INPUT OUTPUT INC
Form 10-K/A
April 23, 2004

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-K/A-1

For Annual and Transition Reports Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Fiscal Year Ended December 31, 2003

or

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

Commission file number 1-12691

Input/Output, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**22-2286646**
(State or Other Jurisdiction of Incorporation or Organization)	*(I.R.S. Employer Identification No.)*

12300 Parc Crest Drive
Stafford, Texas 77477
(Address of Principal Executive Offices, Including Zip Code)

(281) 933-3339

(Registrant s Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $0.01 par value	New York Stock Exchange
Rights to Purchase Series A Preferred Stock	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes þ No o

Aggregate market value of the voting stock held by non-affiliates of the registrant: approximately $243.4 million as of June 30, 2003.

Indicate the number of shares outstanding of each of the registrant s classes of common stock, as of the latest practicable date: common stock, $.01 par value, 53,106,079 shares outstanding as of March 2, 2004.

EXPLANATORY NOTE

This Form 10-K/A is being filed to revise certain sections of Part I, Item 1, Part II, Item 7, Part IV, Item 15 and the Consolidated Financial Statements of the Company s Annual Report on Form 10-K for the year ended December 31, 2003, as filed with the Securities and Exchange Commission on March 12, 2004.

In addition, this Form 10-K/A includes the disclosures required under Part III of Form 10-K, since the Company s definitive proxy statement for its 2004 annual meeting of stockholders is now expected to be filed in May 2004.

This amendment revises the paragraph entitled Products and Services Marine Imaging Products VectorSeis Ocean-Bottom Acquisition Systems under Item 1. *Business* of Part I of the Form 10-K. In addition, this amendment replaces, in its entirety, the language under Research and Development , and revises the third and fourth paragraphs under Markets and Customers under Item 1.

The amendment revises the paragraph entitled Critical Accounting Policies and Estimates Revenue Recognition and Product Warranty under Item 7. *Management s Discussion and Analysis of Financial Condition and Results of Operations* of Part II of the Form 10-K. It also amends and updates the section entitled Risk Factors under Item 7. In addition, it revises the paragraph entitled Summary of Significant Accounting Policies Revenue Recognition and Product Warranty under Note 1 of *Notes to Consolidated Financial Statements.*

As required by Rule 12b-15 under the Securities Exchange Act of 1934, as amended (the Exchange Act), new certifications by the Company s principal executive officer and principal financial officer are being filed as exhibits to this Form 10-K/ A under Item 15 of Part IV.

For purposes of this Form 10-K/A, and in accordance with Rule 12b-15 under the Exchange Act, each item of the Company s Annual Report on Form 10-K for the year ended December 31, 2003, as originally filed on March 12, 2004, that was affected by this amendment, has been amended and restated in its entirety. No attempt has been made in this Form 10-K/A to modify or update other disclosures as presented in the original Form 10-K, except as required to reflect such amendments.

Part I

Item 1. *Business*
Introduction

In this Annual Report on Form 10-K, Input/Output, I/O, company, we, our, ours and us refer to Input/Output, Inc. and its consolid subsidiaries, except where the context otherwise requires or as otherwise indicated.

The information contained in this Annual Report on Form 10-K contains references to trademarks, service marks and registered marks of Input/Output and our subsidiaries, as indicated. Except where stated otherwise or unless the context otherwise requires, the terms VectorSeis, Tescorp, DigiCourse and VectorSeis System Four refer to our VectorSeis®, Tescorp®, DigiCourse® and VectorSeis System Four® registered marks, and the terms AZIM, True Digital, DigiShot, DigiRANGE II, Applied MEMS, MRX, RSR, Vib Pro and Image refer to o TM True Digital™, DigiShot™, DigiRANGE II™, Applied MEMS™, MRX™, RSR™, Vib Pro™ and Image™ trademarks and service marks.

We are a leading provider of seismic acquisition imaging technology for exploration, production and reservoir monitoring in land and marine, as well as shallow water and marsh, environments. We offer a full suite of related products and services for seismic data acquisition and processing, including products incorporating traditional analog technologies and products incorporating our proprietary VectorSeis and True Digital technology.

Our VectorSeis platform is based on a multi-component digital sensor incorporating a unique micro-electro-mechanical systems (MEMS) based accelerometer, or measuring device, that we design and manufacture. MEMS are micromachined mechanical and electromechanical elements, sensors and electronics integrated on a single silicon chip using techniques similar to traditional integrated circuit process technology. Each of our MEMS-based accelerometers is then combined with a specially designed application-specific integrated circuit (ASIC) microchip that converts analog signals from the MEMS accelerometer into digital signals, thereby becoming a digital sensor. Each combined MEMS accelerometer/ ASIC emits a signal, or component, and three of them are mounted on one element, which we refer to as multi-component digital sensors. Compared to traditional seismic technologies, we believe that our VectorSeis platform offers improved seismic data quality and operational efficiency and the potential to substantially improve finding and development economics.

Our data acquisition products are well suited for both traditional three-dimensional (3-D) and four-dimensional (4-D) data collection techniques, as well as more advanced multi-component data collection techniques. Our strategy is to be the leading company in delivering cost-effective imaging technology that we believe will improve exploration and production economics for the energy industry.

Our executive headquarters are located at 12300 Parc Crest Drive, Stafford, Texas 77477. Our telephone number is (281) 933-3339. Our home page on the Internet is *www.i-o.com*. We make our website content available for information purposes only. It should not be relied upon for investment purposes, nor is it incorporated by reference into this Form 10-K.

In portions of this Form 10-K, we incorporate by reference information from parts of other documents filed with the Securities and Exchange Commission (SEC). The SEC allows us to disclose important information by referring to it in this manner, and you should review this information. We make our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and proxy statement for our annual shareholders meeting, as well as any amendments to those reports, available free of charge through our website as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. You can learn more about us by reviewing our SEC filings on our website. Our SEC reports can be accessed through the investor relations page of our website, namely *www.i-o.com/ About_us/ Investor_Relations/*. The SEC also maintains a website at *www.sec.gov* that contains reports, proxy statements and other information regarding SEC registrants, including our company.

Seismic Industry Overview

Oil and gas companies have traditionally used seismic data to reduce exploration risk by creating an image of the subsurface. Typically, an oil and gas company will contract with a geophysical contracting company to acquire data in a selected area. After collection, either the geophysical contractor or another data processor will process the data with algorithms designed to create an image. Finally, a geoscientist interprets the data by reviewing the image and integrating known facts about the surrounding geology.

Two principal factors have affected demand for seismic data by oil and gas companies in recent years: the maturation of 3-D data collection technology and the business model adopted by geophysical contractors to leverage large fixed investments in equipment. Advances in computing power made commercial collection of 3-D seismic data possible in the 1980s. Oil and gas companies reacted to the availability of 3-D data by sharply increasing demand for seismic data during the 1990s. However, without further advances in imaging technology, oil and gas companies have not had a compelling reason to continue purchasing seismic surveys at the same high rate. Much of the demand for conventional analog 3-D seismic surveys currently comes from areas where use of the technology was not quickly adopted, such as China and the Commonwealth of Independent States (CIS). In an effort to achieve higher utilization of large investments in equipment needed to conduct a 3-D survey, geophysical contractors increasingly began to conduct speculative surveys for their own account. Contractors typically selected an area and acquired data using generic acquisition parameters and generic processing algorithms. The contractors capitalized the costs of their data acquisitions and sold the survey results to multiple parties. The availability of data collected by geophysical contractors in speculative surveys has contributed to an oversupply of seismic data. Additionally, since contractors incurred most of the costs of speculative seismic data at the time of acquisition, contractors continued to lower prices to recover as much of their fixed investments as possible.

Despite the widespread availability of 3-D seismic data, oil and gas companies continue to seek improvement in image quality in order to identify promising drilling prospects. Generic surveys using conventional analog 3-D acquisition technology and generic processing algorithms can present general subsurface spatial relationships, but these techniques cannot address the increasingly complex reservoir interpretive issues faced by oil and gas companies. We believe the adoption of new technologies that can address characteristics of more complicated reservoirs should stimulate oil and gas companies to shoot new surveys. Exploration and production companies also require partners who can design surveys to address specific problems and apply technologies that account for the differences of the geology in a particular area. With the limitations of traditional analog technologies, lithology and fluid properties remain challenges. Digital sensors allow collection of higher quality seismic data and allow collection of new measurements that enable a clearer subsurface image.

Oil and gas companies are increasingly using seismic data to enhance production of known fields as well as to explore for new reservoirs. By repeating a seismic survey over a defined area, oil and gas companies can detect untapped areas of a reservoir and adjust their drilling program to optimize production. Time-lapsed seismic images are referred to as four-dimensional surveys. 4-D surveys make seismic data relevant to the entire life of a reservoir from exploration to development to production to closure. However, for results to be valid, 4-D surveys require data to be collected in the same spot on multiple occasions. In marine environments where data is collected by towing large streamers containing sensors, repeatability is a challenge and oil and gas companies are demanding better positioning equipment that ensures proper placement of the streamer.

Our Strengths

We believe our strengths include the following:

A Leader in Seismic Imaging Technology. We believe that our technology is central to the next generation of seismic data acquisition and processing. Our proprietary technologies include our:

VectorSeis digital sensors, which allow full wave data acquisition on land, on the seabed and in-well, and which have been proven effective in over 60 field surveys;

Processing services incorporating our proprietary AZIM technology which, when combined with VectorSeis data, result in advanced seismic imaging; and

DigiCourse positioning technology which supports highly accurate and repeatable surveys in marine applications.

Experienced Management. Our executive management team has extensive industry experience in the seismic technology and services industry. In April 2003, Robert P. Peebler became our chief executive officer after serving as a member of our Board of Directors since 1999. Mr. Peebler has over 30 years experience in the oil and gas industry, during most of which he has focused on recognizing and commercializing new technology to enhance hydrocarbon exploration and production. To help lead the implementation of our seismic imaging-based strategy, Mr. Peebler has recruited several new senior executives to augment our management team, including Jorge Machnizh, Executive Vice President and Chief Operating Officer, J. Michael Kirksey, Executive Vice President and Chief Financial Officer, Chris Friedemann, Vice President Commercial Development, and Jim Hollis, Vice President Land Imaging Systems. In addition, Bjarte Fageraas has become Vice President Land Imaging Systems.

Strategic Alliances with Oil Companies. In October 2003, we entered into a memorandum of understanding to form a strategic seismic technology alliance with Apache Corporation, a leading independent oil and gas exploration and production company. This proposed alliance is designed to accelerate the adoption of our VectorSeis and AZIM technologies while solving some of the more complex reservoir problems in Apache s global portfolio. We are pursuing similar strategic alliances with other oil and gas exploration and production companies.

Operating Efficiencies. We have reduced our headcount by 40% since the beginning of 2002 by closing five facilities, outsourcing a broad range of operations and combining several business units. Outsourcing, in particular, has enabled us to reduce our fixed costs and to enhance our manufacturing efficiency. Overall, we believe these changes will enable us to improve our gross margins, increase both our operating and net income and enhance our cash flows.

Our Strategy

Our goal is to provide the seismic imaging industry with the next generation of sensors and image processing technology that will enable oil and gas companies to cost-effectively find and manage reservoirs throughout the discovery and production life cycle. We intend to do this by building on our current technology platforms through both internal development and selective acquisitions. In addition, we intend to use our advanced technology to drive down the cost of seismic surveys by replacing labor-intensive processes with more efficient systems. Specifically, we intend to:

Lead the Next Generation of Seismic Imaging Technology. The oil and gas industry has largely realized the benefits of current seismic imaging technology, which provides a basic 3-D image of oil and gas reservoirs on land and beneath the seabed. Our VectorSeis sensor captures significantly greater data during the seismic imaging process. We intend to use this advanced technology in combination with our AZIM family of data processing techniques to provide more detailed images of oil and gas reservoirs. Without these more detailed images, we believe oil and gas companies will not be able to produce cost effectively from the deeper and more geologically complex fields where they are increasingly working.

Provide High-End Seismic Imaging Services. The reservoir discovery and management process has grown increasingly challenging due to more complex structures and greater depths. We intend to provide oil and gas companies with higher-value consulting and processing services on a more collaborative basis throughout the entire planning, processing and image interpretation cycle. We purchased AXIS Geophysics, Inc. (AXIS) in July 2002 to provide us with a technology and services platform to realize this strategy. We expect AXIS to enjoy rapid, high-margin growth over the next several years, and to provide us with a new source of revenue from oil and gas companies.

Extend our Seismic Imaging Solutions Across the Full Reservoir Life Cycle. In the past, seismic imaging has mainly been used to determine whether and where to drill the next well, but has not been used routinely in production operations. By comparing detailed images of the same reservoir at different points in time, oil and gas companies can enhance production from a given reservoir. We intend to aggressively work with oil and gas companies to assist them in using our advanced seismic imaging technology to increase overall production throughout the life of the reservoir.

Make Selective Acquisitions. We intend to pursue selective acquisitions of products and services that accelerate the adoption of our advanced seismic imaging products and services through complementary technologies. We seek to acquire and integrate technologies and services that will expand our ability to provide next generation imaging services and products directly to oil and gas companies throughout the life of a reservoir. We will continue to identify, evaluate and pursue acquisitions of products, services and organizations that are strategically important to us and our growth strategy. In February 2004, we announced our acquisition of Concept Holdings Systems Limited (see *Recent Developments* below, and Item 7. *Management s Discussion and Analysis of Financial Condition and Results of Operations Recent Developments*).

Expand our Strategic Alliances. We intend to pursue strategic alliances with oil and gas exploration and production companies, which we believe will enable us to more effectively influence the types of equipment that seismic contractors purchase from us. These alliances will also provide us with the opportunity to directly market our consulting and processing services for use throughout the reservoir life cycle. Working directly with oil and gas companies will also provide us with valuable feedback for our product development efforts. Our alliance with Apache Corporation is the first of the strategic alliances that we are working towards.

Recent Developments

On February 24, 2004, we announced that we had purchased all of the share capital of Concept Holdings System Limited, a private limited company incorporated in Scotland, in a privately negotiated transaction. Concept, based in Edinburgh, is a provider of software, systems and services for towed streamer, seabed and land seismic operations. The total purchase price was approximately US$36 million cash and 1,680,000 shares of our common stock. On February 23, 2004, the closing price per share of our common stock on the New York Stock Exchange was $6.41. The cash used to acquire Concept was primarily from the proceeds of our December 2003 offering of US$60 million in principal of our 5.50% Convertible Senior Notes due 2008, and general corporate funds. A portion of the cash component of the purchase price was used to pay down certain outstanding debt of Concept totaling approximately US$26 million. Under a registration rights agreement dated February 23, 2004, we granted to former Concept securityholders certain demand and piggyback registration rights for the shares of our common stock issued in the transaction.

Products and Services

Segments

We evaluate and review our results of operations based on three segments: Land Imaging, Marine Imaging and Processing. See Note 16 of *Notes to Consolidated Financial Statements*.

Land Imaging Products

Products for our Land Imaging segment include the following:

VectorSeis Data Acquisition Systems: Our VectorSeis digital platforms offer high-resolution, cost-effective compression-wave (P-wave) data collection as well as shear wave multi-component acquisition. Digital sensors, when compared with traditional analog geophones, provide increased response linearity and bandwidth and preserve a higher degree of vector fidelity. In addition, one digital sensor can replace a string of six or more analog geophones, providing users with significant operating efficiencies. These advantages enable improved location and characterization of reservoir structure and fluids and more accurate identification of rock properties at reduced total costs.

We began VectorSeis land acquisition field tests in 1999 and we have acquired data throughout Canada, Mexico, the United States, France, Eastern Europe and the CIS. In May 2002, we commercialized our

VectorSeis System Four radio-based land acquisition system, and in the second quarter of 2003, we commercialized our cable-based telemetry system.

Analog Data Acquisition Systems: Our Image land data acquisition system consists of a central electronics unit and multiple remote ground equipment modules, which are either connected by cable or utilize radio transmission and retrievable data storage. The central electronics unit, which acts as the control center of the system, is typically mounted within a vehicle or helicopter transportable enclosure. The central electronics unit receives digitized data, stores the data on storage media for subsequent processing and displays the data on optional monitoring devices. It also provides calibration, status and test functionality. The remote ground equipment of the I/O Image system consists of multiple remote modules (MRX) and line taps positioned over the survey area. Seismic signals from geophones are collected by the MRX modules, which collect multiple channels of analog seismic data. The MRX modules filter and digitize the data, which is then transmitted by the MRX modules via cable to a line tap. Alternatively, our radio telemetry system (RSR) records data across a variety of environments, including transition zones, swamps, mountain ranges, jungles and other environments. RSRs are radio controlled and do not require cables for data transmission since the information is stored at the unit source and subsequently retrieved.

We plan to introduce our new System Four Analog Cable (A/ C) system by the third quarter of 2004; this product will be based on our System Four platform. System Four A/ C will give seismic contractors the flexibility to use traditional analog geophone sensors, or digital full-wave VectorSeis sensors, even on the same survey. With our planned introduction of System Four A/ C, we plan to transition out of our Image analog system during the first half of 2004.

Geophones: Geophones are analog electro-mechanical seismic sensor devices that measure acoustic energy reflected from rock layers in the earth s subsurface. We market a full suite of geophones and geophone test equipment that operate in all environments, including land, marine, ocean-bottom and downhole. Our principal geophone product, the SM-24, provides low distortion and wide bandwidth for greater realization of the potential of 24-bit seismic recording systems.

Vibrators and Traditional Energy Sources: Vibrators are devices carried by large vehicles and are used as energy sources for land seismic acquisition. We market and sell the AHV-IV, an articulated vibrator vehicle with simplified hydraulics and superior maneuverability. In addition, we offer a low impact, tracked vibrator, the X-Vib, for use in environmentally sensitive areas like the Arctic tundra and desert environments.

Our 2001 acquisition of Pelton Company (Pelton) added energy source control and positioning technology to our suite of products. The Vib Pro control system provides digital technology for energy control, and integrates global positioning system (GPS) technology for navigation and positioning of vibrator vehicles. The Shot Pro dynamite firing system is the equivalent technology for seismic operations using dynamite energy sources. Integrated GPS technology and compatibility with the Vib Pro control system helps to streamline field operations and improve operational efficiency.

Specialty Cables and Connectors: Cables and connectors are used in conjunction with most seismic equipment. Our Tescorp cables not only are a replacement option to correct for ordinary wear, but also offer performance improvement and specialization for new environments and applications.

MEMS: Applied MEMS, Inc. holds our MEMS technology development and manufacturing capabilities. In addition to producing the accelerometers for our VectorSeis digital sensor, this business unit is also actively pursuing sales of accelerometer products for applications outside of oil and gas seismic imaging as well as offering product commercialization foundry services for third parties.

Reliability Issues: System reliability is an important competitive consideration for seismic data acquisition systems. Even though we attempt to assure that our systems are always reliable in the field, the many technical variables related to operations can cause a combination of factors that can, and has from time to time, caused service issues. It is believed that our new VectorSeis System Four land data acquisition system has made significant improvements in both field troubleshooting and reliability compared to our analog products, but until we have significantly more field experience we cannot be certain that problems will not arise. Even though we have a large installed base of customers using our analog products without reported problems, we may have customers who have experienced problems and therefore may believe our new products may also suffer from similar issues. In that case, acceptance of our new products could be delayed and our results of operations and financial condition could be adversely affected.

Marine Imaging Products

Products for our Marine Imaging segment include the following:

VectorSeis Ocean-Bottom Acquisition Systems: Since 2002, we have expanded our focus on reservoir applications placing VectorSeis into our Marine Imaging product line. We believe that the VectorSeis ocean-bottom product line will address many shortcomings of current ocean-bottom systems. VectorSeis modules can operate at angles, which eliminates the need for gimbal receiver units that distort data and add cost. In addition, our patented cable de-coupler design reduces data distortions and improves sea-bottom coupling. In 2002, we completed the first test of our VectorSeis ocean-bottom acquisition system in the Ekofisk Field in the North Sea. This test was supported by ConocoPhillips. During 2003, we sold this test system to ConocoPhillips, which represented the only sale of a VectorSeis ocean-bottom acquisition system we recognized in fiscal 2003.

Marine Positioning Systems: Our DigiCourse positioning systems include streamer cable depth control devices, compasses, acoustic positioning systems (DigiRANGE II) and other auxiliary sensors. Marine positioning equipment controls the depth of the streamer cables and provides acoustic, compass and depth measurements to allow processors to tie navigation and location data with geophysical data to determine the location of potential hydrocarbon reserves for precise drilling operations.

Data Acquisition Systems: Our marine data acquisition system consists primarily of towed marine streamers and shipboard electronics that collect seismic data in marine environments with water depths greater than 30 meters. Marine streamers, which contain hydrophones, electronic modules and cabling, may measure up to 12,000 meters in length and are towed behind a seismic acquisition vessel. Seismic sensors installed in the cable (hydrophones) detect acoustical energy transmitted through water from the earth s subsurface structure.

Source and Source Control Systems: Seismic sources (airguns) are the primary seismic energy source used in marine environments to initiate the acoustic energy transmitted through the earth s subsurface. An airgun fires a high compression burst of air underwater to create an energy wave for seismic measurement. Additionally, we offer a digital source control system (DigiSHOT) which allows more precise and reliable control and quality control of airgun arrays for 4D exploration activities.

Processing

In July 2002, we acquired AXIS, a seismic data service company, based in Denver, Colorado that provides specialized data processing and integration services to major and independent exploration and production companies. The AXIS Interpretation-Ready Process integrates seismic and subsurface geological data to provide customers accurate and high quality data that can result in improved reservoir characterizations. In addition, AXIS developed proprietary AZIM data processing techniques. Most processors make a simplifying assumption that seismic energy travels at the same velocity through a geological structure regardless of the path that the energy takes through that structure. In reality, the earth is anisotropic, which means that energy will travel at different velocities through the same structure depending on the direction of the energy. AZIM accounts for the anisotropy effects of the earth which allows for clearer, more accurate images, particularly in complex reservoirs. In 2002, we combined AXIS with our geophysical software operations, Green Mountain Geophysics. Green Mountain offers a wide range of geophysical software used in seismic survey planning and design. These groups, which together make up our Processing Division, allow us to provide oil and gas companies a custom designed survey addressing particular imaging problems while accounting for the actual geophysical properties encountered in a survey.

Product Research and Development

Our research and development efforts are focused on improving both the quality of the subsurface image and the seismic data acquisition economics for our customers. Our ability to compete effectively in the manufacture and sale of seismic equipment and data acquisition systems, as well as related processing services, depends principally upon continued technological innovation. Development cycles of most products, from initial conception through commercial introduction, may extend over several years.

During 2003, our principal research and development efforts involved the migration of our VectorSeis platform into ocean-bottom systems. In 2002, we completed the first test of our VectorSeis ocean-bottom acquisition system and in 2003, we sold the test system. We expect to complete the sale of our first commercialized ocean-bottom system in the first half of 2004. See *Products and Services VectorSeis Ocean-Bottom Acquisition Systems.*

Our efforts in prior years in developing our VectorSeis land seismic data acquisition systems incorporating our digital sensors resulted in their commercialization in late 2002 and 2003, producing approximately $20 million in sales of these systems in 2003. See *Products and Services Land Imaging Products.* We also completed the development of our new DigiRANGE II marine acoustic positioning system, which we commercialized in the fourth quarter of 2003.

During 2003, we evaluated our ongoing project to develop a next-generation solid streamer marine seismic data acquisition product, and determined that we would discontinue its development, resulting in impairment charges. See Note 4 of *Notes to Consolidated Financial Statements*. Also during 2003, we directed our development efforts regarding reservoir monitoring products away from in-well applications, and focused on their application to ocean-bottom systems.

For 2004, one of our principal research and development projects is to introduce our new System Four A/C product by the third quarter of 2004. See *Products and Services Land Imaging Products.*

Because many of these new products are under development, their commercial feasibility or degree of commercial acceptance, if any, is not yet known. No assurance can be given concerning the successful development of any new products or enhancements, the specific timing of their release or their level of acceptance in the marketplace.

For a summary of our research and development expenditures during the past five years, see Item 6. *Selected Consolidated Financial Data.*

Markets and Customers

Our principal customers are seismic contractors that operate seismic data acquisition systems and related equipment to collect data in accordance with their customers specifications or for their own seismic data libraries. In addition, we market and sell products directly to oil and gas companies, particularly for reservoir monitoring applications. In 2003, BGP, an international seismic contractor and subsidiary of the China National Petroleum Corporation (BGP), accounted for approximately 28% of our consolidated net sales. In 2002, two of our largest customers, Western-Geco and Laboratory of Regional Geo Dynamics Limited, were responsible for approximately 11% and 10%, respectively, of our consolidated net sales. In recent years, our customers have been rapidly consolidating, shrinking the demand for our products. The loss of any of our significant customers or deterioration in our relations with any of them could materially and adversely affect our results of operations and financial condition.

A significant part of our marketing efforts are focused on areas outside the United States. Contractors from China and the CIS are increasingly active not only in their own countries, but also in other international markets. Foreign sales are subject to special risks inherent in doing business outside of the United States, including the risks of armed conflict, civil disturbances, currency fluctuations, embargo and governmental activities, as well as risks of non-compliance with U.S. and foreign laws, including tariff regulations and import/export restrictions. We sell products through a direct sales force consisting of employees and several international third-party sales representatives responsible for key geographic areas. During the years ended

December 31, 2003 and 2002, sales to destinations outside of North America accounted for approximately 77% and 71% of net sales, respectively. Further, systems sold to domestic customers are frequently deployed internationally and, from time to time, certain foreign sales require export licenses.

