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IO - Q3 2004 Input/Output Inc. Earnings Conference Call

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streetevents@thomson.com

617.603.7900

www.streetevents.com

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CORPORATE PARTICIPANTS

Jack Lascar

Input/Output Inc. - Partner

Robert Peebler

Input/Output Inc. - President & CEO

Michael Kirksey

Input/Output Inc. - EVP & CFO

CONFERENCE CALL PARTICIPANTS

Unidentified Company Representative

Unidentified Participant

Unidentified Audience Member

Operator

Thiru Ramakrishnan

Simmons & Company - Analyst

Robert Ford (ph)

Sanders Morris Harris - Analyst

John (ph)

ING Personnel Management - Analyst

Byron Hope (ph)

Figuring Energy Partners - Analyst

Perry Leditor (ph)

Steelberg Investment Management - Analyst

Ole Slorer

Morgan Stanley - Analyst

Mary Saffrin (ph)

Gracey Spear Advisors - Analyst

Bill (ph)

- Analyst

PRESENTATION

Operator

Good morning ladies and gentlemen and welcome to the Input/Output Third Quarter Earnings Conference Call. (OPERATOR INSTRUCTIONS). I would now like to turn the conference over to Jack Lascar. Please go ahead sir.

Jack Lascar - *Input/Output Inc. - Partner*

Thank you Rob. Good morning and welcome to Input/Output Third 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 will like to be on an email distribution or fax list to receive future news releases or experience a technical problem and didn't receive yours yesterday, please call DRG&E and relieve 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 a recorded instant replay until November 4, 2004. To use the replay feature, call area code 303-590-3000 and use the fax code 1101-1606.

Information reported on this call speaks only as of today October 28, 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 that are based on management beliefs as well as assumptions made by any information currently available to management. Forward-looking information includes statements regarding expected revenues, gross margin, EBITDA and earnings per share for the fourth quarter and full year 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 and please note that the contents of our conference call this morning are covered by these statements. 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 reconciliation to 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.

Robert Peebler - *Input/Output Inc. - President & CEO*

Good morning and thank you for joining us. The agenda this morning will include review of the major third quarter events and progress against our goals, a review of the third quarter financial results, a look at the remainder of 2004 followed by a question and answer period. The expression, 'When it rains, it pours' is a good way to describe our third quarter. We had

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an unfortunate confluence of events that pushed our results significantly below our original guidance. Our gross product margin of 24 percent was negatively impacted by our lower margin product mix, unexpected costs associated with launching new systems and customers delaying purchase commitments. In addition we recognized a writedown of the Yukos subsidiary geophysical receivable.

Before Mike goes into the specific financial details of the quarter, I would like to step back and give you the bigger picture of my views of IO's business including what we are doing to improve our performance going forward. Even though we are all disappointed to not hear our numbers in this quarter, there are several positive factors that are important to highlight. These include hot strong topline growth that resulted in revenues of 80.9 million in line with our guidances, 75 to 85 million. We had year-over-year growth of a 167 percent and almost a 100 percent when acquisitions of GXT and Concept Systems are excluded.

Operating cost as percent of revenue at 24 percent excluding unusual items compared to 38 percent for Q3 2003. Final shipment of our VectorSeis Ocean to our launch partner RXT and we're now in the early shakedown pace on an initial shoot. Significant VectorSeis expansion oil was sold to the Chinese contractor BGP for a very large VectorSeis shoot in China. The opportunity was driven by working directly with the Chinese oil company, Sinopec which also included GXT processing. This is an excellent example of our business coming together to solve an oil company problem that drives business for everyone and another validation of our strategy.

We also had strong growth in GXT data library pipeline that has been driven by multiple projects around the world. We did progress towards its R&D integration between I/O Imaging Systems, Concept and GXT that is targeting both image quality and productivity gains via systems approach. We're on track with our growth targets for VectorSeis Systems approaching 40 million for the year compared to approximately 20 million in 2003, and finally our EBITDA of 9.5 million excluding the Russian writedown compared to a negative EBITDA of 1.9 million in Q3, 2003. Mike Kirksey will go into more details for the quarter but I would like to make the point that excluding the expenses related to our systems and reductions, we mainly suffered from a poor product and service mix. We have the expected topline growth that fell far short of what we expected in gross margin, mainly due to lower data library sales for GXT and lower margin products sales in our Land Division.

We feel this was an anomaly versus the trend and look forward to significantly improve gross margins in Q4. That being said, we can do better in managing our business, and I would like to provide you with 3 key areas that we are redoubling our efforts. The first is sales management that can give us better visibility into the status of our pipeline of opportunities including probability and timing of closing. Over the last few months, we had combined 2 privately held companies, Concept Systems and GXT with I/O. The fact that we're all in a growth mode coupled with a needed quarterly discipline of a public Company has trained our sales management systems.

