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IO - Q4 2002 Input/Output Inc. Earnings Conference Call

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PRESENTATION

Operator

Good morning. Welcome to the 2002 Input Ouput Earnings conference call. All participants will be in a listen only mode until the question and answer portion of this call. In addition, be advised that the call is being recorded. If anyone does have any objections, we ask that you please disconnect at this time. I will turn the call over to Bob Bunch, President and Chief Operating Officer. Sir begin when ready.

Bob Bunch - *Input Output, Inc. - President, Chief Operating Officer*

Good morning, and welcome to Input Output's 4th quarter 2002 conference call. Your hosts are me, Bob Bunch and Brad Eastman, our Chief Administrative Officer.

As we start the call, I'll refer to the statement regarding forward-looking statements incorporated in our press release issued earlier today. Please note that the contents of the conference call this morning are covered by this statement. Our agenda for this morning will be initially some comments on the -- our industry perspective, a review of our quarterly and year-end results, a update on other significant events this quarter, guidance for our calendar year 2003 performance and first quarter, followed by a question and answer period. As far as the industry is concerned, While trends and commodity prices were generally favorable in the fourth quarter, both drilling and seismic activity remain depressed. Commodity prices remained strong during the quarter with West Texas immediate averaging 28.58 this quarter, essentially flat compared to last quarter $28.25. For the year, West Texas immediate average $26.15, up slightly from the $25.95 in 2001. Natural gas prices improved seasonally during the quarter, with [nimax] spot gas prices averaged $4.14 per MCF compared to 3.19 per MCF last gather. For the year gas prices declined from a average 4.05 per MCF last year to 3.37 per MCF in 2002. U.S. drilling activity averaged 847 rigs during the quarter, down slightly from 853 in the third quarter, and down 16% from last year's fourth quarter average of 1004. For the year, U.S. drilling activity averaged 831 rigs, down 28% from the 1,155 in 2001. Oil directed rigs dropped 37% last year, versus a 26% decline for gas directed rigs. International activity has been steady. The international rig count improved to about 5% from the third quarter, to 753 active rigs last quarter, which was about even with the 4th quarter last year. Canada increased about 13% sequentially, with rigs running averaging 283, which also represents a slight improved compared to the fourth quarter of 2001.

For the year, active rigs operating internationally declined slightly to 732 from the 745 active rigs in 2001. We saw mixed levels of seismic activity this quarter. International land seismic crew count softened averaging 103 for the quarter, down from 115 the same quarter a year ago, and down 8% sequentially. For the year, international land seismic crews averaged 110, down 15% compared to 2001. Seismic activity in Africa and Asia Pacific increased in 2002 compared to 2001, while other significant international geographic areas experienced declines in seismic activity. China in particular remains quite active. Rirbian activity has been hurt by reductions in state incentives for exploratory activity. U.S. land activity also softened with active land crews averaging 32, down from 37 last quarter, and the 39 recorded in last year's fourth quarter. For the year, U.S. land seismic crews averaged 35, compared to 42 in 2001. Canadian land activity averaged 16 crews, up 4 sequentially, but down from a 22-crew average in the fourth quarter last year. Year on year, Canadian land seismic activity declined 32% to a average of 19 active crews. Marine seismic activity was also mixed. U.S. marine activity declined to 12 active vessels compared to 16 last quarter and 17 a year ago. The international marine fleet averaged about 57 active vessels this quarter, down from 65 last quarter, but up significantly from 49 active vessels in the fourth quarter last year. For the year, marine seismic activity was essentially flat with 2001. While seismic activity in North America continues to reflect a challenging exploration environment, we are seeing greater stability in the international arena. In particular, Chinese seismic contractors are increasingly active not only in China but also in other international areas. Moving on to a update on our annual and quarterly results our fourth quarter reflected a continued improvement in our sales volume and our ongoing effort to adjust our cost structure to reflect current business realities.

Brad will now discuss our year in the last quarter in more detail.