During 2002, we formed a strategic marketing alliance with Veritas DGC Inc., a geophysical services company, for the purpose of collecting VectorSeis data in North America in 2002 and into 2003. Under the terms of the alliance, we provided Veritas with our first-generation radio-based VectorSeis land acquisition equipment, and repair and maintenance of this equipment. Veritas utilized the equipment in its day-to-day operations and retained legal title to all seismic library data obtained. Both members of the alliance agreed to share, equally, all proceeds arising from or related to library data and proprietary data services utilizing the VectorSeis equipment. During the years ended December 31, 2003 and 2002, we recognized revenues related to alliance activities of $0.9 million and $0.3 million, respectively. Under the terms of the alliance, Veritas was our exclusive VectorSeis customer within North America, subject to certain minimum utilization requirements. No separate joint venture, partnership or other legal entity was formed.

In May 2003, we agreed with Veritas to terminate this marketing alliance. Upon termination, all VectorSeis equipment was returned to us. As a result, we reassessed the net realizable value of our first-generation VectorSeis land acquisition system equipment that was utilized in alliance activities and recorded an impairment charge of $2.5 million in 2003. See Item 7. *Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates.*

During 2003, we signed a memorandum of understanding for the formation of a strategic technology alliance with Apache Corporation, a leading independent oil and gas producer. The memorandum of understanding is a non-binding arrangement that provides for cooperation between the parties to develop next-generation seismic imaging technology, including collaboration between each party s technical staffs to identify projects within the context of Apache s portfolio of oil and gas properties. The memorandum of understanding is intended to provide the basic outline for our technical collaboration. No separate legal entity has been formed, and we do not expect this alliance to impose any legal obligations on either party.

We are focusing our initial efforts in using System Four land acquisition systems with digital full-wave VectorSeis sensors and AZIM processing techniques for subsurface imaging. Our alliance with Apache is enabling us to work directly with an upstream oil and gas company to gain a better sense of its seismic challenges and opportunities and to use that knowledge to make recommendations regarding technology deployment. In working directly with oil and gas companies, we believe that we will be able to stimulate end-user demand for our VectorSeis products and technology, as well as for our associated processing capabilities. We announced in December 2003 that Trace Energy Services, a privately held seismic contractor based in Calgary, had purchased a VectorSeis System Four cable-based land acquisition system for use in connection with a North American acquisition program of Apache.

During 2003, we established a Technology Advisory Board with external industry and academic experts from major and independent oil companies and from Stanford University. One component of our business strategy is to maintain strong technology leadership in geophysical imaging, as well as other areas as they may emerge. This advisory board allows us to gain insights on emerging technologies from industry technical representatives and receive feedback on our technical programs, as well as provides potential benefits to the participating companies in connection with their goals to discover and produce more hydrocarbons.

Sales to customers are normally on standard net 30-day terms. We also provide financing arrangements to customers through short-term and long-term notes receivable. Notes receivable, which are collateralized by the products sold, bear interest at contractual rates up to 12.7% per year and are due at various dates through 2006. The weighted average annual interest rate at December 31, 2003 was 7.4%.

Suppliers

As part of our strategic direction, we are increasing our use of contract manufacturers as an alternative to our own manufactured products. We may experience supply interruptions, cost escalations and competitive disadvantages if we do not monitor these relationships properly.

We began outsourcing in late 2002, and had relied on annual forecasts, which exposed us to potentially substantial repurchase obligations. We have not, to date, been required to repurchase any excess or obsolete inventory under our outsourcing arrangements. More recently, we have begun providing our outsourced manufacturing suppliers with short-term (usually three months or less) sales forecasts and thereby have better managed our inventory needs. We are not currently aware of any existing obligations to purchase additional excess inventory under our outsourcing arrangements. See Item 7. *Management s Discussion and Analysis of Financial Condition and Results of Operations Future Contractual Obligations.*

We and our contract manufacturers purchase a substantial portion of the components used in our systems and products from third-party vendors. Certain items, such as integrated circuits used in our systems are purchased from sole source vendors. Although we and our contract manufacturers attempt to maintain an adequate inventory of these single source items, the loss of ready access to any of these items could temporarily disrupt our ability to manufacture and sell certain products. Since our components are designed for use with these single source items, replacing the single source items with functional equivalents could require a redesign of our components and costly delays could result.

Competition

The market for seismic data acquisition systems and seismic instrumentation is highly competitive and is characterized by consolidation, as well as continual and rapid changes in technology. Our principal competitor for land and marine seismic equipment is Societe d Etudes Recherches et Construction Electroniques (Sercel), an affiliate of Compagnie General de Geophysique. Unlike us, Sercel possesses an advantage of selling to an affiliated seismic contractor. In addition, we compete with other companies on a product-by-product basis. Our ability to compete effectively in the manufacture and sale of seismic instruments and data acquisition systems depends principally upon continued technological innovation, as well as our reputation for quality, our ability to deliver on schedule and price.

Intellectual Property

We rely on a combination of trade secrets, patents, copyrights and technical measures to protect our proprietary hardware and software technologies. Although patents are considered important to our operations, no one patent is considered essential to our success. Copyright and trade secret protection may be unavailable in certain foreign countries in which we sell products. In addition, we seek to protect trade secrets through confidentiality agreements with employees and agents. We also protect our trademarks by applying for, obtaining and maintaining a number of federal trademark registrations. We are not currently aware of any parties that intend to pursue intellectual property claims against us.

Regulatory Matters

Our operations are subject to laws, regulations, government policies and product certification requirements worldwide. Changes in such laws, regulations, policies or requirements could affect the demand for our products or result in the need to modify products, which may involve substantial costs or delays in sales and could have an adverse effect on our future operating results. Our export activities are also subject to extensive and evolving trade regulations. Certain countries are subject to trade restrictions, embargoes and sanctions imposed by the U.S. government. These restrictions and sanctions prohibit or limit us from participating in certain business activities in those countries.

Our operations are subject to numerous local, state and federal laws and regulations in the United States and in foreign jurisdictions concerning the containment and disposal of hazardous materials, the remediation of contaminated properties and the protection of the environment. We do not currently foresee the need for significant expenditures to ensure our continued compliance with current environmental protection laws. Regulations in this area are subject to change, and there can be no assurance that future laws or regulations will not have a material adverse effect on us. Our customers operations are also significantly impacted by laws and regulations concerning the protection of the environment and endangered species. For instance, many of our marine contractors have been affected by new regulations protecting marine mammals in the Gulf of Mexico. To the extent that our customers operations are disrupted by future laws and regulations, our business and results of operations may be materially and adversely affected.

Employees

At December 31, 2003, we had 479 full-time employees worldwide, 351 of whom were employed in the United States. Also, at December 31, 2003, we had 193 temporary employees. Our temporary employee base fluctuates based upon our level of manufacturing activity, as a majority of these positions are manufacturing related. U.S. employees are not subject to any collective bargaining agreements and we have never experienced a work stoppage.

Part II

Item 7. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

Overview

Our traditional business segments have involved the manufacture and sale of land, marine and transition zone seismic instrumentation for oil and gas exploration and production. In recent years, we have changed our overall focus toward being a provider of seismic acquisition imaging technology for exploration, production and reservoir monitoring in land and marine, including shallow water and marsh, environments. The relatively low level of traditional seismic activity has presented for the past number of years, and continues to present, a challenging environment for companies involved in the seismic industry. This environment, along with product life cycle developments affecting our traditional product lines, has been the principal factor affecting our results of operations in recent years.

However, positive trends for our business include:

- The increasing worldwide demand for hydrocarbons,
- The increasing use of seismic products by oil companies to enhance production from their existing reserves,
- The increasing needs of exploration and production companies for seismic surveys that are custom-designed to meet particular geological formation characteristics, and
- The increasing need for more sophisticated information tools to monitor and assess new and producing oil and gas reservoirs.

Our strategy involves repositioning our company as a seismic imaging company, providing both equipment and services across a broader spectrum of the seismic technology industry than merely an equipment manufacture and sales company. The advantages of our products and services that incorporate full-wave digital imaging capabilities will, we believe, ultimately drive the demand for new survey designs and the associated processing and interpretive skills that we possess. We believe that our products that digitally monitor seismic characteristics of reservoirs will reduce the costs of performing multiple seismic surveys over the same areas, thereby reducing overall seismic costs for operators and owners of the reserves.

However, executing our strategic plan is not without risk. See *Risk Factors* below. Industry fundamentals, while improving, remain weak by historical standards. In December 2003, we successfully refinanced substantially all of our existing short-term indebtedness with the proceeds from our convertible debt offering. See *Recent Developments* below. As of December 31, 2003, our total outstanding indebtedness was $81.2 million, compared to $53.6 million outstanding at December 31, 2002.

Our cash needs are anticipated to increase in 2004. We have typically financed our operations from internally generated cash and funds from equity and debt financings. With our higher debt burden, our interest expense is expected to increase in 2004 compared to 2003. We will continue to need funds to complete the research, development and testing of our products and services. During 2003, net cash from operations was negative $33.1 million.

Our ability to produce positive operating cash flows, return to consistent profitability, grow our business and service and retire our debt (in addition to our other obligations) will depend on the success of our efforts in increasing our revenues from sales of our seismic imaging systems and equipment and our processing services, successfully introducing and continuing to technologically enhance our product line and service offerings, penetrating new markets for our seismic products and services, achieving more consistency in our period-to-period results of operations, improving the margins on our sales and reducing our overall costs.

We have traditionally relied on a relatively small number of significant customers; consequently, our business is exposed to risks related to customer concentration. See Item 1. *Business.* In recent years, our traditional customers have been rapidly consolidating, shrinking the demand for our products. The loss of any of our significant customers or deterioration in our relations with any of them could materially and adversely affect our results of operations and financial condition. The fact that such a high percentage of our sales currently are made to foreign destinations and customers presents additional issues for our revenues and cash flows. We continue to see expansion from Chinese and Eastern European seismic contractors, and we plan to expand our presence internationally. As a result of these factors, the collections cycle for our sales in 2004 may be longer than it has traditionally been which would thereby increase our working capital funding needs.

While we anticipate an increase in worldwide seismic activity in 2004, this anticipated increase may not materialize. As a result, our internal revenue forecast may not be realized, resulting in lower cash flows available for our future capital and operational needs. In order to meet our future capital requirements, we may need to issue additional debt or equity securities. We cannot assure you that we would be able to issue additional equity or debt securities in the future on terms that would be acceptable to us, or at all.

Through our manufacturing outsourcing activities, we have sought to reduce both the unit cost of our products and our fixed cost structure, as well as to accelerate our research and development cycle for non-core technologies. We expect additional reductions in our fixed and semi-variable costs resulting from our cost restructuring program and facility closures. For example, in July 2003, we closed our Alvin, Texas manufacturing facility. Additionally, we closed our Norwich, U.K. geophone stringing operation in the first quarter of 2003, and moved its operations to our leased facility in Dubai, as well as outsourced other manufacturing activities to various partners. Effective January 2004, we consolidated three operating units of our Land Imaging segment into one division. We will continue to work to reduce the unit costs of our products.

We have experienced significant charges in recent years as a result of depressed industry conditions and our cost restructuring program. While we do not anticipate any significant future charges or adjustments to our restructuring accrual accounts, future acquisitions and the fact that technology product lines feature more rapid obsolescence present additional risks of future goodwill write-offs or write-downs and future charges related to impairment of long-lived assets, assets held for sale and intangible assets.

We have anticipated using substantially all of the remaining proceeds from our convertible notes offering to fund acquisitions, as part of our acquisition strategy. See *Recent Developments* below. To the extent we make any future acquisitions, particularly funded with cash, it is likely that we will require new sources of funding, including issuing additional debt or equity, to finance the acquisitions. Additional debt (except for refinancings) would increase our leverage, and the issuance of additional equity could dilute the holdings of our existing shareholders. There can be no assurances that any additional sources of funding for acquisitions will be available to us, or if available, would be available on acceptable terms.

Recent Developments

In December 2003, we issued $60.0 million of convertible unsecured notes, which mature in December 2008 and bear interest at an annual rate of 5.5%, payable semi-annually. The notes, which are not redeemable prior to their maturity, are convertible into our common stock at an initial conversion rate of 231.4815 shares per $1,000 principal amount of notes (a conversion price of $4.32 per share), which represents 13,888,888 total common shares. A portion of the proceeds from this offering was used to repay in full $16.0 million of outstanding indebtedness under a $31.0 million unsecured promissory note due May 7, 2004 (the SCF Note). The SCF Note bore interest at 13% and was to mature in May 2004.

In February 2004, we purchased all of the share capital of Concept, a provider of software, systems and services for towed streamer, seabed and land seismic operations based in Edinburgh, Scotland, in a privately negotiated transaction. The purchase price was approximately US$36 million cash and 1,680,000 shares of our common stock. The source of the cash component of the consideration paid was from the December 2003 sale of our convertible senior notes, and general corporate funds. Under a registration rights agreement, we granted certain demand and piggyback registration rights to holders of the shares of stock issued in the acquisition transaction.

Results of Operations

Year Ended December 31, 2003 Compared to Year Ended December 31, 2002

Net Sales: Net sales of $150.0 million for the year ended December 31, 2003 increased $31.5 million, or 27%, compared to the corresponding period last year. Land Imaging s net sales increased $45.5 million, or 72%, to $108.5 million compared to $63.0 million in the corresponding period of last year. The increase was due to an increase in land seismic activity with our non-Western contractors, primarily in China and the CIS. Marine Imaging s net sales decreased $17.7 million, or 33%, to $35.7 million compared to $53.4 million in the corresponding period last year. The decrease was due to continued overcapacity and reduction in capital spending in the marine contractor market. In 2003, we formed a new reporting segment, Processing, from our acquisition of AXIS in July 2002. Processing s net sales for the twelve months ended December 31, 2003 were $5.8 million compared to $2.2 million recorded from the date of acquisition in July 2002 to the end of 2002.

Cost of Sales: Cost of sales of $121.1 million for the year ended December 31, 2003 increased $21.5 million, or 22%, compared to the corresponding period last year. Cost of sales for Land Imaging, Marine Imaging and Processing were $93.4 million, $25.0 million and $2.7 million, respectively. Cost of sales increased primarily as a result of the increase in sales activity in Land Imaging. In addition, a charge of $2.5 million was included in cost of sales related to the write-down of rental equipment associated with our first-generation radio-based VectorSeis land acquisition systems to its net realizable value. Included in cost of sales for the year ended December 31, 2003 is $0.7 million of severance costs compared to $1.9 million for the year ended December 31, 2002. Cost of sales was also negatively affected by $1.0 million and $4.3 million of inventory-related charges for the years ended December 31, 2003 and 2002, respectively.

Gross Profit and Gross Profit Percentage: Gross profit of $27.8 million for the year ended December 31, 2003 increased $10.3 million, or 59%, compared to the corresponding period last year. Gross profit percentage for the year ended December 31, 2003 was 19% compared to 15% for the year ended December 31, 2002. The improvement in gross profit was driven mainly by volume improvements as well sales of our higher-margin VectorSeis System Four land acquisition system which was commercialized in early 2003. Our gross profit percentage for the year ended December 31, 2003 was negatively impacted in part due to a charge of $2.5 million related to the write-down of rental equipment associated with our first generation radio-based VectorSeis land acquisition systems to its net realizable value, and inventory-related charges of $1.0 million. Inventory related charges for the year ended December 31, 2002 were $4.3 million.

Research and Development: Research and development expense of $18.7 million for the year ended December 31, 2003 decreased $10.1 million, or 35%, compared to the corresponding period last year. This decrease primarily reflects reduced staffing levels, the cancellation of our marine solid streamer project, the entrance into the commercial phase of our VectorSeis System Four land acquisition system and a reduction of rent expense (primarily associated with our vacated Austin, Texas software development facility). For the year ended December 31, 2002, we incurred charges of $1.3 million relating to the closure of this facility. Included in research and development expenses for the year ended December 31, 2003 is $0.4 million of severance costs compared to $0.8 million for the year ended December 31, 2002. For the year ended December 31, 2003, we incurred $0.2 million of expenses related to the cancellation of our solid streamer project within the Marine Imaging segment.

Marketing and Sales: Marketing and sales expense of $12.6 million for the year ended December 31, 2003 increased $1.3 million, or 12%, compared to the corresponding period last year. The increase was primarily related to higher sales and commissions on sales and due to the opening of our sales representative office in Beijing, China. We expect marketing and sales expenses to increase further in 2004, in part due to expenses related to our new Moscow, Russia sales representative office.

General and Administrative: General and administrative expense of $16.8 million for the year ended December 31, 2003 decreased $3.0 million, or 15%, compared to the corresponding period last year. The decrease in general and administrative expense was primarily attributable to reductions in personnel resulting from our 2002 and 2003 staff reduction activities and a reduction in bad debt expense due to collections of previously reserved notes receivable of $0.5 million. This decrease was partially offset by $0.4 million of moving costs associated with vacating our Alvin, Texas facility as well as the inclusion of AXIS, which we acquired in July 2002. Included in general and administrative expenses are severance costs of $0.2 million and $0.4 million for the years ended December 31, 2003 and 2002, respectively.

Impairment of Long-Lived Assets: Impairment of long-lived assets of $1.1 million for the year ended December 31, 2003 relates to the cancellation of our solid streamer project within Marine Imaging in the first quarter of 2003. Impairment of long-lived assets of $6.3 million for the year ended December 31, 2002 primarily relates to the impairment of our Alvin, Texas manufacturing facility, the impairment of the leasehold improvements of our Norwich, U.K. geophone stringing facility and certain related manufacturing equipment of both facilities. These impairment charges were triggered by the announced closure of the facilities.

Goodwill Impairment: Goodwill impairment of $15.1 million for the year ended December 31, 2002 relates to the impairment of goodwill of our analog land products reporting unit. There was no corresponding charge during the year ended December 31, 2003. See further discussion at Note 10 of *Notes to Consolidated Financial Statements.*

Net Interest and Other Income (Expense): Total net interest and other income (expense) of $(1.2) million for the year ended December 31, 2003 decreased $0.4 million compared to the corresponding period last year. Interest expense increased primarily due to the issuance of the $31.0 million SCF Note in August 2002, which in May 2003 we repaid $15.0 million in principal. In December 2003, a portion of the proceeds from the issuance of our convertible senior notes was used to repay in full the $16.0 million remaining SCF debt. Interest income decreased due to a decline in our cash balances and short-term interest rates, partially offset by an increase in our notes receivables. The increase in other income was primarily due to fluctuations in exchange rates and a gain on sale of assets primarily resulting from the auction of equipment related to our vacated Alvin manufacturing facility.

Fair Value Adjustment and Exchange of Warrant Obligation: The fair value adjustment and exchange of our warrant obligation totaling $1.8 million was due to a change in the fair value between January 1, 2003 and December 10, 2003 of our common stock warrant. On December 10, 2003, we exchanged the warrant for 125,000 shares of our common stock, which we issued to SCF. A fair value adjustment of $3.3 million was recorded for the year ended December 31, 2002.

Impairment of Investment: Impairment of investment of $2.1 million for the year ended December 31, 2003 relates to the write-down of our investment in Energy Virtual Partners (EVP) to its approximate final liquidation value of $1.0 million. See discussion at Note 5 of *Notes to Consolidated Financial Statements.*

Income Tax Expense: Income tax expense of $0.3 million for the year ended December 31, 2003 decreased $57.6 million compared to the corresponding period last year. Income tax expense for the year ended December 31, 2003 reflects $1.5 million of state and foreign taxes as we continue to maintain a full valuation allowance for our net deferred tax assets, partially offset by federal tax refunds of $1.2 million. In the second quarter of 2002, we began to fully reserve for our net deferred tax assets, which resulted in a net charge to income tax expense of $60.0 million during that period.

Preferred Stock Dividend: Preferred stock dividend of $0.9 million for the year ended December 31, 2002 is related to our previously outstanding Series B and Series C Preferred Stock. We repurchased the preferred stock on August 6, 2002 and, as a result, there were no preferred stock dividends for the year ended December 31, 2003. The preferred stock dividend for the year ended December 31, 2002 includes a preferred stock dividend credit of $2.5 million, which represents the difference between the fair value of the consideration granted to the holder and our carrying value of the preferred stock at the time of the repurchase.

Year Ended December 31, 2002 Compared to Year Ended December 31, 2001

Net Sales: Net sales of $118.6 million for the year ended December 31, 2002 decreased $93.5 million, or 44%, compared to the corresponding period last year. Land Imaging s net sales decreased $99.2 million, or 61%, to $63.0 million, primarily as a result of declining industry conditions and a loss of market share to our principal competitor. Marine Imaging s net sales increased $3.5 million or 7%, to $53.4 million, compared to the prior year, primarily due to an increase in demand from Russian contractors. Processing s net sales of $2.2 million resulted from our acquisition of AXIS in July 2002.

Cost of Sales: Cost of sales of $99.6 million for the year ended December 31, 2002 decreased $38.8 million, or 28%, compared to the corresponding period last year. Costs of sales of Land Imaging, Marine Imaging and Processing were $65.0 million, $33.8 million and $0.8 million, respectively. The decrease was a result of reduced sales activity in Land Imaging, partially offset by lower gross profit on those revenues. Included in cost of sales for the year ended December 31, 2002 were $1.9 million of severance costs, for which there were no corresponding costs for the year ended December 31, 2001. Cost of sales was negatively affected by $4.3 million and $3.6 million of inventory-related charges for the years ended December 31, 2002 and 2001, respectively.

Gross Profit and Gross Profit Percentage: Gross profit of $17.6 million for the year ended December 31, 2002 decreased $55.0 million, or 76%, compared to the corresponding period last year. Gross profit percentage for the year ended December 31, 2002 was 15% compared to 34% in the prior year. The decline in gross profit percentage was primarily due to under-absorbed manufacturing overhead, inventory-related charges of $4.3 million, and to a lesser degree, severance for work force reductions totaling $1.9 million.

Research and Development: Research and development expense of $28.8 million for the year ended December 31, 2002 decreased $0.7 million, or 2%, compared to the corresponding period last year. Research and development expense remained at relatively high levels as we completed the final stages of VectorSeis commercialization and continued to develop a solid marine streamer, a lightweight ground electronics system and an ocean bottom system that would exploit our VectorSeis technology. Also, research and development expenses included severance expenses of $0.8 million and charges related to the closure of our Austin, Texas facility of $1.3 million.

Marketing and Sales: Marketing and sales expense of $11.2 million for the year ended December 31, 2002 decreased $0.4 million, or 4%, compared to the corresponding period last year. The decrease is primarily related to lower payroll costs and commissions on sales, partially offset by severance for work force reductions of $0.3 million.

General and Administrative: General and administrative expense of $19.8 million for the year ended December 31, 2002 increased $0.1 million compared to the corresponding period last year. The increase in general and administrative expense was primarily due to $0.6 million of abandoned lease costs associated with our Louisville, Colorado facility and an increase in bad debt expense (net of recoveries) of $0.5 million, partially offset by decreases in payroll, profit-based bonuses and facility related costs.

Amortization of Goodwill: Amortization of goodwill for the year ended December 31, 2001 was $3.9 million. There was no amortization of goodwill in 2002 due to the implementation of SFAS No. 142 *Goodwill and Other Intangibles Assets* , which, among other things, eliminated the amortization of goodwill.

Impairment of Long-Lived Assets: Impairment of long-lived assets of $6.3 million for the year ended December 31, 2002 primarily related to the impairment of our Alvin, Texas manufacturing facility, the leasehold improvements of our Norwich, U.K. geophone stringing facility and certain related manufacturing equipment of both facilities. The impairments were triggered by the announced closures of facilities. There was no corresponding charge during the year ended December 31, 2001.

Goodwill Impairment: Goodwill impairment of $15.1 million for the year ended December 31, 2002 related to the impairment of goodwill of our analog land products reporting unit. There was no corresponding charge during the year ended December 31, 2001.

Net Interest and Other Income (Expense): Total net interest and other income (expense) of $(1.6) million for the year ended December 31, 2002 decreased $6.2 million compared to the corresponding period last year. The decrease is primarily due to falling interest rates on cash balances, as well as increased interest expense on new debt, compared to the prior year.

Fair Value Adjustment of Warrant Obligation: The fair value adjustment of our warrant obligation totaling $3.3 million was due to a change in the fair value of the SCF Warrant between August 6, 2002 (the issuance date) and December 31, 2002.

Income Tax Expense: Income tax expense of $57.9 million for the year ended December 31, 2002 increased $54.8 million compared to the year ended December 31, 2001 due to a charge of $60.0 million in 2002 to establish an additional valuation allowance for our net deferred tax assets. In the second quarter of 2002, we began to fully reserve for our net deferred tax assets.

Preferred Stock Dividends: Preferred stock dividends for the years ended December 31, 2002 and 2001 were related to previously outstanding Series B and Series C Preferred Stock. The preferred stock dividend charge for the year ended December 31, 2002 was $0.9 million, compared to $5.6 million for the year ended December 31, 2001. We repurchased the preferred stock on August 6, 2002. The decrease in preferred stock dividends was due to a preferred stock dividend credit of approximately $2.5 million, which represented the difference in the fair value of the consideration granted to the holders of the preferred stock and our carrying value of the preferred stock at the time of the repurchase, and less than a full year of dividends in 2002.