I'm confident that we can make significant improvements over the medium term, but I would also caution that even with better sales management systems, we are always going to be challenged on a quarter-by-quarter basis since the mix of our sales include very large deals that can swing earnings by several cents one way or the other. The second area is product engineering manufacturing with a goal to significantly improve quality and lower cost. Although we are delighted to be in the position of bringing 2 major systems into the market this year, we're having too many unplanned startup in cost issues that could have been prevented with better quality assurance programs in the beginning. We are already learning from our experiences and are adjusting to do better in the future. In the meantime, we are aggressively tackling any short-term product related issues to help assure that we satisfy both the oil companies and our launch part to contractors. We will spare no effort to make sure our new products are successful in the market.

The third is the renewed focus on ways to get additional manufacturing cost out of our existing products and to strengthen our pricing even possible. We have multiple programs to improve margins and even though we fell short of our Q3 targets, we have made substantial progress over last year when our gross margin the 16 percent compared to 24 percent for the third quarter this year. We look forward to progress that carries on into 2005. Now to our view on the overall market. It's our expectation in 2005 we'll see a substantial increase in oil companies exploration spending. Most of the larger companies are currently in the planning phase for next year and the feedback we're getting is they are bullish mainly due to the growing belief about the sustainability of higher commodity prices. Many and as you drive increases in exploration and development spending and seismic services.

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We expect to see some normal year-end spending, but I don't believe that the higher commodity prices are translating into significantly higher exploration spending for the balance of the year. The large oil companies seem to be sticking to their original exploration plans to emphasize financial discipline with the increases coming through their new 2005 plans. We have also seen some portfolio shuffling due to the higher prices that is actually delayed some short-term spending until they sort out what assets they plan to sell. We still have a view that the international markets including new ones like Libya are going to be our main growth engines with limited expansion in North America. I am frankly bullish on next year's overall industry activity and believe that the service sector should benefit from increasing businesses in firming up the prices. This obviously helps if our customer contractors return to stronger profitability.

In summary, I view our third quarter as mainly hitting a speed bump rather than any systemic or market problems. I am very confident of our strategy and our key programs to deliver results. We expect to do better in Q4 and look forward to a strong 2005. Most importantly, with the acquisitions of concept systems in GXT, IO is now leader in new seismic imaging technologies and has built a strategic foundation for a technology-based seismic solutions company. The technologies that we have launched along with the game changing technologies we have in our R&D plans can change the face of our industry in the years ahead. Full-wave digital systems, advanced marine positioning technology, leading edge processing tools and advanced data integration capabilities all form the backbone of the future of IO. I could not be more confident in our future. I will now turn it over to Mike.

Michael Kirksey - Input/Output Inc. - EVP & CFO

Thank you Bob. As indicated in our press release, second quarter sales were 80.9 million, GX Technology accounted for 17.5 million of which 4 million were library sales. Before I go into division-by-division details, let me summarize the impact on our margins of the Q3 issues, Bob, referred to. Net expected start-up costs for new products impacted gross margins by 2.5 points, this is unfortunate, but when we launch new technologies, we are going to over deliver service to make sure our launch partners are well taken care off. Lower than expected revenues from both high margin data library sales and system sales reduced our gross margin about 4 points compared to our expectations. Some of these will materialize in Q4. Additionally, an unfavorable product mix

reduced the gross margin approximately 1.5 points. All of these items had an overall EPS impact of approximately 11 cents, if these items had not impacted Q3, our results would have been within our original guidance provided in July.

Now, for the division details. In our Land Group sales were 38.4 million compared to 36.6 million in Q2 and 20.7 million last year, gross margins were 22 percent in the Land Group compared to 28 percent in Q2. As stated earlier, a combination of product mix and unplanned startup costs reduced gross profit from expected levels. The sensor Geophone Division continue to be a strong performer in our land group on pace for a record year was 16.4 million in sales in Q3. The Marine Division continued its good year with sales of 19.1 million in Q3 compared to 13.1 million in Q2 and 7.6 million a year ago. Positioning products and VectorSeis Ocean both continue to add handsomely to the Marine revenues. The final VectorSeis Ocean shipment for 2004 was made in Q3 bringing total shipments, a VectorSeis Ocean this year to approximately 17 million.

Gross margins in Marine were 29 percent for Q3 compared to 38 percent in Q2. Like Land unexpected startup expenses dropped margins from expected levels. At GXT we expected more library sales, which carry attractive margins, but they did not materialize in Q3. We expect Q4 library sales to be somewhat larger. Also GXT's processing business was somewhat slow in Q3, matching their historical business pattern. This is expected to pick up in Q4 and on into Q5 as the Gulf of Mexico heats up with pending lead sales and expansion in the international markets. Operating expenses were 28 percent of sales, 24 percent excluding the building gain and the Russia Reserve, down from 28 percent of sales in Q3 last year.

