to discuss certain topics that will contain forward-looking information that are based on management's beliefs as well as assumptions made by on information currently available to management. Forward-looking information includes statements regarding the expected revenues, gross margin, and earnings per share for the second half for 2003. Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will have proven to be correct. Furthermore as we start this call please refer to the statement regarding forward-looking statements incorporated in today's press release, and please note that the contents of the conference call this afternoon are covered by this statement. Risks that the Company faces are discussed in greater detail in the Company's filings with the SEC including the Company's report on Form 10-K for the year ended December 31st 2002 and the Company's report on Form 10-Q for the quarter ended March 31st, 2003. Please also note that you can find a reconciliation to reported numbers for non-GAAP measures that are discussed on the call and in the press release. Now further -- I'd now like to turn the call over to Bob Peebler. Bob.

Robert Peebler - *Input/Output Inc - President and CEO*

Yes good afternoon. Before beginning with my prepared remarks, I am very pleased to announce that just this morning we sold another VectorSeis system for a cable-based land acquisitions system to [Vicolo] who is an emerging contractor in the Ukraine looking to capitalize on new technology. This system has 3600 channels and we expect to deliver in the fourth quarter this year. The agenda this afternoon will include some quick industry perspectives, our review of the second quarter

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and year to date results, an update on our significant events this quarter, guidance for the second half of this year followed by Q&A -- question-and-answer period.

While commodity prices have remained relatively strong, we have little indication that the market for our traditional seismic contractors is improving in the short term, but our pipeline of opportunities is growing and our international market is giving us confidence that our year-over-year growth is likely to continue for the balance of the year. Commodity prices weakened moderately during the quarter but are still considered high by historical standards. Westech has averaged \$29.10 this quarter down from last quarter's \$33.01. And after gas prices declined seasonally during the quarter with Nymax spot gas prices averaging \$5.01 MCF compared to \$5.54 MCF last quarter. U.S. drilling activity averaged 1028 rigs during the second quarter up 15% from 897 in the first quarter and up 28% from the last year second quarter average of 808. International activity increased 3% from last quarter with 765 active rigs this quarter. International rig count was up 6% from the second quarter last year. Canada drilling activity reflects a seasonal decline for the spring from last quarter; average rig count in Canada was 198 this quarter, which represents a 38% improvement compared to second quarter 2002.

We saw slightly lower size in the crew counts during the second quarter. International land sizing and crew counts average 133 for the quarter down from 164 the same quarter a year ago and down slightly sequentially. United States land activity also softened with active land crews averaging 27 down from 29 last quarter and 32 recorded in last year's second quarter. Canadian land activity averaged 16 crews up slightly from the 15 crew average in the second quarter last year. Marine seismic activity was also mixed. U.S. marine activity increased slightly to 12 active vessels compared to 11 last quarter to decline from 16 a year ago. The international marine fleet averaged approximately 59 active vessels for the quarter up slightly from 57 last quarter and from 56 active vessels in the second quarter last year. Continuing the trend, we have reported over the last several quarters we are seeing Chinese, Eastern European, and former Soviet Union contractors more active than North American-centric seismic contractors. The seismic war continues to be dominated by proprietary shoots; low cost providers are still being favored by the market. For example, we recently had a large sale to Chinese seismic contractor who was awarded a large survey by Pemex in Mexico. ENP companies continue to talk about the imports of seismic to defining the development efforts and realizing that to better explore more complex geologies these companies will require new seismic shoots that

are higher quality and better designed to the specific problems that would suggest reprocess inevitable [spec] data.

Although market conditions have improved over last year we are still not seeing a robust seismic market despite the opportunities presented by the high commodity prices. As I stated in our call last quarter, I believe that it is inevitable that all companies will embrace new seismic technologies to unravel the geologic and reservoir problems to unlock future reserves and I/O will be well positioned when that happens. It's also important to understand the trends below the surface of the overall seismic crew count. While the aggregate crew counts are languishing, the mix of contractors are rapidly changing, and pressures to replace old equipment is increasing to meet the demands of the market for better images and crew efficiency. For example BGP, the largest seismic contractor in the world, has a program to reduce our overall crew count in China through a program of increasing efficiency by upgrading to new 3D systems and increasing channel counts. As a general trend, future reservoir complexity will continue to put demands on seismic for better resolution and accuracy driving the replacement of old equipment with new for both gains and channel count and crew efficiency. I expect this trend accelerate as pressures mount on all companies for better performance results in reserve replacements and as new markets open up such as Iraq. Our second quarter results reflect the expected historical quarter-to-quarter revenue decline combined with aggressive cost cutting efforts to get the Company into the black by the end of the year. I'm confident that we are on track to align our cost structure to accomplish that goal. Brad will now discuss the quarter in more detail.