Liquidity and Capital Resources

In December 2003, we issued $60.0 million of 5.5% senior convertible notes due in 2008. A portion of the proceeds were used to pay in full the $16.0 million remaining outstanding debt under the SCF Note. We have anticipated using substantially all of the remaining proceeds from this offering to fund acquisitions. See *Recent Developments* above. We are significantly more leveraged after the consummation of the offering. As a result, our interest expense is expected to increase for 2004 and the foreseeable future. Our ability to make scheduled payments of principal or interest on, or to refinance, our indebtedness depends on our future business performance, which is subject to many economic, financial, competitive and other factors beyond our control.

We may seek a revolving line of credit to support our working capital requirements. Whether we will enter into such a credit arrangement will depend on the terms available to us from lenders. We can give no assurances as to whether such a line of credit will be arranged, and, if so, whether the terms will be advantageous to us or whether the amounts available for borrowing will be sufficient for our purposes.

Based upon our management s internal revenue forecast, our liquidity requirements in the near term and our projected increase in seismic activity primarily outside of North America, we currently believe that the combination of our projected internally-generated cash and our working capital (including cash and cash equivalents on hand) will be adequate to meet our anticipated capital and liquidity requirements for the next twelve months. We also anticipate that a larger percentage of our future sales in 2004 and beyond will be to foreign customers, particularly those in China and the CIS. As a result of this change in customer mix, our collections cycle may be longer than we have traditionally experienced.

We anticipate an increase in worldwide seismic activity in 2004. However, this anticipated increase may not materialize. As a result, our internal revenue forecast may not be realized, resulting in lower cash flows available for our future capital needs. In order to meet these future capital requirements, we may need to issue additional debt or equity securities. We cannot assure you that we would be able to issue additional equity or debt securities in the future on terms that would be acceptable to us, or at all.

Cash Flow from Operations

We have traditionally financed operations from internally generated cash and funds from equity and debt financings. Cash and cash equivalents were $59.5 million at December 31, 2003, a decrease of $16.7 million, or 22%, compared to December 31, 2002. Net cash used in operating activities was $33.1 million for the year ended December 31, 2003, compared to cash provided by operating activities of $13.7 million for the year ended December 31, 2002. The net cash used in operating activities for 2003 was due in part to the loss from operations for the year. Also contributing to the net cash used during the period were an increase in accounts and notes receivable, as well as an increase in inventory related to increased activity in Land Imaging. We also took advantage of our cash position to reduce our accounts payable level. The increase in our accounts receivable was primarily due to a continued shift in our sales to foreign customers, which historically have been slower to pay.

Cash and cash equivalents were $76.2 million at December 31, 2002, a decrease of $25.1 million, or 25%, compared to December 31, 2001. Net cash provided by operating activities was $13.7 million for the year ended December 31, 2002, compared to $17.6 million for the year ended December 31, 2001. This decrease in cash flow provided from operations was generally a result of lower operating levels in 2002 with smaller gross margins.

Cash Flow from Investing Activities

Net cash flow used in investing activities was $7.5 million for the year ended December 31, 2003, which represented a decrease of $3.3 million compared to the year ended December 31, 2002. The principal investing activities were $4.6 million relating to capital expenditure projects, $3.0 million related to the investment in EVP in April 2003 and $1.3 million of additional consideration paid to the former shareholders of AXIS to settle all future contingent purchase price obligations. As further discussed in Note 5 of *Notes to Consolidated Financial Statements,* in the fourth quarter of 2003 we received $0.9 million from the liquidation of EVP. Planned capital expenditures for 2004 are approximately $5.8 million.

Net cash flow used in investing activities was $10.9 million for the year ended December 31, 2002; a decrease of $3.9 million compared to the year ended December 31, 2001. Our principal investing activities in 2002 were $8.2 million relating to capital expenditure projects and $2.7 million, net of cash acquired, relating to our acquisitions of AXIS and S/ N Technologies.

Cash Flow from Financing Activities

Cash flow provided by financing activities was $21.2 million for the year ended December 31, 2003; an increase of $52.5 million compared to the use of cash for the year ended December 31, 2002. In December 2003, we issued $60.0 million of convertible senior notes which mature in December 2008. As part of this issuance we incurred approximately $3.5 million of underwriting and professional fees, which were recorded as deferred financing costs and are being amortized over the 5-year term. A portion of the proceeds from this issuance was used to repay in full the $16.0 million in outstanding debt under the SCF Note. In May 2003, we had repaid $15.0 million of outstanding debt under the SCF Note. In addition, we paid $3.2 million related to other debt obligations.

Cash flow used in financing activities was $31.3 million for the year ended December 31, 2002, representing a decrease of $38.9 million compared to the year ended December 31, 2001. The principal use of cash was $30.0 million relating to the repurchase of preferred stock and $2.6 million for the repayment of long-term debt, partially offset by proceeds of $0.8 million from the issuance of common stock under our employee stock purchase plan and $1.0 million from the exercise of stock options.

Acquisition Indebtedness

In July 2002, in connection with our acquisition of AXIS, we issued a $2.5 million three-year unsecured promissory note payable to the former shareholders of AXIS, bearing interest at 4.34% per year. Principal is payable in quarterly installments of $0.2 million, plus interest, with the final payment due in July 2005. The unpaid balance as of December 31, 2003 was $1.5 million.

In January 2001, in connection with our acquisition of all of the outstanding capital stock of Pelton Company, we issued a $3.0 million two-year unsecured promissory note payable to the former shareholder of Pelton, bearing interest at 8.5% per year. Principal was payable in quarterly payments of $0.4 million plus interest. The final payment on this note was made in February 2003.

Sale and Lease of Stafford Facilities

In August 2001, we sold the land and buildings that house our corporate headquarters, our land imaging division and our MEMS facility in Stafford, Texas for $21.0 million cash, and repaid the outstanding mortgage loan secured by that property. At the same time, we entered into a non-cancelable lease with the purchaser of the property. This lease has a 12-year term with three consecutive options to extend the lease for five years each. We have no purchase option under this lease. As a result of the terms of the lease, the commitment was recorded as a twelve-year $21.0 million lease obligation with an implicit annual interest rate of 9.1%. We paid $1.7 million in commissions and professional fees, which were recorded as deferred financing costs and are being amortized over the 12-year term of the obligation. The unpaid balance of the lease payments as of December 31, 2003 was $18.8 million.

The carrying value of the land and buildings are included as assets, and the value of the related lease obligations are included as liabilities, on our consolidated balance sheet under U.S. generally accepted accounting principles. As of December 31, 2003, the net carrying value of the facilities on our consolidated balance sheet was approximately $12.6 million.

The lease agreement contains financial covenants requiring us to maintain certain current ratios and tangible net worth during the first five years of the lease term. These financial covenants provide that if we fail to meet certain current ratio or tangible net worth requirements for any four consecutive quarters, we would have to provide a letter of credit to the landlord in the amount of $1.5 million. At June 30, 2003, we failed to meet the tangible net worth requirement for four consecutive quarters, and as a result, we provided a letter of credit to the landlord in the amount of $1.5 million during the third quarter of 2003. To secure the issuance of the letter of credit, we were required to deposit $1.5 million with the issuing bank. This letter of credit will remain outstanding until we achieve and maintain compliance with the tangible net worth requirements for eight consecutive quarters, or until the expiration of the eighth year of the lease, which is in 2009. We were not in compliance with the tangible net worth requirement at December 31, 2003.

Future Contractual Obligations

The following table sets forth estimates of future payments for 2004 through 2009, and thereafter, of our consolidated contractual obligations as of December 31, 2003 (in thousands):

	Payments Due by Fiscal Year						
Contractual Obligations	**Total**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009 and Thereafter**
Long-Term Debt and Lease Obligations	$ 81,203	$ 2,687	$1,840	$1,470	$1,610	$61,763	$11,833
Operating Leases	5,120	2,453	806	559	374	928	
Product Warranty	3,433	3,433					
Purchase Obligations	19,812	19,422	390				
Total	$109,568	$27,995	$3,036	$2,029	$1,984	$62,691	$11,833

The debt and lease obligations at December 31, 2003 consist primarily of $60.0 million in convertible senior notes that mature in December 2008. The remaining amount of these obligations consist of $1.5 million in unsecured promissory notes related to our acquisition of AXIS in 2002, $0.9 million of insurance costs we financed through short-term notes payable, and $18.8 million related to the lease arrangement housing our corporate headquarters, our Land Imaging division and MEMS facility in Stafford, Texas. For further discussion of our notes payable, long-term debt and lease obligations, see Note 13 of *Notes to Consolidated Financial Statements.*

The operating lease commitments at December 31, 2003 relate to our lease of certain equipment, offices and warehouse space under non-cancelable operating leases.

The liability for product warranties at December 31, 2003 relates to the estimated future warranty expenditures associated with our products. Our warranty periods range from 90 days to three years from the date of original purchase, depending on the product. We record an accrual for product warranties and other contingencies when estimated future expenditures associated with those contingencies become probable and the amounts can be reasonably estimated.

Our purchase obligations primarily relate to our committed inventory purchase orders for which deliveries are scheduled to be made in 2004. Included in this amount is a minimum payment commitment of labor hours to the outsource provider for the manufacturing of our vibrator vehicles, which extends through 2005 and approximates $0.4 million in each of the years ended December 31, 2004 and 2005.

As part of our business plan, we are increasing the use of contract manufacturers as an alternative to in-house manufacturing. Under a few of our outsourcing arrangements, our manufacturing outsourcers first utilize our on-hand inventory, then directly purchase inventory at agreed-upon quantities and lead times in order to meet our scheduled deliveries. If demand proves to be less than we originally forecasted (thereby allowing us to cancel our committed purchase orders with our outsourcer), our manufacturing outsourcer has the right to require us to purchase inventory which it had purchased on our behalf. However, since we now issue purchase orders to our outsourcers based upon our short-term forecast (usually three months or less), we believe we have reduced the risk that we may be required to purchase any substantial quantities of inventory that we may never utilize.

Significant 2002 and 2003 Charges

In 2002, we recorded significant charges in connection with our restructuring program. The related reserves reflected many estimates, including those pertaining to severance costs of $3.4 million, facility related charges (primarily future, non-cancelable lease obligations) of $1.9 million and inventory-related charges of $4.3 million. In addition, during 2002, we recorded charges of $15.1 million relating to the impairment of goodwill and $6.3 million for the impairment of long-lived assets. In 2003, we recorded severance costs of $1.3 million, inventory-related charges of $1.0 million, $1.1 million for the impairment of long-lived assets and $2.5 million related to the write-down of rental equipment associated with our first-generation radio-based VectorSeis land acquisition systems. We will continually reassess the requirements necessary to complete our

restructuring program, which may result in additional charges being recorded in future periods. However, we currently do not anticipate any significant future charges or adjustments to our restructuring accruals, except for $0.4 million of additional severance expenses to be incurred in 2004 associated with the consolidation of three operating units within our Land Imaging segment into one division. See Note 2 of *Notes to Consolidated Financial Statements.*

In 2002, we recorded a net charge of $60.0 million to income tax expense to establish an additional valuation allowance for our net deferred tax assets. In accordance with Statement of Financial Accounting Standards (SFAS) No. 109, *Accounting for Income Taxes,* we established an additional valuation allowance for our net deferred tax assets based on our cumulative operating results in the three-year period ended December 31, 2002. Our results in this period were heavily affected by industry conditions and deliberate and planned business restructuring activities in response to the prolonged downturn in the seismic equipment market, as well as heavy expenditures for research and development. Nevertheless, recent losses represented sufficient negative evidence to establish an additional valuation allowance. We have continued to reserve all of our net deferred tax assets and will continue to do so until we have sufficient evidence to warrant reversal. This valuation allowance does not affect our ability to reduce future tax expense through utilization of net operating losses.

See Note 21 of *Notes to Consolidated Financial Statements* for a tabular presentation of significant charges by segment.

Critical Accounting Policies and Estimates

The preparation of consolidated financial statements in conformity with generally accepted accounting principles in the United States requires management to make choices between acceptable methods of accounting and to use judgment in making estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses. The following accounting policies are based on, among other things, judgments and assumptions made by management that include inherent risks and uncertainties. Management s estimates are based on the relevant information available at the end of each period.

Revenue Recognition and Product Warranty Revenue is derived from the sale of data acquisition systems and other seismic equipment, as well as from the processing of seismic data. For the sales of data acquisition systems, we follow the requirements of SOP 97-2 *Software Revenue Recognition*, and recognize revenue when the system is delivered to the customer and risk of ownership has passed to the customer, or, in the limited case where a customer acceptance clause exists in the contract, the later of delivery or when customer acceptance is obtained. For the sales of other seismic equipment, we recognize revenue when the equipment is shipped and risk of ownership has passed to the customer. For processing of seismic data, revenue is recognized at the time of delivery of the processed data to the customer.

When elements such as a data acquisition system and other seismic equipment are contained in a single arrangement, or in related arrangements with the same customer, we allocate revenue to each element based on its relative fair value, provided that such element meets the criteria for treatment as a separate unit of accounting. The price charged when the element is sold separately generally determines fair value. We limit the amount of revenue recognition for delivered elements to the amount that is not contingent on the future delivery of products or services. We do not grant return or refund privileges to our customers.

We warrant that all manufactured equipment will be free from defects in workmanship, material and parts. Warranty periods range from 90 days to three years from the date of original purchase, depending on the product. At the time of sale, we record an accrual for product warranties and other contingencies, which is when estimated future expenditures associated with such contingencies are probable and the amounts can be reasonably estimated. However, new information may become available, or circumstances (such as applicable laws and regulations) may change, thereby resulting in an increase or decrease in the amount required to be accrued for such matters (and therefore a decrease or increase in reported net income in the period of such change).

Impairment of Long-Lived Assets We periodically evaluate the net realizable value of long-lived assets, including property, plant and equipment, relying on a number of factors including operating results, business plans, economic projections and anticipated future cash flows. We recognize impairment in the carrying value of an asset whenever we estimate that anticipated future cash flows (undiscounted) from an asset are less than its carrying value. We recognize the difference between the carrying value of the asset and its fair value as the amount of the impairment. Since we must exercise judgment in determining the fair value of long-lived assets, the carrying value of our long-lived assets may be either overstated or understated.

In May 2003, a strategic marketing alliance with Veritas DGC Inc. was terminated. We reassessed the net realizable value of our rental equipment, which was being utilized in North America as part of the alliance. This equipment was associated with our first-generation radio-based VectorSeis land acquisition systems. This equipment was an older generation of our technology, therefore the market demand and its net realizable value was significantly less than our current generation VectorSeis land acquisition systems. As a result, we recorded an impairment charge of $2.5 million in 2003.

In early 2003, we initiated an evaluation of our marine solid streamer project and concluded we would no longer internally pursue this product for commercial development. In conjunction with this evaluation, certain fixed assets and patented technology were considered impaired, resulting in a write-down of fixed assets of $0.5 million and intangible assets of $0.6 million in the first quarter of 2003.

In 2002, we announced plans to close our Alvin, Texas and Norwich, U.K. manufacturing facilities. Applicable accounting rules required us to perform an impairment analysis as a result of the announced closures. As a result, we recorded an impairment charge of $6.3 million in 2002. We relied upon third party quoted market prices for the facilities and internally developed operating cash flows during the interim period prior to their closure to determine the amount of the impairment of other related assets.

Impairment of Goodwill On January 1, 2002, we adopted SFAS No. 142 *Goodwill and Other Intangible Assets.* Since adoption of SFAS No. 142 we no longer amortize goodwill, but instead test for impairment at least annually and as triggering events occur. In making this assessment we rely on a number of factors including operating results, business plans, internal and external economic projections, anticipated future cash flows and external market data. There are inherent uncertainties related to these factors and our judgment in applying them to the analysis of goodwill impairment. Since our judgment is involved in performing goodwill valuation analyses, the carrying value of our goodwill may be either overstated or understated.

In the third quarter of 2002, we recorded an impairment charge of $15.1 million, which related to all the goodwill of our land analog products reporting unit, a reporting unit within Land Imaging. The continuing weakness in the traditional analog land seismic markets and the financial condition of many of the seismic contractors, coupled with the anticipated decrease in demand for analog products, precipitated the need for this interim impairment. We determine the fair value of our reporting units using a discounted future returns valuation method.

Realization of Investments We accounted for our investment in EVP under the cost method, where we review the investment for impairment when we estimate that the fair value of our investment has fallen below the then-current carrying amount. When we deem the decline to be other than temporary, we record an impairment charge for the difference between the investment s carrying value and its estimated fair value at the time. Since the time of our investment, EVP failed to close two anticipated asset management agreements, which resulted in EVP s management re-evaluating its business model and adequacy of capital. The board of directors of EVP voted to liquidate EVP, as it was unable to present a clear and feasible business strategy. As a result, we wrote our investment in EVP down to its approximate fair value of $1.0 million. This fair value represents our best estimate of the expected liquidation payout. In December 2003 we received a portion of our liquidation payment and expect to receive our final liquidation payment in the first quarter of 2004.

Accounts and Notes Receivable Collectibility We consider current information and circumstances regarding our customers ability to repay their obligations, and consider an account or note impaired when it is probable that we will be unable to collect all amounts due. When we consider an account or note as impaired, we measure the amount of the impairment based on the present value of expected future cash flows or the fair value of collateral. We include impairment losses (recoveries) in our allowance for doubtful accounts and for loan loss through an increase (decrease) in bad debt expense. Notes receivable are collateralized by the products sold, bear interest at contractual rates up to 12.7% per year and are due at various dates through 2006. The weighted average interest rate at December 31, 2003 for our notes receivable was 7.4%. We first apply cash receipts on impaired notes to reduce the principal amount of such notes until the principal has been recovered and then we recognize additional cash receipts as interest income.

Inventory Obsolescence We provide reserves for estimated obsolescence or excess inventory equal to the difference between the cost of inventory and its estimated market value based upon assumptions about future demand for our products and market conditions. For the years ended December 31, 2003, 2002 and 2001, we recorded inventory-related charges of approximately $1.0 million, $4.3 million and $3.6 million, respectively.

Deferred Tax Valuation Allowance In 2002, we established an additional valuation allowance to reserve all of our net deferred tax assets. In accordance with SFAS No. 109, we established an additional valuation allowance for our net deferred tax assets based on our cumulative operating results in the most recent three-year period. Our results in this period were heavily affected by both industry conditions and deliberate and planned business restructuring activities in response to the prolonged downturn in the seismic equipment market, as well as heavy expenditures on research and development of our VectorSeis technology. Nevertheless, more recent losses represented sufficient negative evidence to establish an additional valuation allowance. We will continue to reserve all of our net deferred tax assets until we have sufficient evidence to warrant reversal. This valuation allowance does not affect our ability to reduce future tax expense through utilization of net operating losses.

Stock-Based Compensation We have elected to continue to follow the intrinsic value method of accounting for equity-based compensation as prescribed by APB Opinion No. 25. If we had adopted SFAS No. 123, net earnings (loss), basic earnings (loss) per share and diluted earnings (loss) per share for the periods presented would have been reduced (increased) as follows (in thousands, except per share amounts):

	Years Ended December 31,		
	2003	**2002**	**2001**
Net loss applicable to common shares	$(23,152)	$(120,821)	$ 3,709
Add: Stock-based employee compensation expense included in reported earnings (loss) applicable to common shares	(222)	417	246
Deduct: Stock-based employee compensation expense determined under fair value methods for all awards	$ (2,463)	$ (3,531)	$(4,244)
Pro forma net loss	$(25,837)	$(123,935)	$ (289)
Basic and diluted earnings (loss) per common share as reported	$ (0.45)	$ (2.37)	$ 0.07
Pro forma basic and diluted loss per common share	$ (0.50)	$ (2.43)	$ (0.01)

The above amounts are based on Black-Scholes valuation model variables of an average risk free interest rate based on 5-year Treasury bonds, an estimated option term of five years, $0 dividends and expected price volatility of 60% during the years ended December 31, 2003 and 2002 and 41% during the year ended December 31, 2001.

We believe that all of the judgments and estimates used to prepare our financial statements were reasonable at the time we made them, but circumstances may change requiring us to revise our estimates in ways that could be materially adverse to our results of operations and financial condition.

Recent Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 143, *Accounting for Asset Retirement Obligations.* This Statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The provisions of this statement are effective for fiscal years beginning after June 15, 2002. We adopted SFAS No. 143 on January 1, 2003 and its adoption did not have a significant impact on our results of operations or financial position.

In June 2002, the FASB issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities,* which addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force (EITF) Issue No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring).* SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity is recognized when the liability is incurred. Under EITF Issue 94-3, a liability for an exit cost was recognized at the date of an entity s commitment to an exit plan. The provisions of SFAS No. 146 are effective for exit or disposal activities that are initiated after December 31, 2002, and we have adopted them for 2003. For all exit and disposal activities initiated on or before December 31, 2002, we have continued to follow EITF No. 94-3.

In November 2002, the FASB issued Interpretation (FIN) No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others: an Interpretation of FASB Statements No. 5, 67, and 107 and Rescission of FASB Interpretation No. 34.* FIN No. 45 clarifies the requirements of FASB No. 5, *Accounting for Contingencies,* relating to the guarantor s accounting for, and disclosure of, the issuance of certain types of guarantees. The initial recognition and measurement provisions of FIN No. 45 are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. Our adoption of FIN No. 45 did not have a significant impact on our results of operations or financial position.

In December 2002, the FASB issued SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure and Amendment of FASB No. 123.* SFAS No. 148 amends FASB No. 123, *Accounting for Stock-Based Compensation,* to provide alternative methods of transition for a voluntary change in fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require more prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. We have elected to continue to follow the intrinsic value method of accounting prescribed by Accounting Principal Board Opinion No. 25. See Note 1 to the *Notes to Consolidated Financial Statements.*

In January 2003, the FASB issued FIN No. 46, *Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51* . The primary objective of the interpretation is to provide guidance on the identification of and financial reporting for entities over which control is achieved through means other than voting rights; such entities are known as variable-interest entities (VIEs). FIN No. 46 provides guidance that determines (1) whether consolidation is required under the controlling financial interest model of Accounting Research Bulletin No. 51, *Consolidated Financial Statements,* or other existing authoritative guidance, or, alternatively, (2) whether the variable-interest model under FIN No. 46 should be used to account for existing and new entities. In December 2003, the FASB completed deliberations of proposed modifications to FIN 46 (FIN 46-R) resulting in multiple effective dates based on the nature as well as creation date of the VIE. FIN No. 46, as revised, did not have a significant impact on our results of operations or financial position.

In April 2003, the FASB issued SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities,* which amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities under SFAS No. 133. This statement is effective for contracts entered into or modified after June 30, 2003, and for hedging relationships designated after June 30, 2003. Our adoption of this statement had no initial impact on the results of operations or financial position.

In May 2003, the FASB issued SFAS No. 150*, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity.* This statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires a financial instrument within its scope to be classified as a liability. It is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. These effective dates are not applicable to the provisions of paragraphs 9 and 10 of SFAS 150 as they apply to mandatorily redeemable noncontrolling interests, as the FASB has delayed these provisions indefinitely. Our adoption of this statement had no initial impact on our results of operations or financial position.

In December 2003, the SEC issued Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition,* which supercedes SAB 101, *Revenue Recognition in Financial Statements.* SAB 104 s primary purpose is to rescind accounting guidance contained in SAB 101 related to multiple element revenue arrangements, which was superceded as a result of the issuance of EITF 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables.* While the wording of SAB 104 has changed to reflect the issuance of EITF 00-21, the revenue recognition principles of SAB 101 remain largely unchanged by the issuance of SAB 104. The impact of SAB 104 did not have a material effect on the Company s results of operations or financial position.

Credit Risk

Currently, our principal customers are seismic contractors, which operate seismic data acquisition systems and related equipment to collect data in accordance with their customers specifications or for their own seismic data libraries. In addition, we market and sell products and services to oil and gas companies. In 2003, BGP accounted for approximately 28% of our consolidated net sales. In 2002, two of our largest customers, Western-Geco and Laboratory of Regional Geo-Dynamics, Limited, were responsible for approximately 11% and 10%, respectively, of our consolidated net sales. The loss of any one of these customers or deterioration in our relations with any of them could have a material adverse effect on our results of operations and financial condition. In recent years, our customers have been rapidly consolidating, shrinking the demand for our products.

During the year ended December 31, 2003, we recognized $20.0 million of sales to customers in the CIS, $15.4 million of sales to customers in Latin American countries, $20.0 million of sales to customers in Europe and $44.7 million of sales to customers in Asia. The majority of our foreign sales are denominated in U.S. dollars. In recent years, the CIS and certain Latin American countries have experienced economic problems and uncertainties as well as devaluations of their currencies. A continuation of weak demand for the services provided by certain of our customers will further strain their revenues and cash resources, thereby resulting in a higher likelihood of defaults in the timely payment of their obligations to us under our credit sales arrangements. Increased levels of payment defaults by our customers with respect to our credit sales arrangements could have a material adverse effect on our results of operations. To the extent that world events or economic conditions negatively affect our future sales to customers in those and other regions of the world or the collectibility of our existing receivables, our future results of operations, liquidity and financial condition may be adversely affected. See *Risk Factors Significant payment defaults under extended financing arrangements could adversely affect us.*

SCF Note and Warrant

In August 2002, we repurchased all of the 40,000 outstanding shares of our Series B Convertible Preferred Stock and all of the 15,000 outstanding shares of our Series C Convertible Preferred Stock from

SCF, a Houston-based private equity fund specializing in oil service investments. In exchange for the preferred stock, we paid SCF $30.0 million in cash at closing, issued the SCF Note and granted SCF a warrant to purchase 2,673,517 shares of our common stock at $8.00 per share which expired on August 5, 2005. The Note bore interest at 8% per annum until May 7, 2003, at which time the interest rate increased to 13%. We recorded interest on this note at an effective rate of approximately 11% per year. In May 2003, we repaid $15.0 million of the note and in December 2003, we repaid, in full, the remaining outstanding $16.0 million indebtedness. In addition, in December 2003, we terminated the warrant in exchange for 125,000 shares of our common stock with a market value of $3.54 per share.