We continue to leverage our existing infrastructure which is built for higher sales levels we announced starting with this in Russia concerning the Yuko subsidiary geophysical which owed us a 11 million came to a hit recently when we were informed by Yuko that this subsidiary would likely not continue to operate. All related vendors started taking action under their individual contracts. Our receivables were superioered by the equipment and a majority of the equipment has been recovered but the whereabouts of some is still unknown and some has been damaged. While we continue to pursue all our avenues of recovery, the Company believes the reserve of 5.2 million is appropriate at this time and should cover any exposure related to the receivables. This amount is reflected in G&A expenses. The low taxes for Q3 continue to reflect the use of our US net operation loss carry forward.

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This lower rate is likely to continue in the 2005 as US profitability continues to improve. Our balance sheet finished the third quarter with approximately 32 million in cash and CapEx was 2 million. I'll now turn it back to Bob for some other comments

Robert Peebler - Input/Output Inc. - President & CEO

Looking at the rest of 2004, we expect continued acceptance of our new products in major systems, which is reflected was lower than expected due to start-up issues during Q3. Though we believe most of these are behind us and we are now renewing our sales average going into Q4. We now have the advantage of a much more competitive offering in the analog land system market and look forward to improving our market share over the next several quarters. An additional advantage of System Four Analog is a fiber capability that allows recording of both analog and/or VectorSeis digital

4-ways depending on the desires of the all company customer. Because of this fiber capability every system for analog sale creates a future opportunity to sell VectorSeis 4-way digital into the market. We've recently sold a 6000-channel system for analog to BGP to be used initially in the Chinese domestic market. This is a good start on our goal to gain market share in our international markets.

Our safety group in Holland is enjoying a record year that is carrying on into Q4. We believe that the Sensor business is a good indicator of overall seismic land business since they have a large market share and sell geophones that are used with both IO and competitive land systems. Our pipeline continues to look good for this quarter and into 2005. The integrated seismic services and processing offerings of GXT including the access service line are positioned to have excellent results going forward. Several multi-client projects are ongoing that will come into the market in Q4 and on into 2005. The market is rapidly shifting from spectator purchases to specific reprocessing requirements and custom shoots, both preparatory and multi-clients sponsored. The increasing need for customer design surveys and high-end imaging should benefit IO moving forward and these noncommodity-imaging solutions are the focus of GXT.

In addition to this ISF's business GXT excels in ultra deep depth imaging which is critical in assessing regional petroleum systems. As we've stated before in the Gulf of Mexico specifically, approximately 3000 blocks will likely change hands over the next 3 years. This turnover would drive

demand for the ultra deep data licenses along with tailored seismic acquisition processing. Again a major future driver for business related to the Gulf of Mexico where we expect to start becoming a major business driver for GXT.

Looking ahead, based on our current pipeline of business, we expect 2004 revenues to be in the 260 to 270 million range. We expected consolidated gross margins to be approximately 30 percent. Based on the expected level of revenues in gross margin EBITDA should be 30 to 35 million. Excluding the impact of the Russian write-off earnings per share should range from 14 to 20 cents. The third quarter is traditionally a weaker quarter with the fourth quarter and first quarter being the strongest. Because of the large individual sales in our pipeline we've widened the traditional range in order to better demonstrate the impact of timing and product mix with our overall expectations. As a result, we expect fourth quarter revenues to be in the 80 to 90 million range and earnings per share to range between 18 to 14 cents. In summary, Q3 was a difficult one for us. We learnt some lessons. We have dealt with the old Russian receivable problem from a financial reporting perspective, but we'll continue to pursue recovery. We remain confident that we have laid a strategic foundation for profitable future. We will now open for questions.

QUESTIONS AND ANSWERS

Operator

(OPERATOR COMMENTS) Thiru Ramakrishnan, Simmons & Company International.

Thiru Ramakrishnan - Simmons & Company - Analyst

It's one quick clarification, your Q4 guidance is, what?

Michael Kirksey - Input/Output Inc. - EVP & CFO

8 to 14 cents.

Thiru Ramakrishnan - Simmons & Company - Analyst

8 to 14 cents. Looking into Q4, when you look at some of the unfavorable items that you had delayed data library sales and the delayed higher margin land systems, how much of that

you expect to get in the fourth quarter versus what was expected?

Robert Peebler - *Input/Output Inc. - President & CEO*

The pipeline -- there is a sort of two questions on the data library side, the pipeline of opportunities, if anything gone into the fourth quarter is the same or has grown, and what's more promising compared to the third quarter is that if you get into the fourth quarter, typically the oil companies are easier to transact with, they are effectively, as you know, gone into the end of the year spending. I've spent considerable time with our GXT guys, and they have plenty of projects, they have a very large pipeline and they have real deals. We are talking to, obviously, to backup the numbers, so I would say, some of the ones that obviously, we're in the Q3 will likely be among the ones who will close in Q4, probably some that would in the Q3 or Q4. So, for those it's a long list and there is a lot of different reasons that oil companies buy, and because they all look at their own exploration programs, it's sort of a -- it's a dynamic.