Brad Eastman - *Input Output, Inc. - Vice President*

Thank you Bob average sales of 188.6 million were down 93.5 million or 44% from last year, principally attributable to our land division. Land sales this year were 65.2 million dollars, a decrease of 60%, compared to $162.3 million in 2001. Marine activity increased about 7%, with sales of 53.4 million dollars this year. For the quarter, sales were 37.0 million, down 14.1 million dollars, or about 28% from last year's fourth quarter. But up 8.5 million dollars, or about 30 percent sequentially. Land sales this quarter were 20.4 million, a decrease of 21.7 million, or 52% from last year's fourth quarter. But up 4.0 million dollars or 24% from last quarter. Marine sales of 16.6 million dollars increased 7.6 million dollars, or 84% compared with the same period of last year, a increased 4.5 million dollars or 37% from last quarter. Marine sales this quarter reflect a large order for a Russian customer, including equipment for a new vessel and a upgrade to a existing vessel. Our gross profit rate for 2002 was 16.0%, compared to 35.0% last year. Adjusting for special charges, totalling 5.8 million dollars, relating to severance and the discontinuance of certain products, our gross profit rate was 20.8% in 2002. The adjusted gross profit rate for land was 6.1 percent this year, compared to 34.0% last year. For marine, the adjusted gross profit rate was 38.9% of revenues, compared to 41.0% last year. This year's adjusted gross profit rates reflect lower absorption of fixed and semi fixed overhead due to reduced production volumes as we elected to leave facilities idle rather than build to inventory. For the quarter our adjusted profit weight was 18.2% of revenues before 1.02 million of special charges, relating principally to severance related to facilities closures, compared to 26.6% last quarter and 38.0% for the fourth quarter last year. Adjusted land gross profit rates declined to 11.8% of revenues this quarter, compared to 14.2% last quarter, and 41.2% during the same period last year. Adjusting marine gross profit rates were 25.9%, compared to 43.4% last quarter and 25.9% in the same period last year. Selling, general and administrative expense was 30.4 million dollars. Or 25.6% of revenues, compared to 31.4 million dollars or 14.8% of revenues in the prior year. Included in 2002's amount is about 0.8 million dollars of special charges relating principally to severance costs. For the quarter, SG&A expenses were 7.7 million, down 0.3 million from last quarter and down 1.1 million, compared to the same period in 2001. Selling, general and administrative expenses included about 0.4 million of severance and other costs associated with our exit from the norich and albin manufacturing facilities. As always we remain mindful of the need to contain costs, full time employees were 598 at December 31, 2002, representing a decrease of 201 during the year, despite the acquisition of axis geophysics and sm geotechnologies.

R and D expense of about 6.3 million dollars or 17.0% of revenue was 0.4 million less than last quarter and 1.2 million dollars less than the same period last year. This quarter's amount also includes about 0.3 million dollars of severance expense. For the year, research and development expense decreased about 0.7 million dollars, to 28.8 million dollars, despite the fact that this year's amount includes 2.2 million dollars relating to severance and facilities closure expenses. These decreases primarily reflect reduced staffing left and lower prototype expense. In 2003, we expect research and development expenses to decline significantly, particularly in the second half of the year, as we complete development of our new cable-based Vectorcize land system.

We recorded expense of 1.0 million this quarter attribute to the impairment of assets related to the closure of our Texas and UK manufacturing facilities. For the year expense attribute to the impairment of expense total 22.0 million dollars. Our operating loss for the current year was 63.6 million dollars, compared to operating income last year of 7.9 million dollars of the excluding the previously discussed special charges, our operating loss for 2002 was 32.9 million dollars. Our operating loss for the quarter was 9.7 million dollars, versus 32.3 million dollars last quarter, and operating income in the same period of last year of 1.9 million dollars. Excluding the previously discussed charges, our operating loss for the quarter was 7.0 million dollars, compared to a operating loss before special charges of 7.4 million dollars last quarter. Excluding special charges, EBITDA for the fourth quarter was a negative 3.4 million, compared to 4.0 million last quarter and a positive 6.0 million during the same period one year ago.