Under the terms of a registration rights agreement, SCF had the right to demand that we file a registration statement for the resale of the shares of common stock SCF acquired upon exercise of the warrant. If we were acquired in a business combination pursuant to which our stockholders receive less than 60% of the aggregate consideration in the form of publicly traded common equity, then the holder of the warrant had the option to require the Company to acquire the warrant at its fair value as determined by the Black-Scholes valuation model, as further refined by the terms of the warrant agreement. Because we could have been required to repurchase the warrant in these limited circumstances, we had classified the warrant as a current liability on our consolidated balance sheet.

Certain Relationships and Related Party Transactions

On March 31, 2003, we announced that we had appointed Robert P. Peebler as our president and chief executive officer. In April 2003, we invested $3.0 million in preferred securities of Energy Virtual Partners, LP and its affiliated corporation (EVP) in exchange for 22% of the outstanding ownership interests and 12% of the outstanding voting interests of EVP. EVP had been formed in 2001 to provide asset management services to large oil and gas companies in order to enhance the value of their oil and gas properties. Mr. Peebler had founded EVP and had served as its president and chief executive officer until his joining us in March 2003. Mr. Peebler continued to serve as the Chairman of EVP and held a 23% ownership interest in EVP. Under Mr. Peebler s employment agreement with us, he was permitted to devote up to 20% of his time to EVP.

During the second quarter of 2003, EVP failed to close two anticipated asset management agreements, which resulted in EVP s management re-evaluating its business model and adequacy of capital. During August 2003, the board of directors of EVP voted to liquidate the company. For that reason, we wrote our investment in EVP down to its approximate liquidation value of $1.0 million, resulting in a charge against earnings in 2003 of $2.1 million. In December 2003, we received a portion of our final liquidation payment of $0.7 million and expect to receive our final liquidation payment of $0.1 million in the first quarter of 2004. Mr. Peebler offered, and we agreed, that all proceeds Mr. Peebler receives from the liquidation of EVP will be paid by him to us. In December 2003, we received $0.1 million from Mr. Peebler, and this amount has been included in our estimate of our liquidation value in EVP. See Item II. Executive Compensation Compensation Committee Interlocks and Insider Participation.

James M. Lapeyre, Jr. is the chairman and a significant equity owner of Laitram, L.L.C. (Laitram) and has served as president of Laitram and its predecessors since 1989. Laitram is a privately owned, New Orleans-based manufacturer of food processing equipment and modular conveyor belts. Mr. Lapeyre and Laitram together owned 15.2% of our outstanding common stock as of December 31, 2003.

We acquired DigiCourse, Inc., our marine positioning products business, from Laitram in 1998 and have renamed it I/O Marine Systems, Inc. In connection with that acquisition, we entered into a Continued Services Agreement with Laitram under which Laitram agreed to provide us certain accounting, software, manufacturing and maintenance services. These manufacturing services consist primarily of machining of parts for our marine positioning systems. The term of this agreement expired in September 2001, but we continue to operate under its terms. In addition, when we request, the legal staff of Laitram advises us on certain intellectual property matters with regard to our marine positioning systems. During 2003, we paid Laitram a total of $1.2 million, which consisted of $0.6 million of manufacturing services and $0.6 million of rent and other facilities charges. In the opinion of our management, the terms of these services are fair and reasonable and as favorable to us as those that could have been obtained from unrelated third parties at the time of their performance.

In March 2000, our board of directors established an executive matching program under which we issued one share of restricted stock for each share purchased by our senior executives in open-market transactions in March and April of 2000. In connection with this program, we issued 33,000 shares of restricted stock to C. Robert Bunch, a former executive officer of I/O. Mr. Bunch funded his purchase through a loan from a commercial bank in the amount of $200,000. We guaranteed this indebtedness in 2000 and would have been liable for the entire amount outstanding under this loan if Mr. Bunch had defaulted on his obligation under the loan. Our guarantee of Mr. Bunch s indebtedness expired by its terms in March 2003. Mr. Bunch left our employment in May 2003.

Risk Factors

This report contains statements concerning our future results and performance and other matters that are forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). These statements involve known and unknown risks, uncertainties, and other factors that may cause our or our industry s results, levels of activity, performance, or achievements to be materially different from any future results, levels of activity, performance, or achievements expressed or implied by such forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as may, will, should, intend, expect, plan, anticipate, believe, estimate, predict, potential, or continue or the negative of su comparable terminology.

Examples of other forward-looking statements contained in this report include statements regarding:

our expected revenues, operating profit and net income;

future growth rates and margins for certain of our products and services;

the adequacy of our future liquidity and capital resources;

anticipated timing and success of commercialization and capabilities of products and services under development;

our plans for facility closures and other future business reorganizations;

charges we expect to take for future reorganization activities;

savings we expect to achieve from our restructuring activities;

future demand for seismic equipment and services;

future seismic industry fundamentals;

future oil and gas commodity prices;

future worldwide economic conditions;

our expectations regarding future mix of business and future asset recoveries;

our expectations regarding realization of deferred tax assets;

our beliefs regarding accounting estimates we make;

the result of pending or threatened disputes and other contingencies;

- our future acquisitions and levels of capital expenditures; and
- our proposed strategic alliances.

These forward-looking statements reflect our best judgment about future events and trends based on the information currently available to us. Our results of operations can be affected by inaccurate assumptions we make or by risks and uncertainties known or unknown to us. Therefore, we cannot guarantee the accuracy of the forward-looking statements. Actual events and results of operations may vary materially from our current expectations and assumptions. While we cannot identify all of the factors that may cause actual results to vary from our expectations, we believe the following factors should be considered carefully:

We may not gain rapid market acceptance for our VectorSeis products, which could materially and adversely affect our results of operations and financial condition.

We have spent considerable time and capital developing our VectorSeis product lines. Because VectorSeis products rely on a new digital sensor, our ability to sell our VectorSeis products will depend on acceptance of our digital sensor and technology solutions by geophysical contractors and exploration and production companies. If our customers do not believe that our digital sensor delivers higher quality data with greater operational efficiency, our results of operations and financial condition will be materially and adversely affected.

System reliability is an important competitive consideration for seismic data acquisition systems. Even though we attempt to assure that our systems are always reliable in the field, the many technical variables related to operations can cause a combination of factors that can and have, from time to time, caused service issues with our analog products. If our customers believe that our analog products have reliability issues, then those customers may delay acceptance of our new products and reduce demand for our analog products. Our business, our results of operations and our financial condition, therefore, may be materially and adversely affected.

While we believe that our new VectorSeis System Four land data acquisition system has made significant improvements in both field troubleshooting and reliability compared to our legacy systems, products as complex as this system, however, sometimes contain undetected errors or bugs when first introduced. Despite our testing program, these undetected errors are not discovered until the product is purchased and used by a customer. If our customers deploy our new products and they do not work correctly, our relationship with our customers may be materially and adversely affected. Errors may be found in future releases of our products, and these errors could impair the market acceptance of our products. If our customers do not accept our new products as rapidly as we anticipate, our business, our results of operations and our financial condition may be materially and adversely affected.

The loss of any significant customer could materially and adversely affect our results of operations and financial condition.

We rely on a relatively small number of significant customers. Consequently, our business is exposed to the risks related to customer concentration. In 2003, BGP, an international seismic contractor and subsidiary of the China National Petroleum Corporation (BGP), accounted for approximately 28% of our consolidated net sales. In 2002, two of our largest customers, Western-Geco and Laboratory of Regional Geo-Dynamics Limited, were responsible for approximately 11% and 10%, respectively, of our consolidated net sales. The loss of any of our significant customers or a deterioration in our relations with any of them could materially and adversely affect our results of operations and financial condition.

Our business reorganization and facilities closure plans may not yield the benefits we expect and could harm our financial condition, reputation and prospects.

We have significantly reduced our corporate and operational headcount, closed certain manufacturing facilities and combined certain of our business units. These activities may not yield the benefits we expect, and may raise product costs, delay product production, result in or exacerbate labor disruptions and labor-related legal actions against us and create inefficiencies in our business. In addition, if the markets for our products do not improve, we will take additional restructuring actions to address these market conditions. Any such additional actions could result in additional restructuring charges.

If we fail to implement our business strategy, our financial condition and results of operations could be materially and adversely affected.

Our future financial performance and success are dependent, in large part, upon our ability to successfully implement our business strategy to introduce new seismic technologies and to reduce costs through outsourcing manufacturing and certain research and development activities. We cannot assure you that we will be able to successfully implement our business strategy or be able to improve our operating results. In particular, we cannot assure you that we will be able to stimulate sufficient demand for our VectorSeis products, our AZIM processing services or our traditional analog product line, to execute our growth strategy (including acquisitions) or to sufficiently reduce our costs to achieve required efficiencies. Our strategic direction also may give rise to unforeseen costs, which could wholly or partially offset any expense reductions or other financial benefits we attain as a result of the changes to our business.

We are in the process of evaluating and may, from time to time in the future, evaluate the acquisition of assets or operations that complement our existing businesses. We cannot estimate what impact, if any, our acquisition of these assets or operations may have on our business.

Furthermore, we cannot assure you that we will be successful in our acquisition efforts or that we will be able to effectively manage expanded or acquired operations. Our ability to achieve our acquisition or expansion objectives and to effectively manage our growth depends on a number of factors, including:

- our ability to identify appropriate acquisition targets and to negotiate acceptable terms for their acquisition;

- our ability to integrate new businesses into our operations; and

- the availability of capital on acceptable terms.

Our business strategy may require additional funding, which may be provided in the form of additional debt, equity financing or a combination thereof. We cannot assure you that we will be able to obtain this financing, and if so, on advantageous terms and conditions.

Implementation of our business strategy could be affected by a number of factors beyond our control, such as increased competition, general economic conditions or increased operating costs. Any failure to successfully implement our business strategy could materially and adversely affect our financial condition and results of operations. We may, in addition, decide to alter or discontinue certain aspects of our business strategy at any time.

Technologies and businesses that we acquire may be difficult to integrate, disrupt our business, dilute stockholder value or divert management attention.

An important aspect of our current business strategy is to seek new technologies, products and businesses to broaden the scope of our existing and planned product lines and technologies. While we intend to focus on acquisitions that complement our technologies and our general business strategy, there can be no assurance that we will be successful in locating such acquisitions or that any completed acquisition will achieve the expected benefit.

In addition, an acquisition may result in unexpected costs, expenses and liabilities. For example, during 2002, we acquired certain assets of S/ N Technologies and, in April 2003, we invested $3.0 million in EVP. These transactions were not successful and we have since completely written down the costs of the assets we purchased from S/ N Technologies and have written down our investment in EVP to its approximate liquidation value of $1.0 million.

Our ability to achieve our expansion and acquisition objectives will also depend on the availability of capital on acceptable terms. Our combined businesses resulting from any acquisitions may not be able to generate sufficient operating cash flows in order for us to obtain additional financing or fund our acquisition strategy.

Acquisitions expose us to:

- increased costs associated with the acquisition and operation of the new businesses or technologies and the management of geographically dispersed operations;
- risks associated with the assimilation of new technologies, operations, sites and personnel;
- the possible loss of key employees;
- risks that any technology we acquire may not perform as well as we had anticipated;
- the diversion of management s attention and other resources from existing business concerns;
- the potential inability to replicate operating efficiencies in the acquired company s operations;
- the inability to generate revenues to offset associated acquisition costs;
- the continuing need to maintain uniform standards, controls, and procedures;
- the impairment of relationships with employees and customers as a result of any integration of new and inexperienced management personnel; and
- the risk that acquired technologies do not provide us with the benefits we anticipated.

The identification of suitable acquisition candidates can be difficult, time-consuming and costly, and we may not be able to successfully complete identified potential acquisitions. Integration of acquired businesses require significant efforts from each entity, including coordinating existing business plans and research and development efforts. Integrating operations may distract management s attention from the day-to-day operation of the combined companies. If we are unable to successfully integrate the operations of acquired businesses, our future results will be negatively impacted.

Acquisitions may also result in the issuance of dilutive equity securities, the incurrence or assumption of debt and additional expenses associated with the amortization of acquired intangible assets or potential businesses. There is no assurance that past or future acquisitions will generate additional income, cash flows or provide any benefit to our business.

We have developed outsourcing arrangements with third parties to manufacture some of our products. If these third parties fail to deliver quality products or components at reasonable prices on a timely basis, we may alienate some of our customers and our revenues, profitability and cash flow may decline.

As part of our strategic direction, we are increasing our use of contract manufacturers as an alternative to our own manufacture of products. If, in implementing this initiative, we are unable to identify contract manufacturers willing to contract with us on competitive terms and to devote adequate resources to fulfill their obligations to us or if we do not properly manage these relationships, our existing customer relationships may suffer. In addition, by undertaking these activities, we run the risk that the reputation and competitiveness of our products and services may deteriorate as a result of the reduction of our control over quality and delivery schedules. We also may experience supply interruptions, cost escalations and competitive disadvantages if our contract manufacturers fail to develop, implement, or maintain manufacturing methods appropriate for our products and customers.

If any of these risks are realized, our revenues, profitability and cash flow may decline. In addition, as we come to rely more heavily on contract manufacturers, we may have fewer personnel resources with expertise to manage problems that may arise from these third-party arrangements.

The current oversupply of seismic data and downward pricing pressures has, and may continue to, adversely affect our operations and significantly reduce our operating margins and income.

The current industry-wide oversupply of speculative surveys conducted and collected by geophysical contractors, and their practice of lowering prices to their customers for these surveys, in order to recover investments in assets used to conduct 3-D surveys has in recent years adversely affected our results of operations and financial condition. Particularly during periods of reduced levels of exploration for oil and gas, the oversupply of seismic data and downward pricing pressures limit our ability to meet sales objectives and maintain profit margins for our products and sustain growth of our business. These industry conditions have reduced, and if continued into the future, will reduce, our revenues and operating margins.

Oil and gas companies and geophysical contractors will reduce demand for our products and services if the level of exploration expenditures continues to remain relatively low.

Historically, demand for our products has been sensitive to the level of exploration spending by oil and gas companies and geophysical contractors. Exploration expenditures have tended in the past to follow trends in the price of oil and gas, which have fluctuated widely in recent years in response to relatively minor changes in supply and demand for oil and gas, market uncertainty and a variety of other factors beyond our control. Prolonged reductions in oil and gas prices will generally depress the level of exploration activity and correspondingly depress demand for our products and services. A prolonged downturn in market demand for our products or services will have a material adverse effect on our results of operations and financial condition. Additionally, we cannot assure you that increases in oil and gas prices will increase demand for our products and services or otherwise have a positive effect on our results of operations or financial condition.

Factors affecting the prices of oil and gas include:

- level of demand for oil and gas;
- worldwide political, military and economic conditions, including the ability of the Organization of Petroleum Exporting Countries (OPEC) to set and maintain production levels and prices for oil
- level of oil and gas production;
- government policies regarding the exploration for, and production and development of, oil and gas reserves in their jurisdictions; and
- global weather conditions.

The markets for oil and gas historically have been volatile and are likely to continue to be so in the future.

We have a history of operating losses and we may have losses in the future.

As of and for the year December 31, 2003, we had:

- an accumulated deficit of approximately $159.7 million; and
- incurred an operating loss of $21.3 million and net loss of $23.2 million.

We also had an operating loss and net loss for the year ended December 31, 2002. While we intend to increase revenues, operating income and net income through acquisitions and internal growth, there can be no assurance we will be successful and our business and financial condition could be materially and adversely affected.

We will require a significant amount of cash to fund our operations and future acquisitions. We may have difficulty raising needed capital in the future.

We are significantly more leveraged after the consummation of the offering of the notes. As of December 31, 2003, our outstanding indebtedness was $81.2 million. As a result, our interest expense is expected to increase for 2004 and in the foreseeable future. In addition, we presently estimate that our capital expenditures for plant, property and equipment for 2004 will be approximately $5.8 million and that we will need approximately $28.0 million to meet our contractual obligations in 2004. Moreover, we have expended and will continue to expend substantial funds to complete the research, development and testing of our products and services. We will require additional funds for these purposes, to establish additional manufacturing arrangements and to provide for the marketing of our products and services.

We have typically financed operations from internally generated cash and funds from equity and debt financings. Our cash and cash equivalents decreased $16.7 million, or 22%, from December 31, 2002 to December 31, 2003. This decrease was primarily due to net cash used in operating activities of $33.1 million and the payment of $31.0 million of indebtedness under the SCF Note. These factors were partially offset by the $56.5 million of net proceeds from the notes offering. The net cash used in operating activities was mainly due to the loss from operations for the year, an increase in accounts and notes receivable, an increase in our inventory and a decrease in our accounts payable and accrued expenses. The increase in our accounts receivable was primarily due to a continued shift in our sales to foreign customers, which historically have been slower to pay. Our cash and cash equivalents also decreased approximately 24% from December 31, 2001 to December 31, 2002.

There is increasing risk that our collections cycle will further lengthen as we anticipate a larger percentage of our sales will be to foreign customers, particularly in China and the CIS.

We cannot assure you that our sources of cash will be sufficient to meet our anticipated future capital requirements. We used a substantial portion of the proceeds from the sale of the notes to repay in full the approximately $16.0 million of remaining outstanding indebtedness under the SCF Note and we used a total of $36 million cash from such proceeds and from our general corporate funds for the Concept acquisition in February 2004. As a result, the proceeds from the offering of the notes are not available to fund our future capital requirements and contractual obligations. Additional funds may not be available on acceptable terms, if at all. If adequate funds are unavailable from operations or additional sources of financing, we might be forced to reduce or delay acquisitions or capital expenditures, sell assets, reduce operating expenses, refinance all or a portion of our debt, or delay or reduce important initiatives, such as marketing programs and research or development programs.

In addition, we may seek to raise any necessary additional funds through equity or debt financings, convertible debt financing, alliance arrangements with corporate partners or other sources, which may be dilutive to existing stockholders and may cause the price of our common stock to decline.

We derive a substantial amount of our revenues from foreign sales, which pose additional risks.

Sales to customers outside of North America accounted for approximately 77% of our consolidated net sales for the year ended December 31, 2003, and we believe that export sales will remain a significant percentage of our revenue. United States export restrictions affect the types and specifications of products we can export. Additionally, to complete certain sales, United States laws may require us to obtain export licenses, and we cannot assure you that we will not experience difficulty in obtaining these licenses. Operations and sales in countries other than the United States are subject to various risks peculiar to each country. With respect to any particular country, these risks may include:

- expropriation and nationalization;
- political and economic instability;
- armed conflict and civil disturbance;
- currency fluctuations, devaluations and conversion restrictions;
- confiscatory taxation or other adverse tax policies;
- tariff regulations and import/export restrictions;
- governmental activities that limit or disrupt markets, or restrict payments or the movement of funds; and
- governmental activities that may result in the deprivation of contractual rights.

There is increasing risk that our collections cycle will further lengthen as we anticipate a larger percentage of our sales will be to foreign customers, particularly those in China and the CIS.

The majority of our foreign sales are denominated in United States dollars. An increase in the value of the dollar relative to other currencies will make our products more expensive, and therefore less competitive, in foreign markets.

In addition, we are subject to taxation in many jurisdictions and the final determination of our tax liabilities involves the interpretation of the statutes and requirements of taxing authorities worldwide. Our tax returns are subject to routine examination by taxing authorities, and these examinations may result in assessments of additional taxes, penalties and/or interest.

The rapid pace of technological change in the seismic industry requires us to make substantial research and development expenditures and could make our products obsolete.

The markets for our products are characterized by rapidly changing technology and frequent product introductions. We must invest substantial capital to maintain a leading edge in technology, with no assurance that we will receive an adequate rate of return on such investments. If we are unable to develop and produce successfully and timely new and enhanced products, we will be unable to compete in the future and our business, our results of operations and financial condition will be materially and adversely affected.

Competition from sellers of seismic data acquisition systems and equipment is intensifying and could adversely affect our results of operations and financial condition.

Our industry is highly competitive. Our competitors have been consolidating into better-financed companies with broader product lines. Certain of our competitors are affiliated with seismic contractors, which forecloses a portion of the market to us. Some of our competitors have greater name recognition, more extensive engineering, manufacturing and marketing capabilities, and greater financial, technical and personnel resources than those available to us. Our ability to compete effectively in the manufacture and sale of seismic instruments and data acquisition systems depends principally upon continued technological innovation, as well as our reputation for quality, our ability to deliver on schedule and price.

Our competitors have expanded or improved their product lines, which has adversely affected our results of operations. One competitor has introduced a lightweight land seismic system that we believe has made our current land system more difficult to sell at acceptable margins. In addition, another competitor introduced a marine solid streamer product that competes with our oil-filled towed streamer product. Streamers are towed behind marine vessels to acquire seismic data in marine environments and can either be solid or oil-filled. Our net sales of marine streamers have been, and will continue to be, adversely affected by customer preferences for solid products. In May 2003, we decided to cancel our internal project to develop a solid streamer product.

Further consolidation among our significant customers could materially and adversely affect us.

Historically, a relatively small number of customers has accounted for the majority of our net sales in any period. In recent years, our customers have been rapidly consolidating, shrinking the demand for our products. The loss of any of our significant customers to further consolidation could materially and adversely affect our results of operations and financial condition.

Large fluctuations in our sales and gross margins can result in operating losses.

As our products are technologically complex, we experience a very long sales cycle. In addition, the revenues from any particular sale can vary greatly from our expectations due to changes in customer requirements. These factors create substantial fluctuations in our net sales from period to period. Variability in our gross margins compound the uncertainty associated with our sales cycle. Our gross margins are affected by the following factors:

pricing pressures from our customers and competitors;

product mix sold in a period;

inventory obsolescence;

unpredictability of warranty costs;

changes in sales and distribution channels;

availability and pricing of raw materials and purchased components; and

absorption of manufacturing costs through volume production.

We must establish our expenditure levels for product development, sales and marketing and other operating expenses based, in large part, on our forecasted net sales and gross margins. As a result, if net sales or gross margins fall below our forecasted expectations, our operating results and financial condition are likely to be adversely affected because not all of our expenses vary with our revenues.

Write-offs related to the impairment of long-lived assets and other non-cash charges may adversely impact or delay our profitability.

We may incur significant non-cash charges related to impairment write-downs of our long-lived assets, including goodwill and other intangible assets. In accordance with Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets,* we recorded an impairment charge of $15.1 million in 2002 relating to our analog land products reporting unit. Also, in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* we recorded an impairment charge relating to other long-lived assets of $6.3 million in 2002 (relating to the impairment of our Alvin, Texas manufacturing facility, the leasehold improvements in our Norwich, U.K. geophone stringing facility and certain related manufacturing equipment at both facilities) and $1.1 million in 2003 (relating to the cancellation of our solid streamer project within our Marine Imaging segment in the first quarter of 2003).

We will continue to incur non-cash charges related to amortization of other intangible assets. We are required to perform periodic impairment reviews of our goodwill at least annually. To the extent these reviews conclude that the carrying value of our goodwill exceeds its implied fair value, we will be required to record an impairment charge to write down our goodwill to its implied fair value. Also, we periodically evaluate the net realizable values of our other long-lived assets. To the extent these reviews conclude that the expected future cash flows generated from our business activities are not sufficient to recover the cost of our other long-lived assets, we will be required to measure and record an impairment charge to write down these assets to their net realizable values. We will conduct our annual goodwill assessment in the fourth quarter. We cannot assure you that upon completion of this and subsequent reviews, a material impairment charge will not be recorded. If this and future periodic reviews determine that our assets are impaired and a write down is required, it will adversely impact or delay our profitability.

Our outsourcing relationships may require us to purchase inventory when demand for products produced by third-party manufacturers is low.

Under a few of our outsourcing arrangements, our manufacturing outsourcers purchase agreed-upon inventory levels to meet our forecasted demand. Since we typically operate without a significant backlog of orders for our products, our manufacturing plans and inventory levels are principally based on sales forecasts. If demand proves to be less than we originally forecasted, these manufacturing outsourcers have the right to require us to purchase any excess or obsolete inventory. Should we be required to purchase inventory under these provisions, we may have to hold inventory that we may never utilize.

To date, we have not been required to purchase any fixed amount of excess inventory under our outsourcing arrangements, and we have no existing obligation to purchase any such fixed amount of excess inventory. We are in the process of revising our sales forecasting techniques with our outsourcers, providing short-term forecasts (usually less than three months) rather than long-term forecasts, which should mitigate the risk that we will significantly overestimate our inventory needs from these outsourcers.

We may be unable to obtain broad intellectual property protection for our current and future products and we may become involved in intellectual property disputes.