Thiru Ramakrishnan - *Simmons & Company - Analyst*

And on the land systems?

Robert Peebler - *Input/Output Inc. - President & CEO*

The land systems, yes, the land systems, I would say that what we saw in the Q4 that came out of Q3.

Thiru Ramakrishnan - *Simmons & Company - Analyst*

When we look at start-up costs, as your products become more prolific in the marketplace, or should we expect this sort of cost to be recurring or is just kind of our learning curve, I think, you get it right in the first time and then--?

Robert Peebler - *Input/Output Inc. - President & CEO*

It's learning curve. I would like to say we are at the top of the curve. These systems are large, complex real time systems, and you have a multiple field circumstances that we put them in, and so even though you can actually do a significant test payment probably you get them in the field, they are just circumstances that you don't anticipate, and so what will happen, we started out with probably 70 percent of the circumstances covered, and then you get into a complex job

and you find issues that you have to deal with. So, I would say we are long way from where we were, even 2 or 3 months ago we made a lot of progress, we've learnt a lot of things. I think, we are still going to have -- we will still probably have some expenses going forward, frankly, it's a little bit of a known force.

What we are dedicated to is to do whatever it takes basically to make sure that the products are successful, and so what we would do is that we need spend a little more money to make sure that we are fixing the problem or making sure the customer is satisfied, we would do that. So, we are going to hear on the side of customer satisfaction, port launches force that the -- we just cannot do that. I would say you have been in the sort of the technology service business for a long, long time and this is that is really surprised me, In retrospect, we've seen a lot of things we could do better, and with new products, we also have an offer. We're going to be a lot smarter on how we roll them amount and allow the quality control process as we can put in place to do a better job. All that being said, is not unusual in the oil field when you get out that you have to sort of nurture these products a little bit at the beginning. So -- that's a long, winded way of saying, I think we've made a lot of progress. I can't promise you that we won't have some more expenses associated with the rollout. I think that more of it is behind us than in front of us.

Thiru Ramakrishnan - *Simmons & Company - Analyst*

All right. And then, with some of the sales, data library and the land -- the land systems' sales were delayed, revenue was made up with kind of your lower margin traditional equipment?

Robert Peebler - *Input/Output Inc. - President & CEO*

It sort of worked out -- it just worked out that way that we had some -- we start out the quarter with a large backlog or pipeline of opportunities. And normally what happens is you at the end you get a reasonable distribution of how they come in and in this case, it wasn't so -- like we could just -- we were seeing a s l o p (ph) in-and-out things. In this case, the veins that came disproportionate to what we had anticipated in revenue mix. The things that we got in were things like products which are -- which right now are a pretty good business force. But they can't carry today.

We got to have a mix of the other higher margin products and we just haven't seen this mix develop like that. I think a

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lit bit of it is the reflection of the third quarter. The third quarter is a little bit -- is historically a little bit slower. I think some of the -- particularly on the data library sales, I think as we look at the business, I think it will be more naturally skewed. I think Q3, we plan -- going forward, we don't look at Q3 is going to be probably a normal soft quarter in that part of our business. But even that, I think it is just a confluence of things that all added up to -- we had a pretty good revenue -- we had a -- we were pretty where we thought on the revenue, but the mix just didn't work for us.

Thiru Ramakrishnan - *Simmons & Company - Analyst*

In Q4, are you expecting the same strong sales from the VectorSeis, the more traditional equipment?

Robert Peebler - *Input/Output Inc. - President & CEO*

We are expecting our margins to get back to a more normal mix. I mean we just look at the mix of the business and we should see a more normal mix and it should be reflected in the gross pipe margins. It's more in target with what we have -- we made a lot of progress there, it should be more on target to what we have been experiencing and versus how it drop down like it did.

Thiru Ramakrishnan - *Simmons & Company - Analyst*

Last question with your Q4 gross margin guidance. Are you guys comfortable of using that same gross margin guidance for '05?

Robert Peebler - *Input/Output Inc. - President & CEO*

Yes, we have been pretty much saying that toward the low 30s is a good solid number to be using.

Operator

(OPERATOR INSTRUCTIONS). Mary Saffrin, Gracey Spear Advisors (ph).

Mary Saffrin - *Gracey Spear Advisors - Analyst*

I am wondering if you could give us an update on what's going on with your arrangements with Apache and I read about another one that started with 4 companies in the North

Sea. How is this going in to lead into product sales? Has it led into anything so far or is it still more in the research?