Similar to last quarter, depreciation and amortization was about $3.5 million. Depreciation and amortization for 2002 was $13.1 million and capital expenditures were 6.9 million. The Company recorded a income tax benefit of about 3.1 million for the quarter, and expense of 57.9 million dollars year-to-date, including a 61.0 million dollar charge to establish reserves for our deferred tax assets, which consists primarily of accumulated net operating losses. We expect a effective tax rate of 37% for 2003 as a result of our anticipated mix of U.S. and foreign income. Adjusting for the effect of special charges, our net loss attributable to common shareholders this quarter $0.08 per share, compared to a net loss of $0.18 last quarter. We continue to focus on and make solid progress and strengthening the balance sheet. At year end weed about 77 million dollars of cash on hand, 4 million dollars more than on September 30. Despite higher sales volumes, our notes and accouts receivable remained essentially flat compared to less quarter at 18.7 million, while inventories decreased 5.8 million dollars during the quarter to about 50 million.

Bob Bunch - *Input Output, Inc. - President, Chief Operating Officer*

Thanks, Brad. In last quarter's conference call, Tim Probert eloquently described the current state of the seismic sector, and the implications for Input Output. In particular, Tim articulated a three-part strategy that remains the blueprint by which we are managing our company. Slash costs in order to provide products and services at prices our customers and end users, the EMP companies are willing to pay, prove the value of Vectorcize technology in land surface ocean bottom and end well applications and use the Vectorcize platform as a spring board for entering into reservoir products and services.

As we discussed last quarter, our focus is to reduce both the unit cost of our products, and our fix cost structure with a goal of bringing our annual break even revenue level to 140 million. We are in the process of vacating our alvin Texas and UK manufacturing facilities and have completed the relocation of the GM G unit to axis offices in Denver, Colorado. Late last year we were very happy to finalize an agreement with Stuart and Stevenson to manufacture our land energy sources in one of their Houston Texas manufacturing facilities. This business will be transferred to Stuart and Stevenson as soon as we complete a current build of 15 vibrateors for a customer. We are in the process of relocating the geophone and cable facilities to facilities in the U A E and Mexico. By the end of this year, we will have substantially transformed our business by outsourcing most of our none core products and otherwise relocating our operations to lower cost venues.

On the Vectorcize front, Vectorcize is a new seismic data acquisition platform centred around our multicomponent digital sensor. The horn of our digital sensor is a unique [men's excellerometer] that we manufacture here in Houston. Vectorcize provides a platform for knew seismic data acquisition systems for land surface applications, ocean bottom applications, as well as end well applications. Regarding land applications, we are pleased that our alliance crew located by VERITAS is fully booked for the Canadian winter season. The demand for our Vectorcize crew has exceeded availability. In addition to repeat customers, such as [encanna, nexin and def von] new customers are [eog and kesh]. Much of the Canadian activity stems from Vectorcize's unique ability to provide increased I amaging of oil reservoirs, we are pleased that crew productivity with the new Vectorcize system 4 is even better than we or our customers had anticipated and we thought it would be awfully good. In fact, our alliance Vectorcize crew has been setting records for shots acquired per day. Last quarter we also announced the sale of our first Vectorcize system four acquisition system. The buyer is BGP, a Chinese contractor that is currently the largest land seismic contractor in the world. This is a exciting entry into what appears to be a major growth market in the coming years. This system will be delivered in the first quarter this year.

We are also continuing to conduct trials for clients throughout the world, including Russia, Latin America, the United States, Eastern Europe and the far east. We are on schedule to beta test our Vectorcize system for cable system later this quarter. Also last quarter we completed the first test of the Vectorcize ocean bottom acquisition system in the echo fisk field in the north sea. This test was supported by ConocoPhillips and delivered excellent results. Based on the success, we are negotiating with a number of companies regarding the purchase of retrieveable and permanent Vectorcize ocean bottom systems.