We rely on a combination of patent, copyright and trademark laws, trade secrets, confidentiality procedures and contractual provisions to protect our proprietary technologies. We believe that the technological and creative skill of our employees, new product developments, frequent product enhancements, name recognition and reliable product maintenance are the foundations of our competitive advantage. Although we have a considerable portfolio of patents, copyrights and trademarks, these property rights offer us only limited protection. Our competitors may attempt to copy aspects of our products despite our efforts to protect our proprietary rights, or may design around the proprietary features of our products. Policing unauthorized use of our proprietary rights is difficult, and we are unable to determine the extent to which such use occurs. Our difficulties are compounded in certain foreign countries where the laws do not offer as much protection for proprietary rights as the laws of the United States.

Third parties inquire and claim from time to time that we have infringed upon their intellectual property rights. Any such claims, with or without merit, could be time consuming, result in costly litigation, result in injunctions, require product modifications, cause product shipment delays or require us to enter into royalty or licensing arrangements. Such claims could have a material adverse affect on our results of operations and financial condition.

We are not currently aware of any parties that intend to pursue intellectual property claims against us.

Significant payment defaults under extended financing arrangements could adversely affect us.

We often sell to customers on payment terms other than cash on delivery. We allow many of our customers to finance substantial purchases of our products through the issuance to us of promissory notes. The terms of these promissory notes initially range from eight months to five years. As of December 31, 2003, we had outstanding accounts receivable of approximately $34.3 million and notes receivable of approximately $20.8 million. Significant payment defaults by customers could have a material adverse effect on our results of operations and financial condition.

Approximately $9.7 million of our total notes receivable at December 31, 2003 related to one Russian customer. During 2003, this customer became delinquent on approximately $0.8 million of its scheduled principal and interest payments, in addition to becoming delinquent on $1.8 million of its trade receivables. In January 2004, we refinanced the delinquent portion of its notes and accounts receivable into a new note totaling $2.6 million, with payments due in equal installments over a twelve month period. The customer is expected to pay all of its obligations in full.

With respect to customer defaults, our levels of expense for loan loss in recent years have been as follows:

Period Ended	**Expense for Loan Loss (in thousands)**
Year ended May 31, 2000	$7,057
Seven months ended December 31, 2000	$1,305
Year ended December 31, 2001	$1,577
Year ended December 31, 2002	$ 158
Year ended December 31, 2003	

Our operations, and the operations of our customers, are subject to numerous government regulations, which could adversely limit our operating flexibility.

Our operations are subject to laws, regulations, government policies and product certification requirements worldwide. Changes in such laws, regulations, policies or requirements could affect the demand for our products or result in the need to modify products, which may involve substantial costs or delays in sales and could have an adverse effect on our future operating results. Our export activities are also subject to extensive and evolving trade regulations. Certain countries are subject to restrictions, sanctions and embargoes imposed

34

by the United States government. These restrictions, sanctions and embargoes also prohibit or limit us from participating in certain business activities in those countries. Our operations are subject to numerous local, state and federal laws and regulations in the United States and in foreign jurisdictions concerning the containment and disposal of hazardous materials, the remediation of contaminated properties and the protection of the environment. These laws have been changed frequently in the past, and there can be no assurance that future changes will not have a material adverse effect on us. In addition, our customers operations are also significantly impacted by laws and regulations concerning the protection of the environment and endangered species. Consequently, changes in governmental regulations applicable to our customers may reduce demand for our products. For instance, regulations regarding the protection of marine mammals in the Gulf of Mexico may reduce demand for our airguns and other marine products. To the extent that our customer s operations are disrupted by future laws and regulations, our business and results of operations may be materially and adversely affected.

Disruption in vendor supplies will adversely affect our results of operations.

Our manufacturing processes require a high volume of quality components. Certain components used by us are currently provided by only one supplier. We may, from time to time, experience supply or quality control problems with suppliers, and these problems could significantly affect our ability to meet production and sales commitments. Reliance on certain suppliers, as well as industry supply conditions, generally involve several risks, including the possibility of a shortage or a lack of availability of key components and increases in component costs and reduced control over delivery schedules; any of these could adversely affect our future results of operations.

Our stock price may fluctuate, and your investment in our stock could decline in value.

The average daily trading volume of our common stock for the twelve months ending December 31, 2003, was approximately 198,000 shares. The trading volume of our stock may contribute to its volatility, and an active trading market in our stock might not continue.

If substantial amounts of our common stock were to be sold in the public market, the market price of our common stock could fall. Some of the other factors that can affect our stock price are:

- future demand for seismic equipment and services;

- the announcement of new products, services or technological innovations by us or our competitors;

- the adequacy of our liquidity and capital resources;

- consolidation among our significant customers;

- continued variability in our revenues or earnings;

- changes in quarterly revenue or earnings estimates for us made by the investment community; and

- speculation in the press or investment community about our strategic position, financial condition, results of operations, business or significant transactions.

The market price of our common stock may also fluctuate significantly in response to factors that are beyond our control. The stock market in general has recently experienced extreme price and volume fluctuations. In addition, the market prices of securities of technology companies have also been extremely volatile, and have experienced fluctuations that often have been unrelated or disproportionate to the operating performance of these companies. These broad market fluctuations could result in extreme fluctuations in the price of our common stock, which could cause a decline in the value of our investors stock.

Our certificate of incorporation, our bylaws, Delaware law and our stockholder rights plan contain provisions that could discourage another company from acquiring us.

Provisions of Delaware law, our certificate of incorporation, bylaws and stockholder rights plan may discourage, delay or prevent a merger or acquisition that stockholders may consider favorable, including transactions in which you might otherwise receive a premium for shares of our common stock. These provisions include:

- authorizing the issuance of blank check preferred stock without any need for action by stockholders;
- providing for a dividend on our common stock, commonly referred to as a poison pill , which can be triggered after a person or group acquires, obtains the right to acquire, or commences a tender or exchange offer to acquire, 20% or more of our outstanding common stock;
- providing for a classified board of directors with staggered terms;
- requiring supermajority stockholder voting to effect certain amendments to our certificate of incorporation and by-laws;
- eliminating the ability of stockholders to call special meetings of stockholders;
- prohibiting stockholder action by written consent; and
- establishing advance notice requirements for nominations for election to the board of directors or for proposing matters that can be acted on by stockholders at stockholder meetings.

The loss of certain members of our senior management team (many of whom have only recently joined our company) could have a material adverse effect on our financial condition and results of operations.

Our success depends, in part, on the efforts of our senior management and other key employees. These individuals possess sales, marketing, technical, engineering, manufacturing and processing skills that are critical to executing our business strategy. If we lose or suffer an extended interruption in the services of one or more of our senior officers, our financial condition and results of operations may be adversely affected. Moreover, the market for qualified individuals may be highly competitive, and we may not be able to attract and retain qualified personnel to replace or succeed members of our senior management or other key employees, should the need arise.

While many members of our current senior management team have significant experience working at various large corporations, with some of them working together at those corporations, our senior management has had limited experience working together at our company and implementing our current business strategy. In April 2003, Robert P. Peebler became our chief executive officer after serving as a member of our Board of Directors since 1999. To help lead the implementation of our seismic imaging-based strategy, Mr. Peebler has recruited several new senior executives to augment our management team, including Jorge Machnizh, Executive Vice President and Chief Operating Officer, J. Michael Kirksey, Executive Vice President and Chief Financial Officer, Chris Friedemann, Vice President Commercial Development, and Jim Hollis, Vice President Land Imaging Systems.

Our significant debt obligations could limit our flexibility in managing our business and expose us to certain risks.

As a result of the offering of the notes, we now have an increased level of indebtedness outstanding. As of December 31, 2003, we had $81.2 million of indebtedness outstanding (including our lease obligations under our facilities sale-leaseback arrangements). As a result, our interest expense is expected to increase for 2004 and in the foreseeable future. Our ability to make scheduled payments of principal or interest on, or to refinance, our indebtedness depends on our future business performance, which is subject to many economic, financial, competitive and other factors beyond our control. We do not have a working capital or other senior credit facility in place to finance our working capital needs. Our degree of leverage may have important consequences to you, including the following:

- we may have difficulty satisfying our obligations under the notes or other indebtedness and, if we fail to comply with these requirements, an event of default could result;

we may be required to dedicate a substantial portion of our cash flow from operations to required payments on indebtedness, thereby reducing the availability of cash flow for working capital, capital expenditures and other general corporate activities;

covenants relating to future debt may limit our ability to obtain additional financing for working capital, capital expenditures and other general corporate activities;

covenants relating to future debt may limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;

we may be more vulnerable to the impact of economic downturns and adverse developments in our business; and

we may be placed at a competitive disadvantage against any less leveraged competitors.

The occurrence of any one of these events could have a material adverse effect on our business, financial condition, results of operations, prospects and ability to satisfy our obligations under the notes.

We may not be able to generate sufficient cash flows to meet our operational, growth and debt service needs.

Our cash and cash equivalents declined from $76.2 million at December 31, 2002 to $59.5 million at December 31, 2003, a decrease of $16.7 million, or 22%. Our ability to fund our operations, grow our business and to make scheduled payments on our indebtedness and our other obligations, including the notes, will depend on our financial and operating performance, which in turn will be affected by general economic conditions in the energy industry and by many financial, competitive, regulatory and other factors beyond our control. We cannot assure you that our business will generate sufficient cash flow from operations or that future sources of capital will be available to us in an amount sufficient to enable us to service our indebtedness, including the notes, or to fund our other liquidity needs.

If we are unable to generate sufficient cash flows to fund our operations, grow our business and satisfy our debt obligations, we may have to undertake additional or alternative financing plans, such as refinancing or restructuring our debt, selling assets, reducing or delaying capital investments or seeking to raise additional capital. We cannot assure you that any refinancing would be possible, that any assets could be sold, or, if sold, of the timing of the sales and the amount of proceeds that may be realized from those sales, or that additional financing could be obtained on acceptable terms, if at all. Our inability to generate sufficient cash flows to satisfy debt obligations, or to refinance our indebtedness on commercially reasonable terms, would materially and adversely affect our financial condition and results of operations and our ability to satisfy our obligations under the notes.

Sales (or the expectation of sales) of shares of our common stock under our registration rights agreements may cause the market price of our common stock to decline.

Approximately 7,474,000 of our shares of common stock are subject to registration rights, which include the right to require us to register the sale of their shares or the right to include their shares in secondary public offerings we undertake in the future. These holders include Laitram L.L.C., which beneficially owns approximately 10.9% of our common stock subject to piggyback registration rights. We also may enter into additional registration rights agreements in the future in connection with any subsequent acquisitions we may undertake. Any sales of our common stock under these registration rights arrangements with these stockholders could be negatively perceived in the trading markets and negatively affect the price of our common stock. Sales of a substantial number of our shares of common stock in the public market under these arrangements, or the expectation of such sales, could cause the market price of our common stock to decline.

NOTE: The foregoing factors pursuant to the Private Securities Litigation Reform Act of 1995 should not be construed as exhaustive. In addition to the foregoing, we wish to refer readers to other factors discussed elsewhere in this report as well as other filings and reports with the SEC for a further discussion of risks and uncertainties which could cause actual results to differ materially from those contained in forward-

looking statements. We undertake no obligation to publicly release the result of any revisions to any such forward-looking statements, which may be made to reflect the events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

Part III

Item 10. ***Directors and Executive Officers of the Registrant***
Directors and Executive Officers

Our current executive officers are as follows:

Name	Age	Position with I/O
James L. Lapeyre, Jr.	51	Chairman of the Board of Directors
Robert P. Peebler	56	President, Chief Executive Officer and Director
Bruce S. Applebaum, Ph.D.	56	Director
Theodore H. Elliott, Jr.	68	Director
Franklin Myers	51	Director
John N. Seitz	52	Director
Sam K. Smith	72	Director
Jorge Machnizh	47	Executive Vice President and Chief Operating Officer
J. Michael Kirksey	48	Executive Vice President and Chief Financial Officer
Bjarte Fageraas	44	Vice President Marine Imaging Systems
Christopher M. Friedemann	39	Vice President Commercial Development
James R. Hollis	42	Vice President Land Imaging Systems
Laura D. Guthrie	45	Vice President Human Resources
Michael L. Morrison	33	Controller and Director of Accounting

James M. Lapeyre, Jr. has been Chairman of our Board of Directors since 1999 and a Director since 1998. Mr. Lapeyre has been President of Laitram L.L.C., a privately held New Orleans-based manufacturer of food processing equipment and modular conveyor belts, and its predecessors since 1989. Mr. Lapeyre joined our Board of Directors when we bought the DigiCourse marine positioning products business from Laitram. Mr. Lapeyre is Chairman of the Governance Committee and a member of the Compensation Committee of our Board of Directors.

Robert P. Peebler has been our President and Chief Executive Officer since April 2003 and a member of our Board of Directors since 1999. Prior to joining I/ O on a full-time basis, Mr. Peebler was the founder, President and Chief Executive Officer of Energy Virtual Partners, an asset development and management company for oil and gas properties. Prior to founding Energy Virtual Partners in April 2001, Mr. Peebler was Vice President of e-Business Strategy and Ventures of the Halliburton Company, a leading provider of products and services to the petroleum and energy industries. Mr. Peebler joined Halliburton in 1996 when Halliburton acquired Landmark Graphics Corporation, the leading provider of workstation-based software for oil and gas exploration and production, where he served as CEO since 1992. Mr. Peebler began his career with Schlumberger, a global oilfield and information services company, in wireline operations, and spent 17 years with Schlumberger in various positions, including head of U.S. wireline operations and executive in charge of strategic marketing for the corporate energy services group.

Bruce S. Applebaum, Ph.D. joined our Board of Directors in 2003. He is currently the Chairman of Mosaic Natural Resources Ltd., a newly formed oil and gas exploration and production company focusing on opportunities in the North Sea. Prior to co-founding Mosaic, Dr. Applebaum was President of Worldwide Exploration and New Ventures for Texaco, Inc. and a Vice President of Texaco. Dr. Applebaum joined Texaco in 1990 as Division Manager of Texaco U.S.A. s offshore exploration division and was elected an officer of Texaco in 2000. Dr. Applebaum is a Trustee of the American Geological Institute Foundation and serves on the Advisory Board to the Department of Oceanography at Texas A&M University. He previously served on the Advisory Board of the School of Earth Sciences at Stanford University. Dr. Applebaum is a member of the Audit Committee of our Board of Directors.

Theodore H. Elliott, Jr. joined our Board of Directors in 1987. He has been Chairman of Prime Capital Management Co., Inc., a Darien, Connecticut-based venture capital company since 1987. Prior to joining Prime Capital Management, Mr. Elliott was Vice President of General Electric s venture capital subsidiary and head of investment banking at Clark, Dodge & Co. Inc. He is a Director of Casio Gavazzi Holding AG, a Swiss-based producer of automation components and computer sub-systems that is listed on the Zurich Stock Exchange and National Interstate, a specialty property and casualty insurance company based in Ohio. Mr. Elliott is Chairman of the Audit Committee of our Board of Directors.

Franklin Myers joined our Board of Directors in 2001. He is currently the Senior Vice President and Chief Financial Officer of Cooper Cameron Corporation, a leading international manufacturer of oil and gas pressure control equipment. Mr. Myers has been Senior Vice President at Cooper Cameron since 1995 and served as General Counsel and Corporate Secretary from 1995 to 1999, as well as President of the Cooper Energy Services Division from 1998 until 2002. Prior to joining Cooper Cameron, Mr. Myers was Senior Vice President and General Counsel of Baker Hughes Incorporated, a leading oilfield services and equipment provider, and an attorney and partner with the law firm Fulbright & Jaworski L.L.P. in Houston, Texas. Mr. Myers is Chairman of the Compensation Committee and a member of the Governance Committee of our Board of Directors.

John N. Seitz joined our Board of Directors in 2003. He is the co-CEO and founder of North Sea New Ventures, a company focused on exploration and development opportunities in the North Sea. From 1977 to 2003, Mr. Seitz held positions of increasing responsibility at Anadarko Petroleum Company, serving most recently as a Director and as President and Chief Executive Officer. Mr. Seitz is a member of the Audit, Compensation and Governance Committees of our Board of Directors.

Sam K. Smith joined our Board of Directors in 1999. He also served as our Chief Executive Officer from 1999 until 2000. From 1989 to 1996, Mr. Smith was Chairman of the Board of Landmark Graphics Corporation. Prior to that time, Mr. Smith was a special limited partner at Sevin-Rosen Management, a Texas-based venture capital firm that has backed high technology firms, including Compaq, Lotus Development, and Silicon Graphics. Mr. Smith began his career at Texas Instruments where he held positions of increasing responsibility, such as Group Vice President for the Equipment Group, Texas Instruments defense business.

Jorge Machnizh has been our Executive Vice President and Chief Operating Officer since May 2003. Previously, he was employed by Landmark Graphics Corporation, where he worked in a variety of positions, most recently serving as Vice President Operations for North and South America. Prior to joining Landmark in 1997, Mr. Machnizh held senior management appointments with large geophysical contractors, including Geco-Prakla (a division of Schlumberger) and Petty-Ray Geophysical (a division of Geosource, Inc.). Mr. Machnizh started his career as a crew chief for United Geophysical.

J. Michael Kirksey has been our Executive Vice President and Chief Financial officer since January 2004. Before then, Mr. Kirksey had been the Chief Financial Officer, and then the Chief Executive Officer, of Metals USA, a leading metals processor and distributor based in Houston, Texas. Following the departure of Metals USA s Chief Executive Officer, he was appointed CEO by the Metals USA board of directors and charged with restructuring the company s operations and finances, and leading the company through an industry recession. Mr. Kirksey led the company through bankruptcy reorganization and succeeded in obtaining confirmation of a plan of reorganization in eleven months. Prior to joining Metals USA in 1997, Mr. Kirksey was Senior Vice President of Corporate Strategic Planning and the Chief Financial Officer Europe for Keystone International Inc., a manufacturer of industrial valves and systems. Before joining Keystone, Mr. Kirksey worked for Arthur Andersen for thirteen years where he focused on growth strategies and technology companies.

Bjarte Fageraas was Vice President and our Chief Technology Officer from May 2001 to February 2004. In February 2004, he was appointed Vice President Marine Imaging Systems. Prior to joining I/O, Mr. Fageraas was President of and a stockholder in Geophysical Instruments AS, a Norwegian seismic technology company that we acquired in May 2001. From 1998 to 1999, Mr. Fageraas was Vice President-Research & Development of Aker Geo ASA, a Norwegian seismic contractor. Previously, Mr. Fageraas was Technical Manager of PGS Reservoir, a provider of seismic contracting services. Mr. Fageraas started his career at Geco-Prakla where he held several research and development positions.

Christopher M. Friedemann has been our Vice President Commercial Development since August 2003. Mr. Friedemann s accountabilities encompass corporate marketing, strategic planning and corporate development. Before joining I/O, Mr. Friedemann served as the Managing Director of RiverBend Associates, a privately held management consulting firm based in Texas. Prior to founding RiverBend in January 2002, he served as President of Tradeum, a venture-backed software company that was sold to VerticalNet in April 2000 at which time Mr. Friedemann assumed the role of managing Director-Europe. Before joining Tradeum in January 2000, Mr. Friedemann was Principal and Partner at the management consulting firm McKinsey & Company. Mr. Friedemann also has experience as a Senior Reservoir Engineer with Exxon, in field operations with Unocal and in energy merchant banking with Bankers Trust.

James R. Hollis has been Vice President Land Imaging Systems since November 2003, and Business Unit Manager Land Surface Systems since July 2003. Prior to joining I/O, Mr. Hollis served in various positions at Landmark Graphics, most recently as General Manager Exploration and Development Solutions. Mr. Hollis joined Landmark Graphics when Landmark acquired Western Atlas Software in 1996. Mr. Hollis managed the Seismic Modeling Software Product line for Western Atlas. Mr. Hollis joined Western Atlas in 1993 when Western Atlas acquired Sierra Geophysics in 1993, where Mr. Hollis led the depth imaging and velocity modeling support and consulting services.

Laura D. Guthrie has been our Vice President Human Resources since March 2002. Prior to joining I/O, Ms. Guthrie had been an independent management consultant specializing in executive coaching and compensation and organization development. From July 1999 until March 2000, Ms. Guthrie served as Vice President Human Resources for Splitrock Services, Inc., a broadband communications company, until the company was sold to McCleod USA. Before joining Splitrock in July 1999, Ms. Guthrie was a management consultant with Sterling Consulting Group, a boutique firm specializing in strategy development for the oil and gas industry. Prior to joining Sterling in 1998, she was the HR Planning Manager for Unocal Corporation. Before joining Unocal in 1996, Ms. Guthrie served as the Region HR Manager for the Americas Division of BHP Petroleum, an Australian oil and gas company, where she held a variety of HR roles during her 11 year tenure.

Michael L. Morrison has been our Controller and Director of Accounting since November 2002, and our Assistant Controller from June 2002. Prior to joining I/O, Mr. Morrison held several positions at Enron Corp., an energy trading and pipeline company, most recently as Director of Transaction Support. Mr. Morrison had held a variety of positions at Deloitte & Touche, LLP, a public accounting firm, from January 1994 until he joined Enron in June 2000.

Audit Committee

The Board of Directors has established an Audit Committee, which is composed entirely of non-employee directors. The Audit Committee is appointed by the Board to assist the Board in monitoring (i) the integrity of I/O s consolidated financial statements, (ii) our compliance with legal and regulatory requirements, (iii) the independence and performance of our external auditors and (iv) the performance of the company s internal audit function. In addition, the Audit Committee has the sole authority and responsibility to select, evaluate and, if necessary, replace our independent auditors. The current members of the Audit Committee are Theodore H. Elliott, Jr. (Chairman), John N. Seitz, and Bruce S. Applebaum, Ph.D. The Board of Directors has adopted the Charter of the Audit Committee, which is available at *http://www.i-o.com*. During the year, in accordance with section 407 of the Sarbanes-Oxley Act of 2002, I/O identified Mr. Elliott as the Audit Committee Financial Expert. Mr. Elliott satisfies the definition of independent in accordance with the NYSE corporate governance listing standards.

Section 16(a) Beneficial Ownership Reporting Compliance

Executive officers, directors and certain persons who own more than ten percent of our common stock are required by Section 16(a) of the Securities Exchange Act of 1934 and related regulations

to file reports of their ownership of common stock with the Securities and Exchange Commission (SEC) and The New York Stock Exchange (NYSE), and

to furnish us with copies of the reports.

We received written representations from each such person who did not file an annual report with the SEC on Form 5 that no Form 5 was due. Based on our review of the reports and representations, we believe that all required Section 16(a) reports were timely filed in 2003, except for (i) Mr. Morrison failed to timely report one option grant; (ii) Ms. Guthrie failed to timely report one option grant; (iii) Mr. Fageraas failed to timely report one option grant; (iv) Mr. Denver failed to timely report one option grant; (v) Mr. Eastman failed to timely report one option grant; (vi) Mr. Machnizh failed to timely file a Form 3; (vii) Mr. Elliott failed to timely report two purchases of stock; (viii) Mr. Bunch failed on two occasions to timely file a report of forfeited restricted stock or restricted stock withheld to satisfy tax obligations; and (ix) Mr. Peebler failed to timely report one option grant.

Code of Ethics

We have adopted a Code of Ethics applicable to all employees and directors of I/O, including our Chief Executive Officer, our Chief Financial Officer and our Controller. We designed our Code of Ethics (i) to deter wrongdoing; (ii) to promote honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships; (iii) to promote full, fair, accurate, timely, and understandable disclosure in reports and documents that we file with the SEC or otherwise communicate with the public; (iv) to promote compliance with applicable governmental laws, rules and regulations; (v) to promote prompt internal reporting of violations of the code to an appropriate person; and (vi) to promote accountability for adherence to the code. Our Code of Ethics is available on our website at *www.i-o.com*.

Item 11. ***Executive Compensation***
General

The following tables and narrative text discuss the compensation paid in fiscal years ended December 31, 2003, 2002 and 2001, to our Chief Executive Officers in 2003, our four other most highly compensated executive officers at December 31, 2003, and certain of our former executive officers.

Summary Compensation Table

		Annual Compensation		Long-Term Compensation Awards		
Name and Principal Position	**Year**	**Salary ($)**	**Bonus ($)**	**Restricted Stock Award(s) ($)**	**Shares Underlying Options/SARs (#)**	**All Other Compensation* ($)**
Robert P. Peebler	2003	$292,308	$	$	1,325,000	$ 8,008(2)
Chief Executive Officer and	2002				10,000	25,000
Director(1)	2001				10,000	19,240
Timothy J. Probert(3)	2003	26,923				143,204(4)
Former President and	2002	350,000			50,000	5,250
Chief Executive Officer	2001	343,269	498,750(5)		60,000	7,282
C. Robert Bunch	2003	315,048		250,001(7)		171,839(8)
Former President and	2002	225,000	40,000		35,000	12,462
Chief Operating Officer(6)	2001	220,673	215,719		35,000	6,740
Jorge Machnizh	2003	163,077	60,000	95,250(10)	200,000	265
Executive Vice President and						
Chief Operating Officer(9)						
Brad Eastman	2003	160,000		120,001(12)	25,000	6,307
Former Vice President and	2002	145,000	20,000		12,500	5,443
Chief Administrative	2001	67,308			20,000	267
Officer(11)			20,000			
Bjarte Fageraas	2003	170,000		127,498(14)	25,000	5,643
Vice President Marine	2002	155,400	30,000(15)		25,000	4,662
Imaging Systems(13)	2001	107,656(5)	61,124(16)		30,000	3,751
Laura Guthrie	2003	135,000		101,250(18)	12,500	4,455
Vice President Human	2002	82,500	30,000		12,500	2,645
Resources(17)						
Larry Denver	2003	96,154		150,000(20)	25,000	126,268(21)
Former Vice President	2002	180,000	30,000		25,000	5,400
Business Development(19)	2001	131,538	94,500	121,155(22)	15,000	1,690

* Except as otherwise noted in the footnotes that follow, All Other Compensation consists of employer matching contributions to the 401(k) plan and the non-qualified deferred compensation plan and premiums paid for our Executive Salary Continuance and Executive Long Term Disability Plan.