Robert Peebler - *Input/Output Inc. - President & CEO*

On Apache - Apache -- probably the best move we have with Apache right now, one is that they are refining to the stage where they are actually interpreting on data in the Canadian shoots in the winter. If you recall, that was where we sort of started out, had shoots last -- sort in the first -- I think it was mid January, February, March time frame. We have been going to process, the data, now they are starting to actually interpret them. We have got a feedback from them that they are quite satisfied; I think the data quality is quite good, I would outstanding. And now they are actually into interpretation and although we don't yet have specifics, it sounds like either there is going to be Jones and Wells offered targets, at least one of the fields that they have been working.

So they are seeing things -- they are apparently seeing things that they couldn't have seen without the shear data, they liked the resolution. So all that will add up to -- once we can get out there with that information in more detail, that does helps build the case for the advantages of all Full Wave. So I would say in that -- that relationship is still going. We are shooting another data shot at -- in a whole different area in Oklahoma. We are probably a quarter way or so having that data shot. Our initial -- we have got some initial feedback that the data shot looks pretty good; not pretty good, looks good. And again they are trying to solve a real tough problem there. We are not sure the application of it, but we are all hopeful that we can actually make some breakthrough there. So, I would say, it's going along as we had expected, it is frustrating for all of us. It has been a long cycle, from time you shoot the data, process the data, and interpret data, in fact as we go through this it really helps and emphasize our strategy of finding ways to shorten that cycle

Mary Saffrin - *Gracey Spear Advisors - Analyst*

Is this -- do you think this is typically short last winter, so--

Michael Kirksey - *Input/Output Inc. - EVP & CFO*

Yes. That's very typical. If you look at the average cycle on land, if you throw in the permit even all things they do, it's not unusual for take a year from the time they fist start to the time they actually drill the wells. You'll get the results and

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drill the wells, I hope you remember, but one thing we've emphasized is that by taking more of a system approach, we are looking for ways to substantially find ways to reduce that cycle time because you can imagine how that drives the net present value on projects.

Operator

Robert Ford, Sanders Morris Harris.

Robert Ford - Sanders Morris Harris - Analyst

Good morning guys. What date did you close the sale on the Alvin facility?

Michael Kirksey - Input/Output Inc. - EVP & CFO

It was in August something, August -- I don't remember exact date.

Robert Ford - Sanders Morris Harris - Analyst

Okay. So, you had a 3-cent gain there included in your guidance that you gave on October 5. Correct?

Michael Kirksey - Input/Output Inc. - EVP & CFO

Yes. October 5, we had a lot of preliminary information. We knew that and so at that point in time, everything we knew, at that point in time we gave that guidance.

Robert Ford - Sanders Morris Harris - Analyst

Okay. Just for future reference you probably won't disclose that that your guidance included the 3-cent gain markets not accepting the numbers rolled out this morning? Switching over to GXT, can you give us some type of revenue guidance for 4Q, some kind of range for the entire business and for data library sales?

Michael Kirksey - Input/Output Inc. - EVP & CFO

I'd like to give a granular data library sales. There are expected revenues in Q4, again, is going down about 27 and \$33 million, if I would remember exactly right, which is quite a bit larger than Q3.

Robert Ford - Sanders Morris Harris - Analyst

Okay. And last thing Mike. Centered at 16.4 million this quarter, what did it do in the second quarter and the third quarter of last year?

Michael Kirksey - Input/Output Inc. - EVP & CFO

It did about 9, about 10 million in the second quarter. And the third quarter last year, I don't have it at my finger tips but I will get that for you.

Robert Ford - Sanders Morris Harris - Analyst

Okay. That's all I have for now. Thank you guys.

Operator

Perry Leditor, Steelberg Investment Management.

Perry Leditor - Steelberg Investment Management - Analyst

Good morning. I just -- first of all I wanted to clarify is the figure that was just given about the gain -- the after-tax impact of the Alvin sale is 3 cents, correct?

Michael Kirksey - Input/Output Inc. - EVP & CFO

That's about correct. Yes.

Perry Leditor - Steelberg Investment Management - Analyst

Okay. And then, you had not had terrific organic revenue growth this quarter and in ocean area -- in the marine area I was wondering if you could give us any indication of how much of the growth there was from the final shipments of this VectorSeis ocean-bottom project?

Michael Kirksey - Input/Output Inc. - EVP & CFO

The final piece of the VectorSeis Ocean was about 10 million.

Perry Leditor - Steelberg Investment Management - Analyst

Okay, terrific. Thank you.

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Operator

Ole Slorer, Morgan Stanley.

Ole Slorer - Morgan Stanley - Analyst

Just to clarify one thing on the Russia (ph) charge, where exactly in the third quarter was that accounted for? Was that in the G&A line or was it--?

Michael Kirksey - Input/Output Inc. - EVP & CFO

Yes, Ole, that's right.