Our end well Vectorcize applications are currently oriented around various passive and 4 Dmonitoring tests being conducted by our clients. These projects place Vectorcize sensors down who will to monitor flewed fronts and dynamic reservoir process using natural formation noise and a energy source. Our Vectorcize marketing and sales effort are targeted towards emp companies who are become to spec Vectorcize equipment for the reservoir characterization programs. In addition to the productivity gains our customers are achieving with Vectorcize system 4, we are very pleased that our manufacturing costs are declining as we anticipated, due to higher manufacturing yields, and higher sales volumes. Outsourcing of various components in assembly and other product refinements.

Now, as to -- as to the current year, recent reports indicate that analysts anticipate a increase in worldwide drilling activity in 2003 of between 10 and 14 percent compared to last year, fueled by an estimated 4% increase in total emp expenditures. We are cautiously optimistic that planned increases in expenditures for oil companies, especially in international areas such as China and Russia, along with growing acceptance of our Vectorcize platform products, will result in higher sales in 2003 than 2002. Accordingly, we currently project 2003 revenues of 155 to 165 million dollars, with earnings per share ranging from break even to a small profit. For the first quarter of 2003, we currently project revenues of about 40 million dollars, with a net loss per share of between 2 and $0.05 before any incremental restructuring expenses. In conclusion, while 2002 has been a difficult year for seismic exploration, we have taken a number of steps to fundamentally reshape Input Output to enable us to be competitive in the challenging marketplace. As we enter 2003 we believe that we are well-positioned in terms of cost structure, technology portfolio and market presence to succeed in the coming months and years.

We will now be -- be happy to take questions, Chris.

QUESTIONS AND ANSWERS

Operator

Very good, sir. If you would like to ask a question at this time, please press star 1 on your touch tone phone. I will announce you prior to your question. Again, if you would like to ask a question at this time please press star 1 on your phone. Our first question comes from Larry Lighton, your line is open.

Larry Lighton

Good morning, thank you. You mentioned that kind of the blueprint remains the same as articulated by Tim at the last quarterly conference call. I'm concerned about his resignation, and maybe it is old news at this point. What does that say about the prospects for the business? It is obviously very difficult, but it also perhaps says something about the long-term prospects as to how difficult the business is for him to depart. Is there any color you can place on his resignation?

Bob Bunch - *Input Output, Inc. - President, Chief Operating Officer*

Well, sure I would be happy though try. I think what it really says is more about Tim Probert than it does about Input Output. Tim, I think in our view, and in our Board's view has done a excellent job at I/O. In talking to Tim, I think that he continues to have confidence in the Company, confidence in the industry sector. However, because of -- in part because of the job he's done here, I think he was presented with an opportunity at Halliburton that was one that was simply too good to pass up, so Tim chose to leave and to accept the challenge at Halliburton. Again, you know, I think that is more a statement on the quality of Tim's management and the esteem in which he is held in the oil service business rather than any kind of a -- a statement about I/O.

Larry Lighton

Not to dwell beyond this, but moving to the division that he is running there, you see that as a promotion as opposed to being a CEO of a independent smaller company; that would be your interpretation.

Bob Bunch - *Input Output, Inc. - President, Chief Operating Officer*

Well, yeah. I mean, obviously, you know, it was Tim's decision. And so I -- I really cannot speak authoritatively for Tim. I just would point out that the -- that the unit that Tim -- the unit that Tim is operating at Halliburton is larger by several multiples than I/O's current size. Certainly, the opportunities at haliburtoferjts n to effect change, I think we would all agree are significant. And so I think for a number of reasons Tim found that situation to be appealing.

Larry Lighton

Okay.