(1) Mr. Peebler became our Chief Executive Officer in April 2003. Prior to that time, he served as a director on our Board of Directors.

(2) The All Other Compensation amounts for Mr. Peebler include $4,000 in directors fees paid to Mr. Peebler in 2003, $25,000 in 2002, and $19,240 in 2001. In 2002, Mr. Peebler received 1,630 shares of common stock as directors fees in lieu of $15,000 in cash, and in 2001, Mr. Peebler received 710 shares of common stock as directors fees in lieu of $8,450 in cash. In addition, the All Other Compensation

amount for 2003 includes $1,020 paid to Mr. Peebler under our program which rewards individuals who are named as inventors on patents owned by us.

(3) Mr. Probert resigned from I/ O in January 2003.

(4) The other compensation amount for Mr. Probert includes $110,000 in additional compensation and $32,752 for accrued vacation time paid to Mr. Probert upon his resignation from I/ O.

(5) The bonus amount for Mr. Probert included $349,950 in cash and 18,600 shares of restricted stock. We use the closing price of our common stock on the date of the restricted stock grant for valuation purposes. This award was granted on February 14, 2002, under our 1998 Restricted Stock Plan, resulting in a grant value of $8.00 per share. In connection with Mr. Probert s resignation, all 18,600 shares of restricted stock were cancelled in January 2003.

(6) Mr. Bunch resigned from I/ O in May 2003.

(7) The restricted stock award was granted under our 2000 Restricted Stock Plan on February 4, 2003, resulting in a grant value of $3.94 per share for 63,452 shares of common stock. This award was to vest in 50% installments each year beginning on the first anniversary of the date of grant. While unvested, Mr. Bunch was entitled to the same voting and dividend rights as all other holders of common stock. We cancelled all of Mr. Bunch s shares of restricted stock upon termination of his employment with I/ O.

(8) The other compensation amount for Mr. Bunch includes severance of $145,833 paid in accordance with the terms of his employment agreement dated February 4, 2003 and $18,627 paid to Mr. Bunch for accrued vacation time upon his resignation from I/ O.

(9) Mr. Machnizh joined I/ O in May 2003.

(10) The restricted stock award was granted under our 2000 Restricted Stock Plan on May 6, 2003, resulting in a grant value of $3.81 per share for 25,000 shares of restricted common stock. This award vests 10,000 shares on the first anniversary of the date of grant and then 5,000 shares on each of the next three anniversaries of the date of grant. While unvested, Mr. Machnizh is entitled to the same voting and dividend rights as all other holders of common stock.

(11) Mr. Eastman joined I/ O in June 2001 and resigned from I/ O in February 2004.

(12) The restricted stock award was granted under our 2000 Restricted Stock Plan on February 4, 2003, resulting in a grant value of $3.94 per share for 30,457 shares of common stock. One-half of this award was to vest on the first anniversary of the date of grant and the rest was to vest on the second anniversary of the date of grant. While unvested, Mr. Eastman was entitled to the same voting and dividend rights as all other holders of common stock. We cancelled all of Mr. Eastman s shares of restricted stock upon termination of his employment with I/ O.

(13) Mr. Fageraas joined I/ O in May 2001.

(14) The restricted stock award was granted under our 1998 Restricted Stock Plan on February 4, 2003, resulting in a grant value of $3.94 per share for 32,360 shares of common stock. One half of this award vested on the first anniversary of the date of grant and the rest will vest on the second anniversary of the date of grant. For unvested shares, Mr. Fageraas is entitled to the same voting and dividend rights as all other holders of common stock.

(15) Mr. Fageraas did not receive any of his bonus for 2002. Mr. Fageraas bonus was retained by us under arrangements with Mr. Fageraas that we made when he joined I/ O. In connection with the acquisition of the outstanding shares of capital stock of his company, Geophysical Instruments AS, we agreed with Mr. Fageraas that in exchange for the cash consideration for his shares, $50,000 per year for the first three years of his employment would be deducted from bonuses otherwise payable to him. If his bonus in any of these three years was less than $50,000, then the balance would be carried forward and set off against any bonus otherwise payable in the next year. If Mr. Fageraas voluntarily terminates his employment with I/O prior to recapture of any portion of $150,000, then he must repay us such unpaid amount.

(16) Mr. Fageraas received only $11,124 of his bonus for 2001. The remaining $50,000 was retained by us pursuant to arrangements with Mr. Fageraas that were made when he joined I/ O. See Note 15 above.

(17) Ms. Guthrie joined I/ O in March 2002.

(18) The restricted stock award was granted under our 2000 Restricted Stock Plan on February 4, 2003, resulting in a grant value of $3.94 per share for 25,698 shares of common stock. One half of this award vested on the first anniversary of the date of grant and the rest will vest on the second anniversary of the

date of grant. For unvested shares, Ms. Guthrie is entitled to the same voting and dividend rights as all other holders of common stock.

(19) Mr. Denver joined I/O in April 2001 and resigned from I/O in May 2003.

(20) The restricted stock award was granted under our 1998 Restricted Stock Plan on February 4, 2003, resulting in a grant value of $3.94 per share for 38,071 shares of common stock. This award was to vest in 50% installments each year beginning on the first anniversary of the date of grant. While unvested, Mr. Denver was entitled to the same voting and dividend rights as all other holders of common stock. We cancelled all of Mr. Denver s shares of restricted stock upon termination of his employment with I/O.

(21) The 2003 All Other Compensation amount for Mr. Denver includes severance of $107,692 paid in accordance with the terms of his employment agreement dated February 4, 2003 and $15,585 paid to Mr. Denver for accrued vacation time upon his resignation from I/O.

(22) Includes 9,850 shares granted to Mr. Denver under our 2000 Restricted Stock Plan. These shares were to vest one-third per year beginning three years after the date of grant. While unvested, Mr. Denver was entitled to the same voting and dividend rights as all other holders of common stock. The restricted shares were valued at $12.30 per share, the closing price on June 7, 2001, which was the date the shares were granted to Mr. Denver.

Option Grants in Last Fiscal Year

	Individual Grants				**Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term***	
Name	**Number of Securities Underlying Option/SARs Granted (#)(1)**	**Percentage of Total Options/SARs Granted to Employees in Fiscal Year(2)**	**Exercise of Base Price ($/Sh)**	**Expiration Date**	**5% ($)**	**10% ($)**
Robert P. Peebler	1,325,000	57.22%	$6.00	03/31/13	$ 0	$4,442,152
Timothy J. Probert						
C. Robert Bunch						
Jorge Machnizh	200,000	8.64%	3.30	05/06/13	415,070	1,051,870
Brad Eastman	25,000	1.08%	3.35	04/21/13	52,670	133,476
Bjarte Fageraas	25,000	1.08%	3.35	04/21/13	52,670	133,476
Laura Guthrie	12,500	0.54%	3.35	04/21/13	26,335	66,738
Larry Denver	25,000	1.08%	3.35	04/21/13	52,670	133,476

* The dollar gains under these columns result from using calculations assuming 5% and 10% growth rates set forth under SEC rules, and are not intended to forecast future price appreciation of our Common Stock. The gains reflect a future value based upon growth at these prescribed rates. We did not use an alternative formula for a grant date valuation, an approach which would state gains at present, and therefore lower, value. Options have value to recipients, including the listed executives, only if the stock price advances beyond the grant price shown in the table during the effective option period.

(1) These awards were made under our 2003 Stock Option Plan and our 2000 Long Term Incentive Plan. The options granted to Mr. Peebler under our 2003 Stock Option Plan are exercisable at an exercise price of $6.00 per share. On March 31, 2003, the date of grant, the closing sales price per share of our common stock on the NYSE was $3.60. The options vest as to one-quarter of the shares on the first anniversary of the date of grant. After that, they vest monthly in 1/36th increments until the options are fully vested on the fourth anniversary of the date of grant. If Mr. Peebler s employment is terminated by I/ O without cause, or is terminated by reason of his death or disability or he resigns for good reason then his options will vest monthly in 1/48th increments over a four year period beginning on the date of grant. His options will automatically accelerate and be fully vested upon a change of control. Upon his termination, he will

have a period of one year after termination to exercise his vested options, unless the 10-year term of his options first expires.

The other options listed in this column were granted under the 2000 Long Term Incentive Plan at an exercise price equal to the fair market value per share of our common stock on the date of grant. The fair market value of a share of our common stock is defined in the Long Term Incentive Plan as the closing sales price on the immediately preceding business day of a share of common stock as reported on the NYSE. The options vest in 25% increments on the first, second, third and fourth anniversaries of the grant date. The Long Term Incentive Plan contains provisions regarding the impact of a change of control, death, disability, retirement and termination of employment on the exercisability of options, with change of control and retirement (subject to certain exceptions) causing acceleration of vesting.

(2) Based on an aggregate of 2,315,500 shares subject to options granted to our employees during the year ended December 31, 2003, including the listed executives.

Fiscal Year-End Option Values

	Number of Securities Underlying Unexercised Options/SARs at Fiscal Year-End (#)		Value of Unexercised In-the-Money Options/SARs at Fiscal Year-End ($)(1)	
Name*	**Exercisable**	**Unexercisable**	**Exercisable**	**Unexercisable**
Robert P. Peebler	50,000	1,325,000	$ 1,600	$
Timothy J. Probert				
C. Robert Bunch				
Jorge Machnizh		200,000		242,000
Brad Eastman	13,125	44,375		29,000
Bjarte Fageraas	21,250	58,750		29,000
Laura Guthrie	3,125	21,875		14,500
Larry Denver				

* None of the officers listed in this table exercised options during the year ended December 31, 2003.

(1) Based on a value of $4.51 per share, the closing price per share on the NYSE on December 31, 2003.

Long-Term Incentive Plan Awards in Last Fiscal Year(1)

			Estimated Future Payouts Under Non-Stock Price-Based Plans(2)		
Name	**Number of Shares, Units or Other Rights (#)**	**Performance or Other Period Until Maturation or Payout**	**Threshold ($ or #)**	**Target ($ or #)**	**Maximum ($ or #)**
Robert P. Peebler					
Timothy J. Probert					
C. Robert Bunch	40,000	3 years		8,000	40,000
Jorge Machnizh					
Brad Eastman	15,000	3 years		3,000	15,000
Bjarte Fageraas	15,000	3 years		3,000	15,000
Laura Guthrie	8,000	3 years		1,600	8,000
Larry Denver	15,000	3 years		3,000	15,000

(1) These performance share awards were issued under our 2000 Long Term Incentive Plan. The Compensation Committee of our Board of Directors, which administers the plan, awards performance shares to certain of our executive officers. The Committee determines the total number of shares of our common stock available for each participant by comparing our performance against our internal plan and against

our industry peers. Actual awards are determined after the end of the three-year period and range from 0% to 100% of the performance shares awarded. No awards are earned until performance is certified by the Compensation Committee at the end of the three-year period. The plan is based on total stockholder return over the three-year period, with no payment if total stockholder return is less than 20% on an annualized basis. Upon a change in control, all awards become fully vested and payable.

(2) At the target level of performance, participants receive 20% of the performance shares awarded. No shares are issued for performance below the target level. The maximum number of shares is earned if an over-achievement target is reached. The over-achievement target is total stockholder return of 25% on an annualized basis for the three-year period.

Director Compensation

Officers who are also directors do not receive any fee or remuneration for services as members of the Board of Directors. Outside directors are entitled to receive an annual retainer fee of $20,000, which each outside director may elect to receive either in cash or in shares of our common stock valued at their fair market value as of the date of their issuance. In addition, the Chairman of the Audit Committee is entitled to receive an annual retainer fee of $7,500, the Chairman of the Compensation Committee is entitled to receive an annual retainer fee of $5,000, and the Chairman of the Governance Committee is entitled to receive an annual retainer fee of $3,000. Each Committee Chairman may elect to receive the retainer for serving as Chairman in cash or shares of Common Stock. Outside directors also receive, in cash, $2,000 for each Board meeting and $2,000 for each committee meeting attended (unless the committee meeting is held in conjunction with a Board meeting, in which case the fee is $1,000) and $1,000 for each Board or committee meeting held via teleconference. Shares issued in lieu of cash directors fees are valued at the closing price per share on the NYSE on the date of issuance, which is the date of our annual stockholders meeting each year. Shares issued in lieu of cash fees were granted from our available treasury shares.

In 1992, we adopted a Directors Retirement Plan. We discontinued this plan in 1996. Mr. Elliott is the only director entitled to receive any benefits under the Directors Retirement Plan. This plan requires us to make a lump sum payment to Mr. Elliott following his retirement from the Board in an amount equal to the present value of $15,000, to be received for a period of ten years.

As a means to attract and recruit qualified new directors and to retain capable directors in a manner that promotes ownership of a proprietary interest in I/O, we adopted our Amended and Restated Non-Employee Director Stock Option Plan in 1996. In 1998, our stockholders approved an increase in the total number of shares available under the Director Stock Option Plan to 700,000 shares. As of April 15, 2004 there were 49,333 shares available for issuance under this plan.

Under the Director Stock Option Plan, each of our non-employee directors is granted an option to purchase 20,000 shares of common stock on the date that his or her service as a director commences. Additionally, each non-employee director receives options to purchase 10,000 shares of common stock on the first business day of each November following the initial grant. The initial 20,000 share grant vests in 33.33% installments on each of the first three anniversaries of the date of grant. The first 10,000 share grant vests in 50% installments on the first two anniversaries of the date of grant. The second 10,000 share grant is fully exercisable on the first anniversary of the date of grant. Any subsequent annual grants are each fully exercisable on their dates of grant. The Director Stock Option Plan also provides for discretionary grants of stock options to non-employee directors as determined from time to time by the Board. In May 2003, the Board awarded Mr. Myers an additional option to purchase 10,000 shares of common stock for his efforts in assisting the Board in identifying and hiring a new Chief Executive Officer.

Employment Agreements

Our employment agreement with Mr. Peebler dated March 31, 2003 provides that Mr. Peebler will serve as president and chief executive officer for a 5-year term, unless sooner terminated. Under the agreement, Mr. Peebler is entitled to an annual base salary of at least $400,000, and to participate in all of our employee benefit plans available to senior executives at a level commensurate with his position. In the event that

Mr. Peebler s employment is terminated by us without cause, or if he resigns for good reason (defined as a reduction in his status, pay or benefits; a demotion to a lesser position with I/O or reduction of his duties and responsibilities; or a change of his principal place of employment by more than 30 miles), then we are obligated to pay Mr. Peebler over a 3-year period a termination payment equal to three times his annual base salary. In addition, we granted Mr. Peebler an option to purchase 1,325,000 shares at $6.00 per share.

The employment agreement contains provisions relating to protection of our confidential information and intellectual property and restricts Mr. Peebler from soliciting our employees and customers or competing with us during the term of his employment and for a period of two years following termination. If he violates these covenants, we can suspend making his termination payment. In the event of a change of control, if Mr. Peebler remains with us or with our successor for a period of 18 months following the change of control, he can then voluntarily resign for any reason, or no reason at all, and be entitled to receive the termination payment referred to above. If any payment or benefit under his employment agreement is determined to be subject to the excise tax for excess parachute payments under U.S. federal income tax rules, we have agreed to pay to Mr. Peebler an additional amount to adjust for the incremental tax costs of those payments to Mr. Peebler. We also agreed to indemnify Mr. Peebler to the fullest extent permitted by our certificate of incorporation and bylaws, and to provide him coverage under our directors and officers liability insurance policies to the same extent as our other executives.

Our employment agreement with Jorge Machnizh was entered into on April 23, 2003. The agreement provides for Mr. Machnizh to serve as our Executive Vice President and Chief Operating Officer until May 12, 2006 and, thereafter, for additional successive terms of one year each, unless terminated by us or Mr. Machnizh at the end of the initial term or any additional term. Under the agreement, Mr. Machnizh is entitled to an annual base salary of at least $265,000 and is eligible to receive a bonus under the terms of our Incentive Compensation Plan. In addition, he was granted a guaranteed bonus for 2003 of $60,000. In connection with this agreement, Mr. Machnizh was granted an award of 25,000 shares of restricted stock and stock options to purchase 200,000 shares under our 2000 Long Term Incentive Plan. Under the agreement, Mr. Machnizh is entitled to participate in all of our employee benefit plans available to senior executives at a level commensurate with his position. In the event Mr. Machnizh s employment is terminated by us other than for cause or by Mr. Machnizh for good reason, then, so long as he executes a general release in favor of I/O, we are obligated to pay Mr. Machnizh in monthly installments over an 18-month period a sum equal to 1.5 times his base salary at the time of termination, as well as a pro rata portion of any annual incentive compensation for the year in which termination occurs, and to provide him continued participation in our health and welfare plans for a period of 18 months. The agreement restricts Mr. Machnizh from soliciting I/O s employees and customers or competing with I/ O for a period of 18 months following termination.

Our employment agreement with Mr. Fageraas provides for Mr. Fageraas to serve as our Vice President Chief Technology Officer for an initial term of two years and, thereafter, for additional successive terms of one year each unless terminated by us or Mr. Fageraas at the end of the initial term or any additional term. Under the agreement, Mr. Fageraas is entitled to an annual base salary of at least $170,000 and is eligible to receive a bonus based on objective criteria established by the Board. Mr. Fageraas is entitled to participate in all of our employee benefit plans available to senior executives at a level commensurate with his position. In the event Mr. Fageraas employment is terminated by us other than for cause or by Mr. Fageraas for good reason, then provided that he executes a general release in our favor, I/ O is obligated to pay Mr. Fageraas in monthly payments over a 12-month period a sum equal to his base salary as well as a pro rata portion of any annual bonus for the year in which such termination occurs and to offer him continued participation in our health and welfare plans for a period of 12 months. In addition, under such circumstances we would be required to reimburse Mr. Fageraas for certain excise taxes he may incur under the laws of Norway. The agreement restricts Mr. Fageraas from soliciting I/ O s employees and customers or competing with I/ O for a period of one year following termination. I/ O has also agreed pursuant to this agreement to indemnify Mr. Fageraas to the fullest extent permitted by I/ O s Certificate of Incorporation and Bylaws.

Our employment agreement with Ms. Guthrie provides for Ms. Guthrie to serve as our Vice President Human Resources for an initial term of two years and, thereafter, for additional successive terms of one year each unless terminated by us or Ms. Guthrie at the end of the initial term or any additional term. Under the agreement, Ms. Guthrie is entitled to an annual base salary of at least $135,000 and is eligible to receive a bonus based on objective criteria established by the Board. Ms. Guthrie is entitled to participate in all of our employee benefit plans available to senior executives at a level commensurate with her position. In the event Ms. Guthrie s employment is terminated by us other than for cause or by Ms. Guthrie for good reason, then provided that she executes a general release in favor of I/O, I/O is obligated to pay Ms. Guthrie in monthly payments over a year a sum equal to her base salary as well as a pro rata portion of any annual bonus for the year in which such termination occurs and to offer her continued participation in our health and welfare plans for a period of twelve months. The agreement restricts Ms. Guthrie from soliciting I/O s employees and customers or competing with I/O during the term of her employment and for a period of one year following termination. I/O has also agreed pursuant to this agreement to indemnify Ms. Guthrie to the fullest extent permitted by I/O s Certificate of Incorporation and Bylaws.

Compensation Committee Interlocks and Insider Participation

Prior to becoming our Chief Executive Officer in March 2003, Mr. Peebler served as a member of the Compensation Committee of our Board of Directors.

In April 2003, we invested $3.0 million in preferred securities of Energy Virtual Partners and its affiliated corporation (EVP) in exchange for 22% of the outstanding ownership interests and 12% of the outstanding voting interests of EVP. EVP had been formed in 2001 to provide asset management services to large oil and gas companies in order to enhance the value of their oil and gas properties. Mr. Peebler had founded EVP, and served as its president and chief executive officer until he joined us in March 2003. Mr. Peebler continued to serve as the chairman of EVP and held a 23% ownership interest in EVP. Under Mr. Peebler s employment agreement with us, Mr. Peebler was permitted to devote up to 20% of his time to EVP.

During the second quarter of 2003, EVP failed to close two anticipated asset management agreements. After that time, EVP management re-evaluated its business model and adequacy of capital. During August 2003, the board of directors of EVP voted to liquidate EVP, since it was unable to present a clear and feasible business strategy. For that reason, we wrote our investment in EVP down to its approximate liquidation value of $1.0 million, resulting in a charge against earnings for our second quarter of 2003 of $2.1 million. Since then, Mr. Peebler offered, and we agreed, that all proceeds that Mr. Peebler receives from the liquidation of EVP will be paid to us. In December 2003, we received liquidation payments of $731,796 from EVP and $137,821 from Mr. Peebler. In March 2004, we received final liquidation payments of $98,302 from EVP and $18,513 from Mr. Peebler. These amounts were included in our estimates of EVP s liquidation value.

Item 12. ***Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

Equity Compensation Plan Information

The following table provides information as of December 31, 2003 with respect to I/ O s common stock issuable under our equity compensation plans:

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights (a)	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights (b)	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column(a)) (c)
Equity compensation plans approved by security holders			
Amended and Restated 1990 Stock Option Plan	1,584,582	$10.71	
Amended and Restated 1991 Directors Stock Option Plan	75,000	$21.89	
Amended and Restated 1996 Non-Employee Director Stock Option Plan	624,000	$10.30	49,333
1998 Restricted Stock Plan			21,807
2000 Long-Term Incentive Plan	1,982,250	$ 7.06	127,025
Employee Stock Purchase Plan			609,402
2003 Stock Option Plan	1,500,000	$ 6.00	175,000
Subtotal	5,765,832		982,567
Equity compensation plans not approved by security holders			
Non-Employee Directors Retainer Plan			73,629
2000 Restricted Stock Plan			65,845
Subtotal			139,474
Total	5,765,832		1,122,041

2000 Restricted Stock Plan. During 2000, our Board approved the Input/ Output, Inc. 2000 Restricted Stock Plan. This plan grants our Compensation Committee the authority to make awards of restricted stock of up to 200,000 shares of our common stock in order to attract and retain key employees of I/ O and our subsidiaries. Awards may be made from authorized and unissued shares or treasury shares, but the plan provides that shares delivered under the initial grants under the plan must be made only from treasury shares or common stock repurchased by I/ O. As of December 31, 2003, there were 101,155 shares of restricted stock issued and outstanding under this plan.

Under the terms of this plan, I/ O enters into individual award agreements with participants designated by the Compensation Committee specifying the number of shares of common stock granted under the award, the price (if any) to be paid by the grantee for the restricted stock, the restriction period during which the award is subject to forfeiture, and any performance objectives specified by the Committee. Participants are not permitted to sell, transfer or pledge their restricted stock during their restriction period.

Upon termination of a participant s employment with us for any reason other than death, disability or retirement, all nonvested shares of restricted stock will be forfeited. In addition, in the event of a change in

49

control of the Company, all shares of restricted stock will become fully vested. Unless sooner terminated, the 2000 Restricted Stock Plan will expire on March 13, 2010.

Directors Retainer Plan. In 2001, our Board adopted arrangements whereby our non-employee directors can elect to receive their annual retainer for service as a director, and any retainer for serving as a committee chairman, in cash or in common stock. Any common stock issued pursuant to these arrangements is valued at the closing price of our common stock on the date before issuance. The Board has reserved 100,000 of our treasury shares for issuance under these arrangements. See Item 11. Executive Compensation Director Compensation.

Ownership of Equity Securities in I/O

Except as otherwise set forth below, the following table sets forth information as of April 15, 2004, with respect to the number of shares of common stock owned by (i) each person known by us to be a beneficial owner of more than 5% of our Common Stock, (ii) each of our Directors, (iii) each of our executive officers named in the Summary Compensation Table set forth in Item 11 Executive Compensation in this Form 10-K, and (iv) all of our Directors and executive officers as a group.

Name of Owner	Common Stock(1)	Rights to Acquire(2)	Restricted Stock(3)	Percent of Common Stock(4)
Laitram, L.L.C.(5)	6,941,044			13.1%
Royce & Associates, Inc.(6)	6,306,200			11.9%
Barclays Global Investors, N.A.(7)	4,394,707			8.3%
Morgan Stanley(8)	3,430,081			6.5%
PRIMECAP Management Company(9)	3,333,896			6.3%
Daruma Asset Management, Inc.(10)	3,237,200			6.1%
Dimensional Fund Advisors Inc.(11)	2,837,750			5.3%
Steinberg Priest & Sloane Capital Management, LLC(12)	2,800,100			5.3%
James M. Lapeyre, Jr.(13)	7,832,540	70,000		14.9%
Bruce S. Applebaum, Ph.D.	3,000			*
Theodore H. Elliott, Jr.(14)	11,000	167,000		*
Franklin Myers	12,874	60,000		*
Robert P. Peebler	35,340	454,861		*
John N. Seitz	5,000			*
Sam K. Smith	24,007	70,000		*
Timothy J. Probert				*
C. Robert Bunch				*
Jorge Machnizh		50,000	25,000	*
Brad Eastman	15,229	13,125		*
Bjarte Fageraas	14,168	41,250	16,180	*
Laura Guthrie	8,653	9,375	12,849	*
Larry Denver				*
All directors and executive officers as a group (14 Persons)	7,946,582	877,986	94,029	16.3%

* Less than 1%

(1) Represents shares for which the named person (a) has sole voting and investment power or (b) has shared voting and investment power. Excluded are shares that (i) are restricted stock holdings or (ii) may be acquired through stock option or warrant exercises.