Ole Slorer - Morgan Stanley - Analyst

Okay. And I wonder whether you can also with respect to -- provide guidance for the fourth quarter, give us some insight if possible to what some of the initial response on the new DXT products have been around the shelf in the fourth quarter for sale?

Michael Kirksey - Input/Output Inc. - EVP & CFO

Let me repeat the question, Ole, because you were hard to hear. What I heard you say was that, you wanted to know what the preliminary reaction--

Ole Slorer - Morgan Stanley - Analyst

Yes. You have West Africa spend, Carreb spend. You have whole of 6 to 7 new GXT products on the shelf there, which should be ready to hit the market about an hour and I wonder whether you gotten any preliminary kind of feedback from customers?

Michael Kirksey - Input/Output Inc. - EVP & CFO

Yes. I can, it's a bit anecdotal because I haven't been involved in -- I've got more or less -- the products are selling, but when I look at what they have in their pipeline, were there strong interest for them in negotiating type stages, it's combination of those products. What we are seeing are that people are interested in two of these and one of those and so there is -- so those conversation is going on. I think this is will be quite usual for us see -- while we may sell A, B, and D to one company and C, A, and 3 to the other company. So, I would

say the interest is good, which is not surprising since they were originally funded, which I already said it was at least -- typically more than one oil company that had a strong interest, then the guys don't really shoot in there unless it is more than the companies that originally put the deal together for substantial future purchases. So I would say it looks like the interest is high.

Ole Slorer - Morgan Stanley - Analyst

Is it possible to say everything about how the backlog has developed -- you mentioned that the backlog is developing very well for equipments. Can you--?

Robert Peebler - Input/Output Inc. - President & CEO

I would use the word (ph) pipeline rather than the backlog -- the pipeline meaning real identified opportunities where we're at some stage in the sell cycle, and when I look at the pipeline, it's made up of many of those data libraries. So it's not just skewed or just one set -- in fact, they have a lot of those in it.

Ole Slorer - Morgan Stanley - Analyst

Is it possible to quantify how that pipeline has developed a little bit more in terms of numbers?

Robert Peebler - Input/Output Inc. - President & CEO

We haven't given out the total pipeline numbers, and I frankly don't have that -- I don't have that historical data in front of me. What I just know right now is that they have a substantial coverage. In other words, when I look at the total pipeline, and what they're trying to close is a pretty substantial coverage.

Ole Slorer - Morgan Stanley - Analyst

I would imagine that the second sale of VectorSeis ocean would be part of that pipeline to the same customers? Is there any kind of more information about when we could expect that to potentially close?

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Robert Peebler - *Input/Output Inc. - President & CEO*

That would be in -- because that project is not a data library, it's a proprietary shoot and it's really not in the pipeline per se of the library sales. It's more or less in a contracted operation that includes some processing.

Michael Kirksey - *Input/Output Inc. - EVP & CFO*

Ole, we haven't looked up or heard your question. Were you talking about VectorSeis ocean or about the data libraries? Which was your first question?

Ole Slorer - *Morgan Stanley - Analyst*

And the backlog that you got on equipment sales most on data library?

Michael Kirksey - *Input/Output Inc. - EVP & CFO*

We will have to look probably hearing you. With regard to VectorSeis ocean, what is in the pipeline for that is into next year. There are couple of customers that are interested and we're talking to right now on that subject. But the VectorSeis ocean part of the pipeline is in 2005.

Robert Peebler - *Input/Output Inc. - President & CEO*

Yes that's 2005, and I would say that our main interest over the rest of this quarter is to -- into early '05 is to really get this RXT system up and running satisfactorily, really demonstrate the performance and all the things that go along with it. But we do have now active conversations in markets starting to prepare for '05.

Operator

(Byron Hope, Figuring Energy Partners) (ph)

Byron Hope - *Figuring Energy Partners - Analyst*

BGP has been a relatively important customer for you in 2003 and in first half of this year. Can you handicap for us how you see activity levels for these guys shaping up for '05? And when do you think these guys purchase more premiums in '05 than they did in '04 or is it just too early to tell?

Robert Peebler - *Input/Output Inc. - President & CEO*

It's a little bit early to tell. My guess is that the -- if I look at the total business I'm not sure that they're going to grow in percent of our total business. They are still in our plans -- I'm sure it is going to be a substantial part of our going forward business. But I haven't seen -- we're right now right in the planning for '05, and still sort of rolling numbers level of how our customer pipeline shake up. But my sense is -- BGP in 2003 has been a lot expanded in international markets. In 2004 this year, they've been consolidating a bit, and I think they're still focused a little more on the domestic market -- the example of our 6000 channel AC going in for domestic -- actually it is quite encouraging for us because we really want to participate in that domestic Chinese market. But I think probably next year, I wouldn't be surprised to see them about the same level of participation as we've had in this year.