Brad Eastman - Input/Output Inc - CAO

Thanks Bob. As we mentioned in our first quarter conference call, our second quarter revenues came inline with the historical trend of Q2 revenues being slightly lower than Q1 revenues. Second quarter sales were up 51% to \$34.6m compared to \$22.9m during the last year's second quarter. The improvement is attributable to an increase in land seismic activity with out non-western contractors. Our land sales for the quarter were \$23.7m, an increase of \$12.9m or about 119% from the last year's second quarter. Marine sales of \$10.9m declined \$1.2m or about 10% compared to last year's second quarter. Our reported gross margin this quarter was 9.3% compared to 10.9% in last year's second quarter. Excluding special charges of \$2.8m this quarter and \$531,000 in the second quarter of last year, adjusted gross margin improved to 17.4% compared to 13.2% in the second quarter of last year. We completed our move out

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of our Alvin manufacturing facility in June. As a result we have eliminated approximately \$2.5m per year in depreciation and facilities charges from our fixed cost structure as well as additional savings from headcount reduction. While some of the costs will be returned to us as variable costs from our outsource partners, we believe that we will realize increased margins as we will not be burdened with under-absorption of this facility. We are continuing to review the utilization of our existing facilities to find additional ways to reduce our fixed cost structure.

Land division gross profit rates excluding special charges were 13.1% this quarter compared to a negative 19.5% in last year's second quarter. The marine division gross profit rate was 26.4% this quarter compared to 42.6% in last year's second quarter. Marine gross margins were hurt by an overall decline in marine revenues combined with a greater percentage of lower-margin acquisition system sales as opposed to positioning system sales. SG&A expenses were \$8.6m this quarter including approximately \$800,000 of severance expense and facility relocation expense.; excluding these charges SG&A expenses totaled \$7.8m, an approximate \$200,000 increase compared with last year's second quarter resulting from higher sales commissions in this year and the inclusion of AXIS, which we required in July 2002 offset in part by a reduction in personnel cost.

As a percentage of revenues, SG&A expenses decreased to about 23% this quarter compared to 33% in the second quarter of last year. Full-time employees declined to 534 at June 30th, 2003 from 556 at the end of the first quarter and from 685 at the end of last year's second quarter. We have reduced the number of full-time employees by an additional 45 people in July and expect approximately 15 more reductions in the third and fourth quarter. We expect an additional severance charge of approximately \$475,000 in the third quarter of this year related to these reductions. Research and development expenses were about \$4.9m excluding \$22,000 of severance expense and an approximate \$2.0m reduction from the second quarter of last year after excluding severance costs and costs associated with closing our Alvin facility. These decreases primary reflect reduced staffing levels and lower prototype expenses. We expect further declines in our R&D expenses as some of the headcount reductions discussed earlier are from research and development.

Our loss from operations this quarter was \$10.4m compared to a loss from operations in the second quarter of 2002 of \$14.0m. Adjusted EBITDA this quarter was a loss of \$6.9m compared to a loss of \$11.2m for the second quarter of last year. You can find a reconciliation of EBITDA and adjusted EBITDA to our reported earnings in our press release issued earlier today. Similar to the second quarter of last year depreciation and amortization

was \$3.0m; capital expenditures during the second quarter were about \$900,000. The Company reported an income tax benefit of \$300,000 this quarter including a one-time federal tax refund of \$632,000 compared to a benefit of \$301,000 during last year's second quarter after excluding the reserve allowance for our deferred tax assets. We continue to reserve our net deferred tax assets and report income tax expense from our foreign operations. Our net loss attributable to common shareholders this quarter was \$13.7m or 27 cents per share compared to a loss of \$78.9m or \$1.55 per share for last year's second quarter. Excluding significant charges, warrants revaluation expense, and impairment of investments net loss for the quarter was \$6.9m as opposed to a net loss last quarter of \$11.1m.

Moving on to the results of the first 6 months, year-to-date sales increased 43% to \$75.7m from \$53.1m during the same period last year. Land sales so far this year were \$56.3m an increase of 98% compared to \$28.4m in 2002. Marine activity decreased about 21% with sales of \$19.4m this year compared to \$24.6m last year. Year-to-date gross margin was 15.8% compared to 17.8% last year. Adjusting for special charges totaling \$3.1m related to severance cost and write-down of an older VectorSeis system held for short-term [rentals], gross margin increased to 19.9% so far this year. The adjusted gross profit rate for land was 17.6% this year compared to a negative 3.0% last year. For marine, the adjusted gross margin was 26.4% of revenues compared to 45.5% last year. Year-to-date SG&A expense were \$16.9m; excluding \$1.6m of asset impairment charges and costs associated with the closing of the Alvin facility SG&A expenses were \$15.3m or 20% of revenue compared to \$15.0m or 28% of revenues in the same period last year.