(2) Represents shares of common stock that can be acquired through stock options exercisable through June 14, 2004.

(3) Represents shares subject to a vesting schedule, forfeiture risk and other restrictions. Although these shares are subject to forfeiture provisions, the holder has the right to vote the shares and receive dividends until they are forfeited.

(4) Assumes shares that such person has rights to acquire are outstanding.

(5) The address for Laitram, L.L.C. is 220 Laitram Lane, Harahan, Louisiana 70123. Mr. Lapeyre is the President and a Director of Laitram, L.L.C. Please read note 13 below. Mr. Lapeyre disclaims beneficial ownership of any shares held by Laitram, L.L.C.

(6) The address for Royce & Associates, Inc. is 1414 Avenue of the Americas, New York, New York 10019.

(7) The address for Barclays Global Investors, N.A. is 45 Fremont Street, San Francisco, California 94105. The shares reported are owned by Barclays Global Investors, N.A., Barclays Global Fund Advisors, Barclays Bank PLC, Barclays Capital Securities Limited and other related entities in trust accounts for the economic beneficiaries of those accounts.

(8) The address for Morgan Stanley and Morgan Stanley & Co. Incorporated is 1585 Broadway, New York, New York 10036. Morgan Stanley is filing solely in its capacity as the parent company of and indirect owner of securities held by one of its business units.

(9) The address for PRIMECAP Management Company is 225 S. Lake Avenue #400 Pasadena, California 91101-3005. PRIMECAP Management Company has sole voting power over only 2,039,652 of the shares of common stock.

(10) The address for Daruma Asset Management, Inc. is 80 West 40th Street, 9th Floor, New York, New York 10018. The shares reported by Daruma Asset Management, Inc. are held by investment advisory clients whose accounts are managed by Daruma Asset Management, Inc. Mariko O. Gordon, who owns in excess of 50% of the outstanding voting stock and is the President of Daruma Asset Management, Inc., may also be considered a beneficial owner of the shares reported by Daruma Asset Management, Inc. Daruma Asset Management, Inc. has sole voting discretion over only 1,521,700 shares.

(11) The address for Dimensional Fund Advisors Inc. is 1299 Ocean Avenue, 11th Floor, Santa Monica, California 90401. The shares of common stock are held by investment companies, trusts and accounts for which Dimensional Fund Advisors Inc. serves as investment advisor. Dimensional Fund Advisors Inc. disclaims beneficial ownership of all such shares.

(12) The address for Steinberg, Priest & Sloane Capital Management, LLC is 12 East 49th Street, New York, New York 10017. Steinberg Priest & Sloane Capital Management, LLC has sole voting power over 2,604,500 shares.

(13) The shares of common stock include 10,500 shares over which Mr. Lapeyre holds joint voting and investment control with his wife, 33,280 shares that Mr. Lapeyre holds as a custodian or trustee for the benefit of his children and 6,941,044 shares owned by Laitram L.L.C., of which Mr. Lapeyre disclaims any beneficial interest. Please read note 5 above. These shares exclude 30,000 shares owned by Mr. Lapeyre s wife, who exercises sole voting and investment control over those shares.

(14) The shares of common stock include 8,000 shares owned by Mr. Elliott s wife, of which Mr. Elliott disclaims beneficial interest.

Item 13. ***Certain Relationships and Related Transactions***

On March 31, 2003, we announced that we had appointed Robert P. Peebler as our president and chief executive officer. In April 2003, we invested $3.0 million in preferred securities of EVP and its affiliated corporation in exchange for 22% of the outstanding ownership interests and 12% of the outstanding voting interests of EVP. EVP had been formed in 2001 to provide asset management services to large oil and gas companies in order to enhance the value of their oil and gas properties. Mr. Peebler had founded EVP, and served as its president and chief executive officer until he joined us in March 2003. Mr. Peebler continued to serve as the chairman of EVP and held a 23% ownership interest in EVP. Under Mr. Peebler s employment agreement with us, Mr. Peebler was permitted to devote up to 20% of his time to EVP.

During the second quarter of 2003, EVP failed to close two anticipated asset management agreements. After that time, EVP management subsequently re-evaluated its business model and adequacy of capital. During August 2003, the board of directors of EVP voted to liquidate EVP, since it was unable to present a clear and feasible business strategy. For that reason, we wrote our investment in EVP down to its approximate liquidation value of $1.0 million, resulting in a charge against earnings for our second quarter of 2003 of $2.1 million. Since then, Mr. Peebler offered, and we agreed, that all proceeds that Mr. Peebler receives from the liquidation of EVP will be paid to us. In December 2003, we received liquidation payments of $731,796 from EVP and $137,821 from Mr. Peebler. In March 2004, we received final liquidation payments of $98,302 from EVP and $18,513 from Mr. Peebler. These amounts were included in our estimates of EVP s liquidation value.

Mr. Lapeyre is the chairman and a significant equity owner of Laitram, L.L.C. (Laitram) and has served as president of Laitram and its predecessors since 1989. Laitram is a privately owned, New Orleans-based manufacturer of food processing equipment and modular conveyor belts. Mr. Lapeyre and Laitram together owned 14.9% of our outstanding common stock as of April 15, 2004.

We acquired DigiCourse, Inc., our marine positioning products business, from Laitram in 1998 and have renamed it I/ O Marine Systems, Inc. In connection with that acquisition, we entered into a Continued Services Agreement with Laitram under which Laitram agreed to provide us certain accounting, software, manufacturing and maintenance services. Manufacturing services consist primarily of machining of parts for our marine positioning systems. The term of this agreement expired in September 2001 but we continue to operate under its terms. In addition, when we have requested, the legal staff of Laitram has advised us on certain intellectual property matters with regard to our marine positioning systems. During 2003, we paid Laitram a total of $1,174,613, which consisted of $589,195 for manufacturing services, $543,108 for rent and other facilities charges, and $42,310 for other services. For the 2002 and 2001 fiscal years, we paid Laitram a total of $1.9 million and $1.4 million, respectively, under this agreement and for these legal advisory services. In the opinion of our management, the terms of these services are fair and reasonable and as favorable to us as those which could have been obtained from unrelated third parties at the time of their performance.

In March 2000, our board of directors established an executive matching program under which we issued one share of restricted stock for each share purchased by our senior executives in open-market transactions in March and April of 2000. In connection with this program, we issued 33,000 shares of restricted stock to C. Robert Bunch, a former executive officer of I/ O. Mr. Bunch funded his purchase through a loan from a commercial bank in the amount of $200,000. We guaranteed this indebtedness in 2000 and would have been liable for the entire amount outstanding under this loan if Mr. Bunch had defaulted on his obligation under the loan. Our guarantee of Mr. Bunch s indebtedness expired by its terms in March 2003, and Mr. Bunch left our employment in May 2003.

Item 14. ***Principal Accountant Fees and Services***

The following table shows the fees billed or accrued by I/ O for the audit and other services provided by PricewaterhouseCoopers LLP, our principal accounting firm, for fiscal 2003 and 2002:

	2003	2002
	(In thousands)	
Audit Fees(a)	$281,410	$294,039
Audit-Related Fees(b)	97,160	91,721
Tax Fees(c)	230,642	256,565
All Other Fees		
Total	$609,212	$642,325

(a) Audit fees represent fees for professional services provided in connection with the audit of our financial statements and review of our quarterly financial statements and audit services provided in connection with other statutory or regulatory filings.

(b) Audit-related fees consisted primarily of accounting consultations, employee benefit plan audits, review of registration statements and issuance of comfort letters and other attestation services not required by statute or regulation.

(c) For fiscal 2003 and 2002, respectively, tax fees principally related to services for tax compliance (principally for U.S. federal and international returns), tax examination assistance, assistance related to the tax impact of mergers, acquisitions and divestitures on tax return preparation, and other tax advice and planning.

Our Audit Committee Charter provides that all audit services and non-audit services must be approved by the Committee or a member of the Committee. The Audit Committee has delegated to the Chairman of the Audit Committee the authority to pre-approve audit-related and non-audit services not prohibited by law to be performed by our independent auditors and associated fees, so long as the Chairman reports any decisions to pre-approve those audit-related or non-audit services and fees to the full Audit Committee at its next regular meeting.

All non-audit services were reviewed with the Audit Committee, which concluded that the provision of such services by PricewaterhouseCoopers LLP was compatible with the maintenance of that firm s independence in the conduct of its auditing functions.

Part IV

Item 15. *Exhibits, Financial Statement Schedules, and Reports on Form 8-K*

(a) *List of Documents Filed.*

(1) *Financial Statements*

The financial statements filed as part of this report are listed in the Index to Consolidated Financial Statements on page F-1 hereof.

(2) *Financial Statement Schedules*

The following financial statement schedule is included as part of this Annual Report on Form 10-K:

Schedule II Valuation and Qualifying Accounts

All other schedules are omitted because they are inapplicable or the requested information is shown in the financial statements or noted therein.

(3) *Exhibits*

3.1	Amended and Restated Certificate of Incorporation filed as Exhibit 3.1 to the Company s Transition Report on Form 10-K for the seven months ended December 31, 2000, and incorporated herein by reference.
*3.2	Certificate of Amendment to the Amended and Restated Certificate of Incorporation, dated October 10, 1996.
3.3	Amended and Restated Bylaws filed as Exhibit 4.3 to the Company s Current Report on Form 8-K filed with the Securities and Exchange Commission on March 8, 2002, and incorporated herein by reference.
4.1	Form of Certificate of Designation, Preference and Rights of Series A Preferred Stock of Input/Output, Inc., filed as Exhibit 2 to the Company s Registration Statement on Form 8-A dated January 27, 1997 (attached as Exhibit 1 to the Rights Agreement referenced in Exhibit 10.5), and incorporated herein by reference.

4.2	Indenture of Input/Output, Inc. dated as of December 10, 2003, filed as Exhibit 4.1 to the Company s Registration Statement on Form S-3 dated January 27, 2004, and incorporated herein by reference.
**10.1	Amended and Restated 1990 Stock Option Plan, filed as Exhibit 4.2 to the Company s Registration Statement on Form S-8 (Registration No. 333-80299), filed with the Securities and Exchange Commission on June 9, 1999, and incorporated herein by reference.
10.2	Lease Agreement dated as of August 20, 2001, between NL Ventures III Stafford L.P. and Input/Output, Inc. filed as Exhibit 10.28 to the Company s Quarterly Report on Form 10-Q for the quarter ended September 30, 2001, and incorporated herein by reference.
**10.3	Input/Output, Inc. Amended and Restated 1996 Non-Employee Director Stock Option Plan, filed as Exhibit 4.3 to the Company s Registration Statement on Form S-8 (Registration No. 333-80299), filed with the Securities and Exchange Commission on June 9, 1999, and incorporated herein by reference.
10.4	Rights Agreement, dated as of January 17, 1997, by and between Input/Output, Inc. and Harris Trust and Savings Bank, as Rights Agent, including exhibits thereto, filed as Exhibit 4 to the Company s Form 8-A dated January 27, 1997, and incorporated herein by reference.
**10.5	Input/Output, Inc. Employee Stock Purchase Plan, filed as Exhibit 4.4 to the Company s Registration Statement on Form S-8 (Registration No. 333-24125) filed with the Securities and Exchange Commission on March 18, 1997, and incorporated herein by reference.
10.6	First Amendment to Rights Agreement by and between the Company and Harris Trust and Savings Bank as Rights Agent, dated April 21, 1999, filed as Exhibit 10.3 to the Company s Form 8-K dated April 21, 1999, and incorporated herein by reference.
*10.7	Registration Rights Agreement by and among the Company and The Laitram Corporation, dated November 16, 1998.
**10.8	Input/Output, Inc. 1998 Restricted Stock Plan, filed as Exhibit 4.7 to the Company s Registration Statement on S-8 (Registration No. 333-80297), filed with the Securities and Exchange Commission on June 9, 1999, and incorporated herein by reference.
**10.9	Input/Output Inc. Non-qualified Deferred Compensation Plan, filed as Exhibit 10.14 to the Company s Annual Report on Form 10-K for the year ended December 31, 2001, and incorporated herein by reference.
**10.10	Amendment No. 1 to the Input/Output, Inc. Amended and Restated 1996 Non-Employee Director Stock Option Plan, dated September 13, 1999, filed as Exhibit 10.4 to the Company s Quarterly Report on Form 10-Q for the fiscal quarter ended August 31, 1999, and incorporated herein by reference.
**10.11	Employment Agreement by and between the Company and Bjarte Fageraas dated effective as of February 4, 2003, filed as Exhibit 10.14 to the Company s Annual Report on Form 10-K for the year ended December 31, 2002, and incorporated herein by reference.
**10.12	Employment Agreement by and between the Company and Laura Guthrie dated effective as of February 4, 2003, filed as Exhibit 10.16 to the Company s Annual Report on Form 10-K for the year ended December 31, 2002, and incorporated herein by reference.
**10.13	Input/Output, Inc. 2000 Restricted Stock Plan, effective as of March 13, 2000 filed as Exhibit 10.27 to the Company s Annual Report on Form 10-K for the fiscal year ended May 31, 2000, and incorporated herein by reference.
**10.14	Input/Output, Inc. 2000 Long-Term Stock Plan, filed as Exhibit 4.7 to the Company s Registration Statement on Form S-8 (No. 333-49382) dated November 6, 2000 and incorporated by reference herein.
**10.15	Amended and Restated 1991 Directors Stock Option Plan, filed as Exhibit 4.3 to the Company s Registration Statement on Form S-8 on October 19, 1994, and incorporated herein by reference.
**10.16	Amendment to the Amended and Restated 1991 Directors Stock Option Plan, filed as Exhibit 10.9 to the Company s Annual Report on Form 10-K for the fiscal year ended May 31, 1997, and incorporated herein by reference.

**10.17	Amendment No. 2 to the Input/Output, Inc. Amended and Restated 1991 Director Stock Option Plan, dated September 13, 1999, filed as Exhibit 10.3 to the Company s Quarterly Report on Form 10-Q for the fiscal quarter ended August 31, 1999, and incorporated herein by reference.
10.18	Registration Rights Agreement dated as of December 10, 2003, between Input/Output, Inc. and Morgan Stanley & Co. Incorporated, filed as Exhibit 4.2 to the Company s Registration Statement on Form S-3 dated January 27, 2004, and incorporated herein by reference.
**10.19	Employment Agreement by and between the Company and Robert P. Peebler dated effective as of March 31, 2003, filed as Exhibit 10.1 to the Company s Current Report on Form 8-K dated March 31, 2003, and incorporated herein by reference.
**10.20	Employment Agreement by and between the Company and Jorge Machnizh dated effective as of April 23, 2003, filed as Exhibit 10.28 to the Company s Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2003, and incorporated herein by reference.
* **10.21	Employment Agreement by and between the Company and J. Michael Kirksey dated effective as of January 1, 2004.
10.22	Share Acquisition Agreement dated February 23, 2004 filed as Exhibit 2.1 to the Company s Current Report on Form 8-K filed with the Securities and Exchange Commission on March 5, 2004, and incorporated herein by reference.
10.23	Registration Rights Agreement dated February 23, 2004 filed as Exhibit 4.1 to the Company s Current Report on Form 8-K filed with the Securities and Exchange Commission on March 5, 2004, and incorporated herein by reference.
10.24	Input/Output, Inc. Non-Employee Directors Retainer Plan, filed as Exhibit 4.7 to the Company s Registration Statement on Form S-8 dated May 15, 2001 (Registration No. 333-60950), and incorporated herein by reference.
*21.1	Subsidiaries of the Company.
23.1	Consent of PricewaterhouseCoopers LLP.
*24.1	The Power of Attorney is set forth on the signature page hereof.
31.1	Certification of Robert P. Peebler, President and Chief Executive Officer, under Section 302 of the Sarbanes-Oxley Act.
31.2	Certification of J. Michael Kirksey, Executive Vice President and Chief Financial Officer, under Section 302 of the Sarbanes-Oxley Act.
32.1	Certification of Robert P. Peebler, President and Chief Executive Officer, pursuant to 18 U.S.C. sec. 1350.
32.2	Certification of J. Michael Kirksey, Executive Vice President and Chief Financial Officer, pursuant to 18 U.S.C. sec. 1350.

---

* Filed with the Company s Annual Report on Form 10-K for the year ended December 31, 2003, filed with the Securities and Exchange Commission on March 12, 2004.

** Management contract or compensatory plan or arrangement.

Filed herewith.

(b) *Reports on Form 8-K*

On December 4, 2003, we filed a Current Report on Form 8-K reporting under Item 5. Other Events and Regulation FD Disclosure the Company s intention to sell its Convertible Senior Notes due 2008 in a private, unregistered offering to qualified institutional buyers pursuant to Rule 144A under the Securities Act.

On December 5, 2003, we filed a Current Report on Form 8-K reporting under Item 5. Other Events and Regulation FD Disclosure the pricing of the Company s private offering of its Convertible Senior Notes due 2008.

On December 17, 2003, we filed a Current Report on Form 8-K reporting under Item 5. Other Events and Regulation FD Disclosure the initial purchaser of Company s 5.50% Convertible Senior Notes due 2008 had exercised its over-allotment option.

(c) *Exhibits required by Item 601 of Regulation S-K.*

Reference is made to subparagraph (a) (3) of this Item 14, which is incorporated herein by reference.

(d) *Not applicable.*

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this Form 10-K/ A-1 (Amendment No. 1 to Form 10-K) to be signed on its behalf by the undersigned thereunto duly authorized.

Input/Output, Inc.
(Registrant)

Date: April 23, 2004

By: /s/ J. MICHAEL KIRKSEY

J. Michael Kirksey
Executive Vice President and
Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this Amendment No. 1 to the Annual Report on Form 10-K has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Name	Capacities	Date
/s/ ROBERT P. PEEBLER Robert P. Peebler	President, Chief Executive Officer and Director (Principal Executive Officer)	April 23, 2004
/s/ J. MICHAEL KIRKSEY J. Michael Kirksey	Executive Vice President and Chief Financial Officer (Principal Financial Officer)	April 23, 2004
/s/ MICHAEL L. MORRISON Michael L. Morrison	Controller and Director of Accounting (Principal Accounting Officer)	April 23, 2004
* James M. Lapeyre, Jr.	Chairman of the Board of Directors and Director	April 23, 2004
* Bruce S. Applebaum, Ph.D.	Director	April 23, 2004
* Theodore H. Elliott, Jr.	Director	April 23, 2004
* Franklin Myers	Director	April 23, 2004

Name	Capacities	Date
*	Director	April 23, 2004
John N. Seitz		
*	Director	April 23, 2004
Sam K. Smith		
*By: /s/ J. MICHAEL KIRKSEY		
J. Michael Kirksey *Attorney-in-fact*		

INPUT/ OUTPUT, INC. AND SUBSIDIARIES

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

All other schedules are omitted because they are not applicable or the required information is shown in the financial statements or notes thereto.

REPORT OF INDEPENDENT AUDITORS

To the Board of Directors and

Stockholders of Input/Output, Inc.:

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Input/Output, Inc. and its subsidiaries (the Company) at December 31, 2003 and 2002, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2003 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company s management; our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1 to the consolidated financial statements, in 2002, the Company changed its method of accounting for goodwill as a result of adopting the provisions of Statement of Financial Accounting Standards No. 142 *Goodwill and Other Intangible Assets.*

/s/ PRICEWATERHOUSECOOPERS LLP

Houston, Texas
February 27, 2004

INPUT/ OUTPUT, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	December 31,	
	2003	**2002**
	(In thousands, except share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 59,507	$ 76,218
Restricted cash	1,127	1,173
Accounts receivable, net	34,270	18,745
Current portion notes receivable, net	14,420	6,137
Inventories	53,551	50,010
Prepaid expenses and other current assets	3,703	3,136
Total current assets	166,578	155,419
Notes receivable	6,409	12,057
Net assets held for sale	3,331	
Property, plant and equipment, net	27,607	39,255
Goodwill, net	35,025	33,758
Other assets, net	9,105	7,956
Total assets	$ 248,055	$ 248,445
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Notes payable and current maturities of long-term debt	$ 2,687	$ 2,142
Accounts payable	14,591	18,927
Accrued expenses	15,833	17,210
Warrant obligation		2,200
Total current liabilities	33,111	40,479
Long-term debt, net of current maturities	78,516	51,430
Other long-term liabilities	3,813	5,199
Commitments and contingencies (Notes 18 and 22)		
Stockholders equity:		
Common stock, $.01 par value; authorized 100,000,000 shares; outstanding 51,390,334 shares at December 31, 2003 and 51,078,939 shares at December 31, 2002, net of treasury stock	522	519
Additional paid-in capital	296,663	296,002
Accumulated deficit	(159,685)	(136,534)
Accumulated other comprehensive earnings (loss)	1,292	(2,380)
Treasury stock, at cost, 777,423 shares at December 31, 2003 and 783,298 shares at December 31, 2002	(5,826)	(5,929)
Unamortized restricted stock compensation	(351)	(341)
Total stockholders equity	132,615	151,337
Total liabilities and stockholders equity	$ 248,055	$ 248,445

See accompanying Notes to Consolidated Financial Statements.

INPUT/ OUTPUT, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	Years Ended December 31,		
	2003	**2002**	**2001**
	(In thousands, except share and per share data)		
Net sales	$ 150,033	$ 118,583	$ 212,050
Cost of sales	121,133	99,624	138,415
Amortization of intangibles	1,059	1,394	1,063
Gross profit	27,841	17,565	72,572
Operating expenses:			
Research and development	18,696	28,756	29,442
Marketing and sales	12,566	11,218	11,657
General and administrative	16,753	19,760	19,695
Amortization of goodwill			3,873
Impairment of long-lived assets	1,120	6,274	
Goodwill impairment		15,122	
Total operating expenses	49,135	81,130	64,667
Earnings (loss) from operations	(21,294)	(63,565)	7,905
Interest expense	(4,087)	(3,124)	(695)
Interest income	1,903	2,280	4,685
Fair value adjustment and exchange of warrant obligation	1,757	3,252	
Impairment of investment	(2,059)		
Other income (expense)	976	(798)	574
Earnings (loss) before income taxes	(22,804)	(61,955)	12,469
Income tax expense	348	57,919	3,128
Net earnings (loss)	(23,152)	(119,874)	9,341
Preferred dividend		947	5,632
Net earnings (loss) applicable to common shares	$ (23,152)	$ (120,821)	$ 3,709
Basic earnings (loss) per common share	$ (0.45)	$ (2.37)	$ 0.07
Weighted average number of common shares outstanding	51,236,771	51,014,505	51,166,026
Diluted earnings (loss) per common share	$ (0.45)	$ (2.37)	$ 0.07
Weighted average number of diluted common shares outstanding	51,236,771	51,014,505	52,308,578

See accompanying Notes to Consolidated Financial Statements.

F-4

INPUT/ OUTPUT, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2003	**2002**	**2001**
		(In thousands)	
Cash flows from operating activities:			
Adjustments to reconcile net earnings (loss) to net cash (used in) provided by operating activities:			
Net earnings (loss)	$(23,152)	$(119,874)	$ 9,341
Depreciation and amortization	11,444	13,237	17,535
Fair value adjustment and exchange of warrant obligation	(1,757)	(3,252)	
Impairment of long-lived assets	1,120	6,274	
Goodwill impairment		15,122	
Write-down of rental equipment	2,500		
Impairment of investment in Energy Virtual Partners, Inc.	2,059		
Amortization of restricted stock and other stock compensation	(222)	417	246
Deferred income tax		59,992	(976)
Bad debt expense	569	2,701	1,959
(Gain) loss on disposal of fixed assets	(291)	930	372
Change in operating assets and liabilities:			
Accounts and notes receivable	(17,059)	14,338	(7,867)
Inventories	(4,877)	19,423	1,143
Accounts payable and accrued expenses	(7,529)	2,875	(3,728)
Other assets and liabilities	4,125	1,469	(444)
Net cash (used in) provided by operating activities	(33,070)	13,652	17,581
Cash flows from investing activities:			
Purchase of property, plant and equipment	(4,587)	(8,230)	(9,202)
Proceeds from the sale of fixed assets	490		
Business acquisition		(3,151)	(7,608)
Cash of acquired business		501	2,032
Contingent consideration paid to former shareholders of AXIS Geophysics, Inc.	(1,267)		
Investment in Energy Virtual Partners, Inc.	(3,036)		
Liquidation of Energy Virtual Partners, Inc.	869		
Net cash used in investing activities	(7,531)	(10,880)	(14,778)
Cash flows from financing activities:			
Net proceeds from issuance of long-term debt	56,550		18,837
Payments on notes payable and long-term debt	(34,237)	(2,550)	(9,409)
Deposit to secure a letter of credit	(1,500)		
Payments of preferred dividends		(411)	(550)
Purchase of treasury stock	(81)	(160)	(4,032)
Proceeds from exercise of stock options		992	2,007
Proceeds from issuance of common stock	470	823	768
Payments to repurchase preferred stock		(30,000)	

Net cash provided by (used in) financing activities	21,202	(31,306)	7,621
Effect of change in foreign currency exchange rates on cash and cash equivalents	2,688	3,385	(1,079)
Net (decrease) increase in cash and cash equivalents	(16,711)	(25,149)	9,345
Cash and cash equivalents at beginning of period	76,218	101,367	92,022
Cash and cash equivalents at end of period	$ 59,507	$ 76,218	$ 101,367

See accompanying Notes to Consolidated Financial Statements.