Byron Hope - *Figuring Energy Partners - Analyst*

Okay. One other question if I could. I think Russian revenues are roughly 18 percent of total revenues in Q2. Just wondering how much of that revenue was related to this Yuko subsidiary that one will see going forward?

Robert Peebler - *Input/Output Inc. - President & CEO*

O O (ph) shipments, I think we mentioned in the press release were 2001, 2002, and 2003.

Operator

(OPERATOR INSTRUCTIONS). (John, ING Personnel Management) (ph).

John - *ING Personnel Management - Analyst*

Couple of question here. Just for the revenues that you guys thought you were going to get sort of turn of the third quarter. Have any of those contracts actually come in, the multi-client sales?

Robert Peebler - *Input/Output Inc. - President & CEO*

Yes, I believe two of them.

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Michael Kirksey - Input/Output Inc. - EVP & CFO

\$2 million.

Robert Peebler - Input/Output Inc. - President & CEO

\$2 million of it.

John - ING Personnel Management - Analyst

Two of that, what was at 4, 5?

Michael Kirksey - Input/Output Inc. - EVP & CFO

There was about \$5 million or so that we expected, that didn't make it, we know of \$2 million of that is.

John - ING Personnel Management - Analyst

Okay, and you had said that GXT is, but the third quarter was a seasonally slow quarter, Bob, that you would expect to pickup as we roll into the fourth quarter, we are sort of a third of the way through there. Have you seen that acceleration happen so far?

Robert Peebler - Input/Output Inc. - President & CEO

Yes, I have seen in terms of what I would say the confidence in their pipeline and the level of activities. The nature of that business, we should see business closing probably November and December, if this works like that. But I am spending some more time over there and most recently it just seems like they feel pretty solid about what they got in front of them.

John - ING Personnel Management - Analyst

I guess -- my question is there is the part of their business is the sale of s u c c e s s (ph) in the library and part of that is the actual processing work, which I would assume that sort of cranks through on day-by-day basis?

Robert Peebler - Input/Output Inc. - President & CEO

Yes, actually there are sort of two components to their ISS business, one is the actual projects they put together and start to process and actually you get revenues from that and then you ultimately at the end have the data library sales.

And then you have the processing business itself. The processing business itself, if you go back and really look at their history, Q3 is almost always their weakest quarter and they are seeing now some interest in more bid activity starting to pickup. So, I think they are starting to follow their normal pattern, I think our learning from this as you could imagine, we're ourselves this is the first full quarter we have had the guys on board and our learning is also understanding the patterns of their business and how to judge it. So, but yes, John, I think their main businesses are following the pattern.

Operator

Bill (ph).

Bill - Analyst

Did you, apologize if I missed this. Did you give an update on how you are coming along with your target for VectorSeis sales in '04?

Michael Kirksey - Input/Output Inc. - EVP & CFO

Yes, I think we are -- we actually rode into the -- I can represent the press release script, but the, as you remember we have made about \$20 million system sales a year ago. We are approaching -- well we should be around \$40 million plus or minus, one bale can put you \$3 or \$4 million one side to other there, but we are making the progress pretty much as we had planned.

Bill - Analyst

It sounds like you are on target, is it too early to maybe venture a guess for what that might look like in '05?

Robert Peebler - Input/Output Inc. - President & CEO

Too early.

Bill - Analyst

Okay.

Robert Peebler - Input/Output Inc. - President & CEO

That is the kind of stuff we are looking at today.

Bill - Analyst

Okay. And GX, I guess, obviously, the timing issue is always something you have to consider, but if you sort of factor into just maybe a bigger picture on GX in terms of the growth rate that you see in that particular segment. Do you still see kind of the similar growth rates heading into '05 that you anticipated say when the deal is made to buy --?

Robert Peebler - Input/Output Inc. - President & CEO

Yes, I think we are still -- we sort of had a 30 percent plus or minus growth rates and sort of an internal thinking and that is still pretty much what we are thinking. Again, we will be quite clarified now when we come back out at beginning of the--after we finish this quarter, but we haven't seen anything that has spooked us about GXT and when I look at the projects that we are working on and the overall activity of the industry, I still have to feel very strong about the quality of that business.

Bill - Analyst

One of the things I guess is a little bit tricky right now, is that over the last 5 years or so, the seismic cycle if you will has sort of been disconnected from the way it used to work when you are very much seeing seismic as a very early reading indicator of initial activity, and I guess it's tougher for some of the side here, at least to try and figure out all the connection between what's going on as you see major oil companies doing a ramp up spending, broadly speaking on global basis and trying to determine how much that's end up in terms of seismic increase review. Can you just maybe give a little color if you have any?