Year-to-date R&D expenses decreased about \$5.2m to \$10.5m compared to last year's \$15.7m. Excluding special items, R&D expense decreased about \$3.6m to \$10.2m. Our operating loss so far this year was \$15.4m compared to an operating loss last year of \$21.5m. The Company reported an income tax expense of about \$300,000 so far this year. We expect to report income tax expense for 2003 despite overall pre-tax losses as a result of our anticipated mix of U.S. and foreign income. Our net loss to common shareholders for the first 6 months of 2003 was \$19.0m or 37 cents per share compared to a net loss to common shareholders of \$84.9m or \$1.67 per share in 2002.

Turning to our balance sheet, our balance sheet remains strong with \$39.5m in our cash balances at the end of June. The decrease in cash during the quarter was mainly due to a \$15m repayment of SEF debt. Account to notes receivable declined by \$3.3m to \$39.8m from the first quarter bringing our working capital, which is current assets less current liabilities, down

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\$20.9m from \$116.1m at the end of March 2003 to \$95.2m at the end of June 2003. Our debt-to-capital ratio decreased from 27% to 22% during the same timeframe. During the quarter, we wrote down our \$3m investment in Energy Virtual Partners to \$1m. This write down resulted from EVP's lack of success in consummating two pending asset management contracts. The Board of EVP has voted to liquidate EVP if it is unable to articulate a clear and feasible business strategy by August 15th. Bob has decided that all proceeds he receives from the liquidation of EVP will be paid to I/O. We are clearly disappointed in the results of EVP, but realize that it was a speculative investment when we made it. I will now turn you back to Bob for discussion and update of our strategy and operational matters.

Robert Peebler - Input/Output Inc - President and CEO

Thanks Brad. In our last conference call, I spoke to the importance of building stronger relationships with all companies to better educate and promote our new full-wave digital imaging systems technology -- VectorSeis. We are continuing to strengthen our I/O team to do the sure successful implementation of our strategy. Related to this effort, I am pleased to announce that we are adding two new Board members who bring unique oil and gas experience to the Company. John Seitz, former CEO of Anadarko; and Dr. Bruce Applebaum, currently Chairman of Mosaic Resources and former President of Worldwide Exploration and New Ventures of Texaco have agreed to join the Board. We will be making a formal announcement after our Board meeting next week. They bring in-depth understanding of ENP technology and how it is used and purchased by all companies. They also have substantial contacts with industry executives around the world, which will be beneficial in achieving our goal of strengthening our ties with all companies.

I spent several days last week making formal presentations to all company executives and our technical staff on I/O technology with specific focus on our VectorSeis technology. I found them very receptive to creating a much stronger relationship with I/O driven by desire to work with us to help shape the evolution of the technology and to gain the advantage of been-early users. Their views are similar to ours that the improved resolution of the VectorSeis P-wave will have the greatest initial value while the [share] applications will grow overtime as processes and interpretation evolves to take advantage of the new measurements. We are only at the beginning of strengthening our all company ties but I am convinced as ever of the merits of that strategy to help drive our technology. Related to

VectorSeis, we have a solid pipeline of leads, as I mentioned we just closed one this morning, in both land and seabed systems that give us confidence that we will likely end with our \$20-30m book this year. Most of the opportunities continue to be outside of our traditional western contractor base of costumers. I am also pleased to report that [inaudible] took delivery and successfully tested the VectorSeis system for cable system and a project for the Polish National Oil and Gas Company. Our senior company executives told us that they were very pleased with the technology and in fact believe it will provide the next generation of full wave digital imaging to the industry.

Before I move into providing second half guidance, I would like to make a comment related to EVP. When I decided to leave to EVP to join I/O, we all understood the risk of the founder and CEO of an early development stage company leaving too early in the game. We attempted to mitigate the risk with the I/O investment plus the recruitment of a strong executive with oil and gas experience. To our disappointment, the impact of changing leadership was even greater than expected and EVP Board with [Michael Corinth] determined that it was better for the shareholders to liquidate the Company then to go forward in the current mode and to risk of remainder of the funds. I am personally disappointed in this unexpected outcome, but at my judgment it's the best decision for both the I/O and the EVP shareholders.