Bob Bunch - *Input Output, Inc. - President, Chief Operating Officer*

So, again, I think it was more of a reflection of the -- of the intrigue of the challenge at Halliburton, the size of the opportunity, thes tape in which Tim is held in the oil service industry and a -- and an opportunity that just could not be passed up.

Larry Lighton

Okay.

Bob Bunch - *Input Output, Inc. - President, Chief Operating Officer*

We were all very sorry to see him -- see him leave, but we understand the reasons.

Larry Lighton

Okay. On a separate front, obviously the short-term goal is is to get the business back to break-even. A two-part question: when you get beyond the break-even point how do you model the business in terms of contributory margins above the break-even, and is there a longer two to three-year goal that you think is realistic in terms of revenues or rates of return or revenues.

Bob Bunch - *Input Output, Inc. - President, Chief Operating Officer*

Yeah, we really look at our business in -- in -- in at least two parts. We have a -- a good, solid core business of analog products that generate a -- you know, a reasonable income strerm on which we make, you know, good margins but, again, not -- you know, not tellar margins. The second piece of the business, the one in which we've been working hard and investing significantly over the last few years is the Vectorcize platform. And certainly we -- we believe that the contribution margins from Vectorcize are going to be, you know, very appealing, you know, and will, you know, move to -- to enhance the Company's overall financial performance. You know, over the next few years as Vectorcize becomes a -- a larger and larger part of the Company's, you know, sales portfolio.

Larry Lighton

On a operating basis or contributing basis, what does Vectorcize do as it gets a bigger part of the business.

Bob Bunch - *Input Output, Inc. - President, Chief Operating Officer*

Well, again, you know, as the volumes grow it will absorb a greater and greater degree of our manufacturing overheads. I do not want to, at this point, attempt to articulate any specific contribution margins, goals, I would simply point out that in the mid-90s and later 1990s when I/O was in the process of -- of taking its system 2 and -- and moving that into the marketplace, and as that product became the industry standard for land data acquisition I/O enjoyed margins, you know, book margins in the -- in the mid-to upper 40%. I do not think that that is a unrealistic possibility for I/O as Vectorcize again begins to capture a larger and larger share of the market.

Larry Lighton

And remind me, the 40% historic margins, that was measured -- that was EBITDA or was this a measure of --

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Bob Bunch - *Input Output, Inc. - President, Chief Operating Officer*

Gross margin.

Larry Lighton

Gross margin.

Bob Bunch - *Input Output, Inc. - President, Chief Operating Officer*

Yes, gross margin. It came through --

Larry Lighton

That translated at one point I think to a 20% operating margin or something like that.

Bob Bunch - *Input Output, Inc. - President, Chief Operating Officer*

That is about right.

Larry Lighton

Okay. Thank you.

Bob Bunch - *Input Output, Inc. - President, Chief Operating Officer*

You are quite welcome.

Operator

The next question comes from Scott Gill. Your line is open.

Scott Gill

Thank you. Good morning, Bob.

Bob Bunch - *Input Output, Inc. - President, Chief Operating Officer*

Hi, Scott.

Scott Gill

Bob can you talk a little bit more about the system being sold to BGP, give us some sense as to what the revenue contribution will be, and the impact to profitability of that system here in the first quarter.

Bob Bunch - *Input Output, Inc. - President, Chief Operating Officer*

Sure. The -- it is a -- a -- about a -- a 4 thousand station system, including -- and it is based on our radio technology rather than our cable technology. The revenue contribution from the -- from the package sales to -- to BGP, which includes some ancillary equipment including vibrateors and some other ancillary equipment is in the 9 to $10 million range.

Scott Gill

Okay. That's --

Bob Bunch - *Input Output, Inc. - President, Chief Operating Officer*

In terms of contribution margin, again it will have a -- you know, a very nice, you know, positive effect on our -- on our gross margins in the first quarter.