Robert Peebler - Input/Output Inc. - President & CEO

Here's what I am saying that's interesting, these are all just, I would say put some color into the way we think about it, one is that some of the products that are most interested to go, our coverage in most interested is related to GXT is the -- what they call those stand products, in fact the data libraries are built on this stand's which are basin by basin, where they go in, into very deep long 2D lines that are designed to better understand the petroleum systems of those basins. Those are really used for exploration. The only reason you would want those, is that you are trying to go in and are looking at deeper exploration place or exploration place in new areas that you

don't understand the regional geology. And we are seeing a trend in some of the major companies that sort of back to basics of beeping up their own regional geological staffs.

And the combination of those things, the combination of those things are what's -- what tells me that, I think that everybody understands that they are going to have to give more into the exploration side of the business, now that's just a marine side, on the land side we are seeing most of the exploration activity coming in interest and more the international markets. It's not on land, on US land it's more into the -- almost a nonconventional area, used to call nonconventional becoming conventional, things like the share and trying to figure out fractures in these things like the low proximity type gas ends in Iraq, and those are we have even seen in those areas a renewed interest in geophysics, because they are finding that those oil is homogenous reservoirs as they thought, and so they are trying to figure out the geological structure well as long as the risk is high and wave that exploration.

So I think, my expense is, is there is a growing interest and a growing push, the one they have learned, I've been trying to cycle around talking to senior people in oil companies over the last several weeks to get my own, just to get sense of it, and the one thing I am discovering with the few data points I have, as when I ask him how come, why we are seeing a bigger increase in spending with the commodity prices in the exploration arena and I always almost get that back this idea of really trying to have the physical discipline as sticking to our plan, and we are going to capture the increase in the 2005 plans. Right now we are planning our exploration budgets, but what we don't want to do is what we've done in the past is start letting commodity prices, secured sales ahead of our planning, we would like to internalize it, decide where we are going to have a price tax and then increase the plan understandings. So I think they all will be watching, when we start getting some rollup's of the plant exploration spending next year. And we are really interested in the spending, and could be interesting if we got at how much of that can be in the exploration area.

Now also we all have to remember that geophysics is also used in development activities and so I think that -- we've already seen, I think people going back into areas that are somewhat complex, whether it's a 4D or for infield drilling, but in more complex highly bolted areas, for example I just have to believe that the net of all that is we are going to see increases. Now as you probably done as we looked at the services companies as they have started increasing their

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businesses, when you get underneath the covers and look at the geophysics side, haven't got in the strong, but they are the pieces of those businesses. So there is still little bit of a lag.

Bill - Analyst

Okay, if I could just ask just one final question please, the fourth quarter guidance 8 to 14 obviously as you noted as a broad range. How comfortable are you with say the low end of that range at this point, in terms of -- is there visibility they have there you get confidence that the 8 cents are sort of we can reach that?

Robert Peebler - Input/Output Inc. - President & CEO

What we are trying to do is our low end of the range, we sort to look at it in a probabilistic way and we sort of look at how things could stack up, and what we are trying to do is to have a low end sort of represent where we are pretty confident out there. Now obviously we just demonstrated that, that doesn't always work.

Michael Kirksey - Input/Output Inc. - EVP & CFO

And frankly the -- a little bit of our difficulty -- in addition to this, look at the deals just this whole mix issue, you know, it should -- as we look over longer time frames those things should work out. We literally have things that can move -- that can move, you know, one deal could move things 2 to 3 cents. So, that makes it pretty difficult for us. So, even though it's a broad range, there's not that many deals that can move you in and out of that range. If I looked at it, I can argue that the probability of 8 is the same probability of 14 almost meaning that there is not -- the uncertainty is fairly broad, it's not a kite distribution. And that's why we are going to try to get better at that and part of that is if you think about it, we have had -- we've put together companies, two of them that I've mentioned have not been in the public domain and so sort of the discipline is exactly understanding where you are at as you always find when you bring in private companies, they're just not there. And so we are working with the guys to get -- give us better visibility, better understand how they think about what the deals are and the deal structure, but that takes time to get that kind of discipline in our own understanding, so we know the questions to ask. We'll get better, I guarantee you. That's a -- when you have a disappointment, you learn from that and we looked at that

how could we do that? So, this is our best current judgment of could we pull outside that range, there is always that possibility, you can't say a 100 percent, but we've obviously -- we'd try to put out something out that we've confidence in.

Operator

And at this time, we have no further questions. I would like to turn the conference back to the management for any concluding comments. Please go ahead.

Michael Kirksey - Input/Output Inc. - EVP & CFO

We continue to build IO in line with our strategy, and this quarter was an important under the circumstances. We've always known the results can have bumps because of the nature of our products. However, our long-term view has not changed. Thank you again for joining us today.

Operator

Ladies and gentlemen, that concludes the Input and Output's Third Quarter Earnings Conference call. If you would like to listen to the replay of today's conference, you may dial 303-590-3000 using pass code 11011606. Thank you again for your participation on today's conference and you may now disconnect.

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