Now to our second half outlook, based on our current activity and our improved cost structure we expect the third quarter revenues to be somewhat improved over the second quarter in the \$35-40m range with gross margin percentage in the mid-20's and expected loss of 5-9 cents per share. We are expecting an increase in gross margin in the second half of this year, as we realize full cost savings in the closing in the Alvin facility and continued headcount reductions later in the year. We expect fourth quarter revenues to be in the \$40-50m range with gross margin percentage in the mid-to-upper 20's and a net income range between breakeven and 5 cents per share. I remain encouraged to have seen top line revenue growth year over year and by the fact that the Company had made great strides in getting its costs more in balance with revenues. In summary I remain optimistic that our efforts to grow our business, while continuing to reduce our cost structure and become more efficient, will continue to pay dividends during the second half of this year and beyond. We are seeing the beginning of market acceptance of our VectorSeis business line and expect that trend to continue. Our goal for the next 6-12 months are to bring SG&A expenses down to 14% of revenues, R&D expenses down to 10% of revenues, bring gross margins up to the 30-35% of revenues and as a result bring the breakeven point of the

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Company down to 150m of revenues. And we know that we are heading in the right direction and with that we are happy now to take your questions.

QUESTIONS AND ANSWERS

Operator

Thank you sir. If you would like to ask a question at this time, simply press "*" "1" on your touchtone telephone keypad; if you are using speakerphone equipment, please pick up your handset before pressing "*" "1" for your question to register. You would like to raise your question press "*" "2". Please standby while any questions registered. Our first question is from Thiru Ramakrishnan (ph) with Simmons & Company. You may begin.

Thiru Ramakrishnan - *Simmons and Company - Analyst*

Good afternoon guys.

Robert Peebler - *Input/Output Inc - President and CEO*

Good afternoon.

Thiru Ramakrishnan - *Simmons and Company - Analyst*

It looks like there has been quite recovery in international activity, land based. Just want to know how sustainable is that and you guys have been talking a lot about your customer mix being more international contractors rather than the typical [inaudible] as such. What -- is that something that we should expect going forward in '03?

Robert Peebler - *Input/Output Inc - President and CEO*

Yes I just to give you a sense of the magnitude, about 80% of our current customers are international or foreign customers really coming out of. I guess we can any longer say it's our non-traditional client base but compared to the historical base of customers, we see when we look at just the sales activity in general and see the sources of the pipeline it's continuing to be from those areas. And we are seeing a growing interest, for example, the system that we just announced is a whole new company that's formed to provide services in the former Soviet Union, so I am expecting to see more of that. We also know that the Chinese contractors are still growing and still have a lot

of equipment needs even within their home country, so I think it's sustainable, I think it's even predictable that is going to continue along those lines. Now, I would expect at some point that we will see a little bit of rebalancing. I would say that most of are more traditional customers, even the smaller ones particularly the one is North American based are sort of -- only that I could describe it's in the maintenance mode. They are buying very, very little and I think the lot of those players, at some point in time they are going to have to move and buy some new equipments. So I think there is a little bit of rebalancing eventually, but I think the mix is -- I suspect that shift in mix is going to continue.

Thiru Ramakrishnan - *Simmons and Company - Analyst*

Okay, that's helpful. And looking at the guidance for the third quarter and the fourth quarter with the revenues to 75-90m for the second half '03, what -- is that growth -- they are primarily coming from land sales and are we seeing -- are we going to continue to see less and less marine revenue, and in turn how is that going to impact?

Robert Peebler - *Input/Output Inc - President and CEO*

Yes, I would say the mix, I think the mix is towards -- skewed towards land. I will say that the marine business for us is small enough now but it's a bit lumpy and so, you know, we could see some large sales, a better large sales move in and move out and sort of on quarter-by-quarter basis, move that marine number around a bit, for example, the last quarter the mixes are little bit odd for us on -- are not having as much positioning technology in the mix. So, we will probably see that, but I think that the land will continue to be the main driver.

Thiru Ramakrishnan - *Simmons and Company - Analyst*

Okay, great. Lastly, not to probe too much into this with the EVP investment with -- we did read the press release and kind of what you eluded to with there -- to anticipate asset management deals. Did the viability of EVP rely on these two asset management deals closing?

Robert Peebler - *Input/Output Inc - President and CEO*

I don't think that -- I wouldn't say that the viability of EVP was --.

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Thiru Ramakrishnan - *Simmons and Company - Analyst*

Really hunched on that?

Robert Peebler - *Input/Output Inc - President and CEO*

Yes. We are on 100% on the basis of those two sales. Those were two important contracts for us. I think it was just a common without getting into the whole, I think it was combination of those sales plus just another factors that just made us feel like we were just off track.

Thiru Ramakrishnan - *Simmons and Company - Analyst*

Okay, that's helpful, thanks a lot guys.

Operator

Thank you sir. Once again, if you would like to ask a question, simply press "*" "1" on your touchtone telephone keypad. Please limit yourself to one question at a time. You may re-queue up and ask another question. Our next question comes from Allen Brooks with CIBC World Market. Sir, you may begin.

Allen Brooks - *CIBC World Markets - Analyst*

Thank you. A question about your strategy with respect to VectorSeis, you had an alliance with Veritas, which I understand, it has been ended is that correct?