Scott Gill

Okay. Bob, I'm trying to reconcile that order and your -- your commentary on better margins with Vectorcize to your guidance for the year, and -- and kind of your goal to break even at 140 million annual run rate. Give us some sense as to all these cost-cutting actions that have taken place, you know, how -- do we get to break even here in the second quarter or is it more a third quarter, how soon do we see all of these cost-cutting measures that come into play here.

Bob Bunch - *Input Output, Inc. - President, Chief Operating Officer*

Yeah. We will not be out of the albion or norwhich facilities until close to the end of Q2.

Scott Gill

Okay.

Bob Bunch - *Input Output, Inc. - President, Chief Operating Officer*

We were in the process, as I said, of moving the operation out of alvin to the Stuart and Stevenson, but that will not occur until probably early in Q2 because of the large order that we are in the row ses of completing, and we just cannot move that until the order is done. Similarly with the norwhich facility, we have gone through the statutory processes to enable us to -- to fulfill that plan, and so it is probably going to be a Q2 move also. It will be the second half of this year efore you start to see the full effects of the -- of the manufacturing restructuring and the cost-cutting.

Scott Gill

Okay.

Bob Bunch - *Input Output, Inc. - President, Chief Operating Officer*

In terms of margins, Scott, again on the -- the 155 to 165 in revenues that we are projecting for -- for 2003, that -- that model reflects a -- what we think is a fairly significant estimate of gross margins for the year, getting back into the low 30s, again with -- with land improving significantly back into the upper 20s or 30% range, marine holding at about the -- the 40% range, which they have enjoyed historically and, again, that is going to be a mix of better margins on our Vectorcize products and on the land side in particular the -- you know, some of the analog products, lower margins, you know, that we have -- we have, you know, typically had as those products kind of -- sort of wind up their end of life.

Scott Gill

Okay. Bob could you talk a little bit more specifically about what you see in terms of potential sales here for your various Vectorcize products, as we move through 2003? I think, oh, you can go back six months ago you were talking about Vectorcize should be contributing 8 to 10 million in revenues during the year. It sounds as though this one order fills that expectation. What is your expectation for Vectorcize technologies now?

Bob Bunch - *Input Output, Inc. - President, Chief Operating Officer*

Yeah. What we had said, Scott, is that our expectation for 2002 is that we would have revenues attributable to Vectorcize technology of 9 to 11 million for 2002. Certainly, if you count the -- the BGP order as a order booked in 2002, then -- then that is true, all though that order will not actually be recorded until the first quarter of this year. Our expectation, and again attempting to be -- to be somewhat conservative, our expectation for Vectorcize revenues in 2003 is in the -- in the 30 to $35 million dollar range, that is going to be a mixture of.

Scott Gill

Okay.

Bob Bunch - *Input Output, Inc. - President, Chief Operating Officer*

-- sales of -- of land surface systems, primarily our cable systems in the -- beginning in Q 2 in the second half of the year, but also some -- some sales of retrieveable obs systems utilizing Vectorcize technology. I do not anticipate a material revenue contribution from the end well products, as that market is -- and that product is continuing to evolve.

Scott Gill

Bob, just maybe -- maybe just a little bit farther on that, 30 million plus type expectations, how much of that is secured by orders to date, and inquiries?

Bob Bunch - *Input Output, Inc. - President, Chief Operating Officer*

Oh, I can tell you in terms of inquiries, we have inquiries that probably exceed that amount at this point.

Scott Gill

Okay.

Bob Bunch - *Input Output, Inc. - President, Chief Operating Officer*

In terms of actual firm orders that we have, other than the other than the BGP order, I do not think we have any purchase orders that are actually -- actually signed up.

Scott Gill

Okay. Thank you.

Bob Bunch - *Input Output, Inc. - President, Chief Operating Officer*

You're welcome.

Operator

Our next question comes from Joe Agular, your line is open. Joe Agular, your line is open, from Johnson Rice. Sir, please check the mute feature on your speakerphone.

Daniel Burke - *Johnson Rice*

This is Daniel Burke calling from Johnson Rice.