Unknown

That's correct.

Allen Brooks - *CIBC World Markets - Analyst*

Okay. And my understanding is that they view the standardization within the industry is moving in a different direction than you are suggesting. And I am just questioning whether are we going to see all startups and foreign companies, be the market for VectorSeis in the future and am I might raise you the question I guess also of payment risk potential from these kinds of clients?

Robert Peebler - *Input/Output Inc - President and CEO*

Yes, let me cover those two separate, I let Brad cover those payments at end, but let me visit about the market. First, just to say a little bit about the Veritas alliance, when we formed the alliance, I guess almost over two years ago a year and half ago or so, it was really started with our first system that I would say was sort of almost a prototype system, it wasn't our full cable system and the intend of the alliance was really to get experience -- start getting the experience and in fact I think in that perspective it was successful for both companies. We ourselves got many jobs into the alliance in Canada. What -- and so from that point of view I think it was successful. I think for us we came into a difference in strategy in the sense that we weren't interested in forming a relationship that will be exclusive for North America. We believe that overtime there is going to be quite a nice business in North America around -- of the digital land systems probably starting more in Canada than working its way into the lower 48. And so we just were not willing to enter into any kind of exclusive arrangement.

We feel like that that would actually hurt us as we won't more of companies and just wanted to have access to the technology. So I would say that what has happened if you think about the seasons in the Canadian market we are really sort of out of the market right now in the sense of, you are in the summer time and people are just now starting to crew up for the winter. And so we will have to see how that market develops sort of following a good experience with VectorSeis and in fact I was just up there enough too long ago and it has got lots of good positive feedback from the oil companies about their experience with VectorSeis. On the -- but you know if you look at the world you look at where the reserves are there is a heck of lot of more of opportunity outside United States to lower 48 and there are in the lower 48 so I think in the -- going forward we are going to see more and more activity international not in U.S. mainly because of the age of the bases and the opportunity. What's happening is that these smaller companies and some are not so small. In fact the world's largest contractor is BGP, and so they are not really startup, they are a very large contractor and they are taking -- interested in taking the technology, in fact we sold our first system to them. On the other hand, the other company's are viable and I will let Brad talk of it about the any concern we might have on taking risk.

Brad Eastman - *Input/Output Inc - CAO*

Thanks Bob with regards to payment risk; regardless of whether the VectorSeis sale or any other sale and we've tightened our turn that we will extend any credit on greatly, and with

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contractors that either we do not know because they are new or because we don't have a relationship with or contractors that are in a weakened financial stage. We normally require either all sales to be backed by letters of credit or some other form of credit enhancement, or we understand very well what our collateral is backing a credit-based sales. And really we have not financed as many sales as, I believe had been I/O's history in the past.

Robert Peebler - *Input/Output Inc - President and CEO*

Okay Jackie.

Operator

Yes sir, our next question comes from Ben Atkinson with Gagnon Securities, you may begin. Mr. Atkinson your microphone is open.

Ben Atkinson - *Gagnon Securities - Analyst*

Thank you, can you hear me?

Robert Peebler - *Input/Output Inc - President and CEO*

Sure can

Ben Atkinson - *Gagnon Securities - Analyst*

Sorry about that. I have been hearing on some other calls from service companies that there have been some delays, for example, in drilling in the deep shelf related to lack of understandings of the formations, and I am just wondering if you could tell me how would have VectorSeis it have -- helped in that issue if at all?

Robert Peebler - *Input/Output Inc - President and CEO*

On the deep shelf interesting enough you take a very mature base and like the Gulf of Mexico you would almost assume that all companies know about the geology almost totally, but in fact as they drill deeper, I think there is -- my minds I think it is about 50,000 wells has been drilled on the shelf, but most of them are shallow so as people have gone into deeper horizon they are now trying to understand a much better understanding of the geology and as you probably know it has been a bit hidden mist that the standard 3D seismic technologies have not worked,

so they have pretty high F&D cost because sometimes it works and sometimes it doesn't using the existing data. What this suggest to me and then I'll to VectorSeis -- what this suggest to me as people start getting the better understanding of the regional geology they are going to start running the lot more sort of I think that is custom design, maybe in the propriety shoots to start reducing the uncertainty on those wells and that really drives you into an interesting situation, one is that you are -- as you know on the Gulf Mexico shelf you've a lot of obstructions, platforms, all those kinds of things and then also you have the issue of deeper wells and the ability to image properly.

I think you are going to see a move to putting sensors on seabed probably with some form of retrievable cables or nodes, and I am not sure that -- we don't know for sure yet on the sort of the total depth limits for the multi-component or the sheer portion of the measurement, but we feel pretty certain that you are going to have much improved -- you have a much improved P-wave just by getting the sensors on the seabed. So my expectations are that overtime we are going to see in some form or another people out there re-shooting the data and probably not using the classical code streamer approach, although, there is some of that. You are probably going to see some people using seabed -- seabed retrieval cables. And we by the way do have in development and soon to be commercial a VectorSeis retrieval systems which has some real competitive advantages. Just on the way the sensor technology works. So, I think there is a reason for them to sue VectorSeis and but to really get there will be probably using C-Band technologies.

Ben Atkinson - *Gagnon Securities - Analyst*

Thank you.

Operator

Thank you sir. Our next question comes from John Morosani (ph.) with ING. You may begin.

John Morosani - *ING - Analyst*

Hi, Bob.

Robert Peebler - *Input/Output Inc - President and CEO*

Hi, John.

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John Morosani - *ING - Analyst*

How have you guys -- I see that you are adding which sounds like two very distinguished guys of the Board, which I am sure they will be very helpful in helping you penetrate the larger oil companies and let them know what your knowledge base is, but have you sort of got a P-wave 101 course that you are getting ready to prepare to the exploration departments, the geological departments of the big companies who have not so far used this technology?

Robert Peebler - *Input/Output Inc - President and CEO*

Well, what I find interesting, John, and what I have been doing over the last months amongst other lot of other things is really get into these oil companies and getting my understanding -- a further understanding to that both of our technology and where they see the technology growing. What I find frankly is that they all -- as you -- if you think about you would expect that the oil company, technical people probably the crews understand better than a lot of your contractors because they are very much more in this business and they are really are now starting to get up against imaging problem. So you have sort of -- in the oil companies you have your technical specialist and then you have the executives. Now that brings you to the 101 course on. It's not so much on P, it's on the -- which is your standard compression-wave, this is really full-wave -- your whole full-wave digital, and we are building up 101 course.

In fact, we challenged our guys to write a white paper that could be brought down to something that I can take to executives and have a discussion with and where that's overdone, in fact I was sort of road testing that presentation last week, and we are going to [pleat] it a bit, but what I found was a lot of interest at the senior levels. I think there is a real perception that they are sort of running out of prospects and there are sort of no, they are sort of running out of the technology cycle we are in and so there has been really an open interest in what we have done and what's is coming is very encouraging and also what our [inaudible] what to expect, as I found the technical people in the few companies we have visited are also very anxious to engage with us directly and have a more tidier relationship with our people in R&D because they know and sense that we are just at the beginning of the new cycle, and they wanted to be involved in helping shape that and give us feedback so -- and that's actually quite encouraging also.

John Morosani - *ING - Analyst*

So, is that something you think you will kind of cracking it through starting this quarter or --?

Robert Peebler - *Input/Output Inc - President and CEO*

Well, we will be -- we are already so starting, I guess -- I can say was out there -- I was elective for something to get and grant trial with few friends before we move it out, but yes I mean it's -- we are just at the beginning of that . We had a limited number of people in our own company that can really work at that level but certainly Jorge and myself. We also just brought in the fellow that runs our land systems group, Jim Hollis (ph.). Jim has a very strong geophysical background and is also very comfortable working at the executive level. And so I think as we change the center gravity of -- so our experience that's in the Company will give us -- you know, we can start business more in a routine that I can tell you there is every week that goes by, every month that goes by we will be increasing the amount of conversation we're having with these senior people and I will agree with you also that the two people we put on the Board are very well known in the industry, both of them are very technically confident but they're also senior executives and we're going to get a lot of good feedback from them from inside the Company, and to shape our thinking that I think also is important they can help us immensely, you know, helping us with contacts and as for them I'm sure they'll be out there, you know, talking to their executive friends.

John Morosani - *ING - Analyst*

Where is the -- where and when is the SEG this year?

Robert Peebler - *Input/Output Inc - President and CEO*

It would be in Dallas and I'm believing that it's in late October. We can -- we'll happily get you some information on that if you like.

John Morosani - *ING - Analyst*

No I'm just I guess my question was really, is it safe to assume that you will have tested this, you know, you're sort of -- you're introduction show-out and that will be very much available at that time?

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Robert Peebler - *Input/Output Inc - President and CEO*

Yes and anyone that's interested, you know, that share holders or potential shareholders and they would like to -- it's probably a good way to get educated because unless you are a specialist at your business it's probably good way to cross the business with you and show you what we're doing. We're happy to do that.

John Morosani - *ING - Analyst*

Great Well congratulations on the sales and new VectorSeis.

Robert Peebler - *Input/Output Inc - President and CEO*

Thank you.

Operator

Thank you sir, our next question comes from Ann Sockvitz (ph.) with Flaxen (ph.); you may begin.

Ann Sockvitz - *[Flaxen] - Analyst*

Following up on the facts that so much of the business is coming internationally now, is, are there your traditional customers or any of them reviewing the VectorSeis current vector currently? Even if they are in the -- just maintenance spending mode?