Operator

Go ahead sir. Your line is open.

Daniel Burke - *Johnson Rice*

Bob, my question for you would be looking away from the Vectorcize product coming into the market this year, what would you say your quarterly revenue rate is simply serving Input Output's installed base level of equipment, what is that base level run rate to be built into each quarter?

Bob Bunch - *Input Output, Inc. - President, Chief Operating Officer*

I would say, you know, just based on your core products, you know, we have about a 25 to $30 million a year qaerlt, you know, base -- a year quarter base run rate, and that is fairly steady based on spares, repairs, sort of end fills of channel capacity for people who have legacy system 2 and image systems.

Daniel Burke - *Johnson Rice*

Okay. So just adding that together with the Vectorcize expected sales, it gets you pretty close to the full year for 2002-2003 forecast. I just wanted to check. One other question, I do not believe that I captured it earlier on in the call, the year-end debt balance.

Bob Bunch - *Input Output, Inc. - President, Chief Operating Officer*

Yes, Brad?

Brad Eastman - *Input Output, Inc. - Vice President*

The year-end dent balance is about 53.5 million.

Daniel Burke - *Johnson Rice*

Okay.

Brad Eastman - *Input Output, Inc. - Vice President*

And that principally relates to our FCF note and the treatment of our sales, lease back transaction on our corporate campus.

Daniel Burke - *Johnson Rice*

Okay. Great. Thank you.

Bob Bunch - *Input Output, Inc. - President, Chief Operating Officer*

Thank you.

Operator

Our next question is a follow-up question from Larry Leighton your line is open.

Larry Lighton

Yes, just continuing on the plan for 2003, can you -- you mentioned that R and D will be down significantly. Can you fill in a little bit what the range of gna and marketing and sales and those things might be.

Bob Bunch - *Input Output, Inc. - President, Chief Operating Officer*

Yes. I can give you some ranges. Again, our goal has-has been to get our R&D spent -- down to approximately 10% of revenues. And so our plan for the year reflects a -- a R&D spend in the range of 10% of -- of revenues, it could be a little higher, likely will not be much lower given -- you know, given I/O's history. And that reduction has started to occur. I mean, we saw a reduction in R&D expense this quarter compared to last quarter. You will continue to see a -- some reduction in the first half of the year with a -- as Brad mentioned, I believe, in his presentation a more significant drop in R&D expenditures in the second half of the year as we complete the beta test and roll-out of our Vectorcize cable system. G&A, SG&A expenditures, again, we expect to come back -- down into the 16, 17% range. And in, again, as I mentioned earlier, gross margins, we anticipate for the year will be in the -- in the low 30s.

Scott Gill

Okay. And also, given the -- roughly break-even level, what are the ramifications for cash flow, will there be much cash generation in 2003.

Bob Bunch - *Input Output, Inc. - President, Chief Operating Officer*

Yeah. Depreciation for the year is running around 13, $14 million. So assuming that we are break even or slightly positive from aernings standpoint we will generate, you know, good cash flow as -- as Brad talked about, we've continued to -- to, I think, do a good job on our working capital, being, you know, fairly conservative in our extension of credit to customers, and working hard to not only, you know, maintain inventory levels but actually bring inventory down and our plan is to continue to work the inventory so that, you know, inventory becomes a cash contributor to us during the year as we continue our -- our programs to outsource manufacturing.

Scott Gill

And would you say -- what did you say capital spending for 2003 was?

Bob Bunch - *Input Output, Inc. - President, Chief Operating Officer*

Projection for cap ex for 2003 is going to be around 7 million.

Scott Gill

Thank you.

Operator

Once again, if you would like to ask a question, please press star 1 now. Sir, I am showing no further questions at this time.

Bob Bunch - *Input Output, Inc. - President, Chief Operating Officer*

Okay. Thank you very much.

Operator

That does conclude today's conference call. We thank you everyone for their participation. All parties may disconnect at this time.