Robert Peebler - *Input/Output Inc - President and CEO*

what was the question I didn't really -- .

Ann Sockvitz - *[Flaxen] - Analyst*

Are of your traditional customers you know in the other western areas currently evaluating the VectorSeis or are they so much in the maintenance mode that they are not at that stage yet?

Robert Peebler - *Input/Output Inc - President and CEO*

No I would say on that front what I expect, I actually expect the main driver of that group of people will be oil companies themselves as we educate the oil companies and they really start almost backing in VectorSeis into some of their programs, and so that will probably start pulling some of the traditional players. The biggest problems they have right now is most of them are

frankly struggling with their balance sheets don't have a large -- they just really don't have a lot of ambition to be purchasing or have anything right now. So even the one is really have an interest I think are being like totally really get pulled by the market.

Ann Sockvitz - *[Flaxen] - Analyst*

Do you have any idea what that timetable would be?

Robert Peebler - *Input/Output Inc - President and CEO*

I don't.

Ann Sockvitz - *[Flaxen] - Analyst*

Okay thank you.

Operator

Thank you, if you would ask a question press "*"1" on your touchtone phone keypad. Our next question is from Frank Perese (ph.) with Stifel Nicolaus you may begin.

Frank Perese - *Stifel Nicolaus - Analyst*

Thanks, you guys were talking about the oil companies having a lot of trouble drilling on the deep shell and in a lot of areas and you mentioned that the -- at least some of the senior executives are very receptive to your -- to the new technology. Do they see your VectorSeis in solving this problem or have you proven that you solved these problems you are facing there without driving their costs up that that [inaudible] geology and whatever else is involved, that was you know my first question, what proof is there or what conviction is from you know the senior management? And then also I -- under the -- gentleman from CIBC had a question about I thought he asked something like that Veritas, thought the industry was going a different way on standards. I guess he had some what reading your systems gather something is that what he was talking about? And so those are my questions there.

Robert Peebler - *Input/Output Inc - President and CEO*

I will take the last and work the way with the forward. I don't know what he meant by standards. What I do know is we have a leading digital sensor and we have the only commercial digital

sensor in the market that has been in the field and I haven't had any customer or technical person tell us any difference from that. As it relates to the opportunities with the oil companies when you get to the senior level they are not really -- maybe some of them have difficult background but when you get to the senior level I think what's resonating with them is one, I think most of them are starting to realize that their current sort of technology cycle as it relates to the drilling challenges they have there is -- it is not enough to solve all the problems and I guess the BTL gas is just one example of that, is that you have people out there and some of them drilled in successful wells and some of them drilled some wells that are on a same bright spot or same kind of bright spot that they ended up with a dry hole. Now, once that starts happening they start looking for or other additional ways to solve these problems and, you know, Geophysics is such an important driver in our industry. So I think it is very natural for them to understand and that Geophysics will have role and I think it is very natural for them now to becoming much more open to wanting to understand what this next generation technology going to be.

Now we are in that early stage; it's the conundrum you always have when you have a new technology is giving the chicken the egg, you gag it up there and run some surveys and get some results and then you start feeding the cycle and that's pretty much where we're at; we're in the early stages, we just have companies starting to buy systems, the ones that buy are early adopters by definition. And -- but what will happen over time is as these systems get into place and people start getting experience, that experience results in success, and then they will -- that word gets around. And of course what we have to do is be very proactive in helping that word get around and really staying close to the customers, so we see how that technology is forming and be proactive. It's -- we're at the early adopter stage of the VectorSeis technology.

Frank Perese - *Stifel Nicolaus - Analyst*

And what -- just you are at the early adopter stage -- and what results have these early adopters been able to show; were there has been big successes, whether it would be a big return on investment that you could tell others about? And then I also just was wondering the -- you have got the only digital sense of the VectorSeis, how does that tie into, you know, the return of investment issue?

Robert Peebler - *Input/Output Inc - President and CEO*

Yes. With the probably -- from our early field testing a year ago in Canada, one of the areas that was very obviously successful -- one area would be what's called stratigraphic [plays]. If you look at how oil and gas is trapped, you have structural traps or you have stratigraphic traps and those are more difficult to resolve. And we have examples in fact on our road show last week with these executives; we've shown a couple of these examples where you could see using the traditional approach and then using the using the new approach, and clearly you can see the channel sands and know where to drill, and in fact you would -- if you drill off of the old image you would have drilled in a wrong place. Then take it long to understand that if you drill in a wrong place it's dry hole, then take much to pay for that image. But the facts to the matter are that there is many, many, many different applications for the technology starting with improved compressional wave and then moving into adding multi-component to ShareWave -- there is a long list of things that could be used for fractured reservoirs, but all those things -- the processing with the interpretation we will be developing over time. Not much different than 3D, this seems so familiar to me-- this I went through the whole 3D evolution starting in the early 80's all the way through the 80's, the 90's and this is the way that market also was developed.

Frank Perese - *Stifel Nicolaus - Analyst*

Okay and there is a lot of the know how that already exists to get an immediate -- looking at things in the short run, we all like to stock to go up soon of course -- but are there a lot of applications that would be available in the short run where this know how already exists?

Robert Peebler - *Input/Output Inc - President and CEO*

You know there are applications in the short run and what we are doing is -- I mean the good news is you don't need to convert the whole world to have a nice business and a nice growing business, and so for us you become sort of targeted working with your clients. So, for example, if you know that it's going to work pretty well Or we think it's going to work well in a shortened fractured shelf then it's important for us to work with clients and get some experience there and then all of a sudden people know that it works in that area and so we start buying more. And another area we are interested in is in the marine environment with our seabed systems you get into what's called gas clouds, which is sort of a low hanging through, and there is literally [inaudible] to keep the equipment world

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out there under gas clouds if you just can't see through the image; and if you put a deployable seabed system you can see the structure and people will drill wells on that. So those are just two examples, so we know where they are -- these are our prioritized as the areas that we know that it works and then you start working down to the areas that you think it works but you need more experience -- and that's what the industry will be doing. The other thing I watch is -- when I watch magazine articles and our technical journals and also what people are talking about the trade shows and all this with the EAGE in Europe just 2-3 months ago and I was impressed on how many more technical papers were being presented in this whole area of improved imaging, and in this case with multi component M40. So there is a -- the world that is lacking of places that the technology can be applied it's just our job to get up to the clients and find and them build the business.

Operator

Thank you sir, our last question comes from David Snow with Energy Equities, sir you may begin.

David Snow - Energy Equities - Analyst

Hi, in the press release the land sales in the second quarter more than doubled to \$23.7m up from \$10.9m a year ago, how much of that was VectorSeis?

Brad Eastman - Input/Output Inc - CAO

Our VectorSeis sales in the second quarter were about \$2m David.

David Snow - Energy Equities - Analyst

Alright. And I am trying to second or third the opinions that the Gulf Coast independence and majors would love to see this technology to help them out of their bind on this deep shelf drilling which has been disappointing and they are regrouping and ripe fruit that would seem to me as others have echoed. I wonder why the Canadians are always the first to take on a new technology and is it just because it's less obstructed land up there for them to lay things out on or why can't it come into the U.S. just as quickly as Canada?

Robert Peebler - Input/Output Inc - President and CEO

I would hate to answer that question, because I might insult some of my customers a little bit out of place, as I really don't know the answer to that Dave. And in fact that is not always true. I have seen a lot of interesting things going on in -- in fact if you really look at where -- for example, for the multi components have first been used that has been more in Europe. If you look at VectorSeis and the marine areas and so the center is gravity is really shooting sheer wave in all that as back sea started outside of the North American continent but there is a lot of reasons but I don't really care to speculate because I will just be speculating.

David Snow - Energy Equities - Analyst

And in fact you had asked couple of questions about the write-down that occurred in just a period of three months or so, can you give us some idea who made that decision, and who else participated in it?

Brad Eastman - Input/Output Inc - CAO

David, that I am sorry are you just asking about I/O's decision to write-down the investment or --?

David Snow - Energy Equities - Analyst

To purchase the \$3m investment.

Brad Eastman - Input/Output Inc - CAO

That was a company decision David. I am not sure what exactly you are asking.

David Snow - Energy Equities - Analyst

Well who was the decision maker it must have been a key decision maker?

Brad Eastman - Input/Output Inc - CAO

The Board of Directors approved that investment and was very active in negotiating that investment.

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David Snow - *Energy Equities - Analyst*

Was it vetted by any third party?

Brad Eastman - *Input/Output Inc - CAO*

Yes. Sure it was

David Snow - *Energy Equities - Analyst*

What type of third party vetting do you have?

Robert Peebler - *Input/Output Inc - President and CEO*

David, it is -- I would suggest if -- just for as everyone else in the call if you want to getting more detail why don't you give Brad a call, and he can give you this information. We really -- the process was handled by the Board, we had a special committee, obviously, that was completely out of it -- intentionally there was a third party the reviewed the evaluation there certainly was a lot of people involved; we are happy if anyone else has any issues we'd like to talk about that and having called [Lan] and Brad can get more information. I think with that we are sort of the end of the time frame and we would like to thank everyone for participating in the conference call and again thanks a lot and feel free to give us a call if you need any follow-up information.

Operator

Thank you for participating in today's teleconference call, you may now disconnect.

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