INPUT/ OUTPUT, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY AND

COMPREHENSIVE EARNINGS (LOSS)
Years Ended December 31, 2003, 2002 and 2001

	Cumulative Convertible Preferred Stock		Common Stock		Additional Paid-in	Accumulated	Accumulated Other Comprehensive	Treasury	Unamortized Restricted Stock	Total Stockholders
	Shares	Amount	Shares	Amount	Capital	Deficit	Earnings (Loss)	Stock	Compensation	Equity
					(In thousands, except share data)					
Balance at January 1, 2001	55,000	$ 1	50,936,420	$ 512	$ 352,294	$ (19,422)	$ (5,353)	$ (1,737)	$ (892)	$ 325,403
Comprehensive earnings:										
Net earnings						9,341				9,341
Other comprehensive loss:										
Translation adjustment							(2,146)			(2,146)
Total comprehensive earnings										7,195
Amortization of restricted stock compensation									246	246
Purchase treasury stock			(499,798)					(4,032)		(4,032)
Preferred dividend					5,082	(5,632)				(550)
Exercise of stock options			326,921	4	2,003					2,007
Issuance of stock for the Employee Stock Purchase Plan			102,186		768					768
Balance at December 31, 2001	55,000	1	50,865,729	516	360,147	(15,713)	(7,499)	(5,769)	(646)	331,037
Comprehensive loss:										
Net loss						(119,874)				(119,874)
Other comprehensive earnings:										
Translation adjustment							5,119			5,119
Total comprehensive loss										(114,755)
Amortization of restricted stock compensation									417	417
Issuance of restricted stock award			28,450		270				(270)	
			(20,000)		(158)				158	

Cancellation of restricted stock award										
Purchase treasury stock			(40,000)					(160)		(160)
Preferred dividend						(947)				(947)
Repurchase and exchange of preferred stock	(55,000)	(1)			(66,069)					(66,070)
Exercise of stock options			126,884	2	990					992
Issuance of stock for the Employee Stock Purchase Plan			117,876	1	822					823
Balance at December 31, 2002			51,078,939	519	296,002	(136,534)	(2,380)	(5,929)	(341)	151,337
Comprehensive loss:										
Net loss						(23,152)				(23,152)
Other comprehensive earnings:										
Translation adjustment							3,672			3,672
Total comprehensive loss										(19,480)
Amortization of restricted stock compensation									498	498
Issuance of restricted stock award			260,038	2	1,047				(1,049)	
Cancellation of restricted stock award			(206,640)	(2)	(1,259)				541	(720)
Purchase treasury stock			(16,939)					(81)		(81)
Exchange of warrant obligation			125,000	1	441					442
Issuance of stock for the Employee Stock Purchase Plan			127,122	2	468					470
Issuance of treasury stock			22,814		(36)			184		148
Balance at December 31, 2003		$	51,390,334	$ 522	$ 296,663	$ (159,685)	$ 1,292	$ (5,826)	$ (351)	$ 132,615

See accompanying Notes to Consolidated Financial Statements.

INPUT/OUTPUT, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) Summary of Significant Accounting Policies

General Description and Principles of Consolidation. Input/Output, Inc. and its wholly owned subsidiaries offer a full suite of related products and services for seismic data acquisition and processing, including products incorporating traditional analog technologies and products incorporating the proprietary VectorSeis, True Digital technology. The consolidated financial statements include the accounts of Input/Output, Inc. and its wholly owned subsidiaries (collectively referred to as the Company or I/O). Inter-company balances and transactions have been eliminated.

Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates are made at discrete points in time based on relevant market information. These estimates may be subjective in nature and involve uncertainties and matters of judgment and therefore cannot be determined with exact precision. Areas involving significant estimates include, but are not limited to, accounts and notes receivable, inventory valuation, deferred taxes, and accrued warranty costs. Actual results could differ from those estimates.

Cash and Cash Equivalents. The Company considers all highly liquid debt instruments with an original maturity of three months or less to be cash equivalents. At December 31, 2003 and 2002 there were $1.1 million and $1.2 million, respectively, of restricted cash used to secure standby and commercial letters of credit.

Accounts and Notes Receivable. Accounts and notes receivable are recorded at cost, less the related allowance for doubtful accounts and loan loss. The Company considers current information and events regarding the customers ability to repay their obligations, and considers an account or note to be impaired when it is probable that the Company will be unable to collect all amounts due according to the contractual terms. When an account or note is considered impaired, the amount of the impairment is measured based on the present value of expected future cash flows or the fair value of collateral. Impairment losses (recoveries) are included in the allowance for doubtful accounts and for loan loss through an increase (decrease) in bad debt expense. Notes receivable are collateralized by the products sold and bear interest at contractual rates up to 12.7% per year. Cash receipts on impaired notes are applied to reduce the principal amount of such notes until the principal has been recovered and are recognized as interest income thereafter.

Inventories. Inventories are stated at the lower of cost (primarily first-in, first-out) or market. The Company provides reserves for estimated obsolescence or excess inventory equal to the difference between cost of inventory and its estimated market value based upon assumptions about future demand for the Company s products and market conditions.

Property, Plant and Equipment. Property, plant and equipment are stated at cost. Depreciation expense is provided straight-line over the following estimated useful lives:

	Years
Machinery and equipment	3-8
Buildings	12-25
Leased equipment and other	3-10

Expenditures for renewals and betterments are capitalized; repairs and maintenance are charged to expense as incurred. The cost and accumulated depreciation of assets sold or otherwise disposed of are removed from the accounts and any gain or loss is reflected in operations.

The Company periodically evaluates the net realizable value of long-lived assets, including property, plant and equipment, relying on a number of factors including operating results, business plans, economic

INPUT/OUTPUT, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

projections and anticipated future cash flows. Impairment in the carrying value of an asset held for use is recognized whenever anticipated future cash flows (undiscounted) from an asset are estimated to be less than its carrying value. The amount of the impairment recognized is the difference between the carrying value of the asset and its fair value.

Financial Instruments. Fair value estimates are made at discrete times based on relevant market information. These estimates may be subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. The Company believes that the carrying amount of its cash and cash equivalents, accounts and notes receivable and accounts payable approximate the fair values at those dates. The fair market value of the Company s notes payable and long-term debt (all fixed interest rates) was $100.3 million at December 31, 2003. See Note 14 of *Notes to Consolidated Financial Statements* for discussion on the fair value of the warrant prior to its termination in December 2003.

Derivatives. Effective January 1, 2001, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities,* as amended, which establishes accounting and reporting standards for derivative instruments and hedging activities. SFAS No. 133 requires that the Company recognize all derivatives as either assets or liabilities in the Consolidated Balance Sheet and measure those instruments at fair value. The adoption of SFAS No. 133 did not have a material impact on the Company s reported results of operations and financial position.

Goodwill and Other Intangible Assets. Goodwill results from business acquisitions and represents the excess of acquisition costs over the fair value of the net assets of businesses acquired. On January 1, 2002, the Company adopted SFAS No. 142 *Goodwill and Other Intangible Assets.* Under SFAS No. 142, existing goodwill is no longer amortized, but instead is assessed for impairment at least annually. Under the transition provisions of SFAS No. 142, there was no impairment at January 1, 2002. Additionally, the Company has elected to make December 31 the annual impairment assessment date for all reporting units, and will perform additional impairment tests when triggering events occur. SFAS No. 142 defines a reporting unit as an operating segment or one level below an operating segment. The Company s reporting units as of December 31, 2003 were as follows: Digital Land Products, Analog Land Products, Marine Products, Processing and Seabed. During the third quarter of 2002, the Company performed an interim impairment test on the analog land products reporting unit and recorded an impairment charge of $15.1 million. The annual impairment assessment performed at December 31, 2003 and 2002 resulted in no impairment of the Company s goodwill. See further discussion at Note 10 of *Notes to Consolidated Financial Statements.*

Intangible assets other than goodwill relate to proprietary technology, patents, customer lists, and non-compete agreements that are amortized over the estimated periods of benefit (ranging from 2 to 18 years) and are included in Other Assets, net in the Consolidated Balance Sheets. The Company reviews the carrying values of these intangible assets for impairment if events or changes in the facts and circumstances indicate that their carrying value may not be recoverable. Any impairment determined is recorded in the current period and is measured by comparing the fair value of the related asset to its carrying value.

Research and Development. Research and development costs primarily relate to activities that are designed to improve the quality of the subsurface image and overall acquisition economics of the Company s customers. The costs associated with these activities are expensed as incurred. These costs include prototype material and field testing expenses, along with the related salaries, facility costs, allocated corporate costs, consulting fees, tools and equipment usage, and other miscellaneous expenses associated with these activities. Research and development expenses were $18.7 million, $28.8 million, and $29.4 million for the years ended December 31, 2003, 2002 and 2001, respectively.

Revenue Recognition and Product Warranty. Revenue is derived from the sale of data acquisition systems and other seismic equipment as well as from the processing of seismic data. For the sales of data acquisition systems, the Company follows the requirements of SOP 97-2 *Software Revenue Recognition,*

INPUT/OUTPUT, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

and recognizes revenue when the system is delivered to the customer and risk of ownership has passed to the customer, or, in the limited case where a customer acceptance clause exists in the contract, the later of delivery or when customer acceptance is obtained. For the sales of other seismic equipment, the Company recognizes revenue when the equipment is shipped and risk of ownership has passed to the customer. For processing of seismic data, revenue is recognized at the time of delivery of the processed data to the customer.

When elements such as a data acquisition system and other seismic equipment are contained in a single arrangement, or in related arrangements with the same customer, the Company allocates revenue to each element based on its relative fair value, provided that such element meets the criteria for treatment as a separate unit of accounting. The Company limits the amount of revenue recognition for delivered elements to the amount that is not contingent on the future delivery of products or services. The Company does not grant return or refund privileges to its customers.

The Company warrants that all manufactured equipment will be free from defects in workmanship, material and parts. Warranty periods range from 90 days to three years from the date of original purchase, depending on the product. The Company provides for estimated warranty as a charge to costs of sales at the time of sale.

Shipping and Handling Fees. The Company classifies cost associated with shipping and handling fees as a component of cost of sales. Amounts billed to customers for shipping and handling services are included in net sales.

Income Taxes. Income taxes are accounted for under the liability method. Deferred income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry-forwards. Deferred income tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The Company reserves all net deferred tax assets and will continue to reserve all net deferred tax assets until there is sufficient evidence to warrant reversal (see Note 17 of *Notes to Consolidated Financial Statements*). The effect on deferred income tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Comprehensive Earnings (Loss). Comprehensive earnings (loss), consisting of net earnings (loss) and foreign currency translation adjustments, is presented in the Consolidated Statements of Stockholders Equity and Comprehensive Earnings (Loss). The balance in accumulated other comprehensive earnings (loss) consists of foreign currency translation adjustments.

Earnings (Loss) per Common Share. Basic earnings (loss) per common share is computed by dividing net earnings (loss) applicable to common shares by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per common share is determined on the assumption that outstanding dilutive stock options have been exercised and the aggregate proceeds were used to reacquire common stock using the average price of such common stock for the period. In addition, diluted earnings (loss) per common share assume the conversion to common shares of the convertible senior notes. The following table summarizes the calculation of weighted average number of common shares and weighted average number of diluted common shares outstanding for purposes of the computation of basic earnings

INPUT/OUTPUT, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(loss) per common share and diluted earnings (loss) per common share (in thousands, except share and per share amounts):

	Years Ended December 31,		
	2003	**2002**	**2001**
Net earnings (loss) applicable to common shares	$ (23,152)	$ (120,821)	$ 3,709
Weighted average number of common shares outstanding	51,236,771	51,014,505	51,166,026
Effect of dilutive stock options			1,142,552
Weighted average number of diluted common shares outstanding	51,236,771	51,014,505	52,308,578
Basic earnings (loss) per common share	$ (0.45)	$ (2.37)	$ 0.07
Diluted earnings (loss) per common share	$ (0.45)	$ (2.37)	$ 0.07

At December 31, 2003, 2002, and 2001, 5,588,832; 4,998,043; and 3,718,248 respectively, of common shares subject to stock options were considered anti-dilutive and not included in the calculation of diluted earnings (loss) per common share. In August 2002, the Company repurchased all outstanding shares of its Series B and Series C Convertible Preferred Stock (the Preferred Stock). As part of the repurchase, the Company granted a warrant to purchase 2,673,517 shares of the Company s common stock at $8.00 per share through August 5, 2005. In December 2003, the Company terminated the warrant by exchanging 125,000 of its common stock for the warrant. Also in December 2003, the Company issued $60.0 million of notes convertible into its common stock at a conversion rate 231.4815 shares per $1,000 principal amount of notes (a conversion price of $4.32), which represents 13,888,888 total common shares. The preferred stock, warrant and convertible senior notes are considered anti-dilutive for all periods outstanding and are not included in the calculation of diluted earnings (loss) per common share.

Foreign Currency Gains and Losses. Assets and liabilities of the Company s subsidiaries operating outside the United States which account in a functional currency other than U.S. dollars have been translated to U.S. dollars using the exchange rate in effect at the balance sheet date. Results of foreign operations have been translated using the average exchange rate during the periods of operation. Resulting translation adjustments have been recorded as a component of Accumulated Other Comprehensive Earnings (Loss) in the Consolidated Statements of Stockholders Equity and Comprehensive Earnings (Loss). Foreign currency transaction gains and losses are included in the Consolidated Statements of Operations as they occur. Total foreign currency transaction gains were $0.6 million, $0.2 million and $0 million, for the years ended December 31, 2003, 2002 and 2001, respectively.

Concentration and Foreign Sales Risk. The Company relies on a relatively small number of significant customers. Consequently, the Company is exposed to the risks related to customer concentrations. In 2003, BGP, an international seismic contractor and subsidiary of the China National Petroleum Corporation (BGP), accounted for approximately 28% of the Company s consolidated net sales. In 2002, two of the Company s largest customers, Western-Geco and Laboratory of Regional Geo-Dynamics, Limited, were responsible for approximately 11% and 10%, respectively, of the Company s consolidated net sales.

Sales outside the United States have historically accounted for a significant part of the Company s net sales. Foreign sales are subject to special risks inherent in doing business outside of the United States, including the risk of war, civil disturbances, embargo and government activities, which may disrupt markets and affect operating results.

Demand for products from customers in developing countries is difficult to predict and can fluctuate significantly from year to year. These changes in demand result primarily from the instability of economies and

INPUT/OUTPUT, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

governments in certain developing countries, changes in internal laws and policies affecting trade and investment, and because those markets are only beginning to adopt new technologies and establish purchasing practices. These risks may adversely affect future operating results and financial position. In addition, sales to customers in developing countries on extended terms can present heightened credit risks.

Stock-Based Compensation. SFAS No. 123, *Accounting for Stock-Based Compensation* allows a company to adopt a fair value based method of accounting for its stock-based compensation plans, or to continue to follow the intrinsic value method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees* . The Company has elected to continue to follow APB Opinion No. 25. If the Company had adopted SFAS No. 123, net earnings (loss), basic earnings (loss) per common share and diluted earnings (loss) per common share for the periods presented would have been reduced (increased) as follows (in thousands, except per share amounts):

	Years Ended December 31,		
	2003	**2002**	**2001**
Net earnings (loss) applicable to common shares	$(23,152)	$(120,821)	$ 3,709
Add: Stock-based employee compensation expense included in reported net earnings (loss) applicable to common shares	(222)	417	246
Deduct: Stock-based employee compensation expense determined under fair value methods for all awards	$ (2,463)	$ (3,531)	$(4,244)
Pro forma net loss	$(25,837)	$(123,935)	$ (289)
Basic and diluted earnings (loss) per common share as reported	$ (0.45)	$ (2.37)	$ 0.07
Pro forma basic and diluted loss per common share	$ (0.50)	$ (2.43)	$ (0.01)

The weighted average fair value of options granted during the years ended December 31, 2003, 2002 and 2001, for which the exercise price was equal to the market price of the Company s common stock on the date of grant, was $2.05, $4.90, and $4.38, respectively. The fair value of options granted during the year ended December 31, 2003, for which the exercise price exceeded the market price of the Company s common stock on the date of grant, was $1.46. The fair value of each option was determined using the Black-Scholes option valuation model. The key variables used in valuing the options were as follows: average risk-free interest rate based on 5-year Treasury bonds, an estimated option term of five years, $0 dividends and expected stock price volatility of 60% during the years ended December 31, 2003 and 2002 and 41% during the year ended December 31, 2001.

Recent Accounting Pronouncements. In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 143, *Accounting for Asset Retirement Obligations.* This Statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The provisions of this statement are effective for fiscal years beginning after June 15, 2002. The Company adopted SFAS No. 143 on January 1, 2003 and its adoption did not have a significant impact on its results of operations or financial position.

In June 2002, the FASB issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities,* which addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force (EITF) Issue No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring).* SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity is recognized when the liability is incurred. Under EITF Issue 94-3, a liability for an exit cost was recognized at the date of an entity s commitment to an exit plan. The provisions of SFAS No. 146 are effective for exit or

INPUT/OUTPUT, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

disposal activities that are initiated after December 31, 2002, and the Company has adopted them for 2003. For all exit and disposal activities initiated on or before December 31, 2002, the Company has continued to follow EITF No. 94-3.

In November 2002, the FASB issued Interpretation (FIN) No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others: an Interpretation of FASB Statements No. 5, 67, and 107 and Rescission of FASB Interpretation No. 34.* FIN No. 45 clarifies the requirements of FASB No. 5, *Accounting for Contingencies,* relating to the guarantor s accounting for, and disclosure of, the issuance of certain types of guarantees. The initial recognition and measurement provisions of FIN No. 45 are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The Company s adoption of FIN No. 45 did not have a significant impact on its results of operations or financial position.

In December 2002, the FASB issued SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure and Amendment of FASB No. 123.* SFAS No. 148 amends FASB No. 123, *Accounting for Stock-Based Compensation,* to provide alternative methods of transition for a voluntary change in fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require more prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The Company has elected to continue to follow the intrinsic value method of accounting prescribed by APB Opinion No. 25.

In January 2003, the FASB issued FIN No. 46, *Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51* . The primary objective of the interpretation is to provide guidance on the identification of and financial reporting for entities over which control is achieved through means other than voting rights; such entities are known as variable-interest entities (VIEs). FIN No. 46 provides guidance that determines (1) whether consolidation is required under the controlling financial interest model of Accounting Research Bulletin No. 51, *Consolidated Financial Statements,* or other existing authoritative guidance, or, alternatively, (2) whether the variable-interest model under FIN No. 46 should be used to account for existing and new entities. In December 2003, the FASB completed deliberations of proposed modifications to FIN 46 (FIN 46-R) resulting in multiple effective dates based on the nature as well as creation date of the VIE. FIN No. 46, as revised, did not have a significant impact on the Company s results of operations or financial position.

In April 2003, the FASB issued SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities,* which amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities under SFAS No. 133. This statement is effective for contracts entered into or modified after June 30, 2003, and for hedging relationships designated after June 30, 2003. The adoption of this statement had no initial impact on the Company s results of operations or financial position.

In May 2003, the FASB issued SFAS No. 150*, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity.* This statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires a financial instrument within its scope to be classified as a liability. It is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. These effective dates are not applicable to the provisions of paragraphs 9 and 10 of SFAS 150 as they apply to mandatorily redeemable noncontrolling interests, as the FASB has delayed these provisions indefinitely. The adoption of this statement had no initial impact on the Company s results of operations or financial position.

INPUT/OUTPUT, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In December 2003, the SEC issued Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition* , which supercedes SAB No. 101, *Revenue Recognition in Financial Statements.* SAB No. 104 s primary purpose is to rescind accounting guidance contained in SAB No. 101 related to multiple element revenue arrangements, which was superceded as a result of the issuance of EITF 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables.* While the wording of SAB No. 104 has changed to reflect the issuance of EITF 00-21, the revenue recognition principles of SAB No. 101 remain largely unchanged by the issuance of SAB No. 104. The impact of SAB No. 104 did not have a material effect on the Company s results of operations or financial position.

Reclassification. Certain amounts previously reported in the consolidated financial statements have been reclassified to conform to the current year presentation.

(2) Restructuring Activities

In 2002, the Company initiated a restructuring program which included reducing its full-time headcount by approximately 300 positions, closing certain of its facilities and relocating those operations to other existing Company facilities or outsourcing those operations to contract manufacturers. In July 2003, the Company completed the closure of its Alvin, Texas manufacturing facility. See further discussion at Note 3 of *Notes to Consolidated Financial Statements.* In 2003, the Company completed the relocation of its geophone stringing operations from a leased facility in Norwich, U.K. to a leased facility in the United Arab Emirates.

Also, as part of this restructuring program, the Company abandoned the non-cancelable lease of its Austin, Texas facility and combined its two Colorado-based operations into one location, abandoning its non-cancelable lease of its Louisville, Colorado operations. Of the total abandoned lease costs of $1.9 million for the year ended December 31, 2002, $1.3 million was included in research and development expense and $0.6 million in general and administrative expense. In 2003, the Company reduced its accrual for its non-cancelable lease obligations by $0.1 million due to more favorable terms than anticipated for the sublease of its Louisville facility. Payments under these non-cancelable leases will expire in 2005.

During 2003, the Company continued evaluating its staffing needs and further reduced its full-time headcount by approximately sixty individuals. The Company s full-time headcount was 479 at December 31, 2003, down from 799 at January 1, 2002. A summary of the Company s restructuring programs is as follows (in thousands):

	2002 Restructuring Plan		**2003 Restructuring Plan**
	Severance Costs	**Abandoned Lease Costs**	**Severance Costs**
Accruals at January 1, 2002	$	$	$
Restructuring expense	3,419	1,933	
Cash payments during the period	(2,410)	(588)	
Accruals at December 31, 2002	1,009	1,345	
Restructuring expense			1,303
Adjustment to accrual	(94)	(138)	
Cash payments during the period	(821)	(567)	(1,205)
Accruals at December 31, 2003	$ 94	$ 640	$ 98

In January 2004, the Company announced the consolidation of three operating units within its Land Imaging segment into one division. This consolidation is expected to eliminate approximately twenty full-time positions resulting in approximate severance charges of $0.4 million in 2004.

INPUT/OUTPUT, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Of the total severance expense of $1.3 million for the year ended December 31, 2003, $0.7 million was included in costs of sales, $0.4 million in research and development expenses and $0.2 million in general and administrative expenses. In 2003, the Company reduced its severance accrual associated with its 2002 restructuring plan by $0.1 million due to revisions to the number of full-time positions eliminated.

Of the total severance expenses of $3.4 million for the year ended December 31, 2002, $1.9 million was included in costs of sales, $0.8 million in research and development expense, $0.3 million in sales and marketing and $0.4 million in general and administrative expenses. The remainder of the severance accruals at December 31, 2003 will be paid in 2004.

(3) Net Assets Held for Sale

In July 2003, the Company completed the closure of its Alvin, Texas manufacturing facility and is currently marketing the facility for sale. The facility and related land had a net carrying value of $2.4 million at December 31, 2003. In addition, during the third quarter of 2003, the Company listed for sale 16.75 acres of land which is located across from the Company s headquarters in Stafford, Texas. In January 2004, the Company completed the sale of the land receiving net proceeds of $1.5 million and will record a gain of $0.6 million in the first quarter of 2004. The carrying value of the land was $0.9 million at December 31, 2003. These assets have been reclassified as Held for Sale under the provisions of SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.*

(4) Impairment of Long-lived Assets

During 2003, the Company incurred a $2.5 million charge to cost of sales related to the write-down of rental equipment associated with the Company s first generation radio-based VectorSeis® land acquisition systems. This equipment was being utilized in North America as part of the strategic marketing alliance between the Company and Veritas DGC Inc. In May 2003, the strategic marketing alliance was terminated. This equipment was an older generation of the Company s technology; therefore, the market demand and its net realizable value was significantly less than the Company s current generation VectorSeis land acquisition systems. The method of determining fair value was based on the forecasted cash flows (discounted) for use of the equipment. The Company s plan is to continue to market this equipment for sale or lease. As of December 31, 2003, the Company had sold approximately $0.4 million and entered into leases for approximately $0.7 million of this equipment for its recorded impaired value.

Also during 2003, the Company initiated an evaluation of its solid streamer project and concluded it would no longer internally pursue this product for commercial development. In conjunction with this evaluation, certain fixed assets and patented technology within the Marine Imaging segment were determined to be impaired in accordance with SFAS No. 144. As a result, fixed assets of $0.5 million and intangible assets of $0.6 million were written off as a charge against earnings. In addition, inventory associated with this project of $0.2 million was written off and included within research and development expenses. The Company is currently evaluating whether there are alternatives for this technology.

In 2002, the Company began the process of vacating its Alvin, Texas and Norwich, U.K. manufacturing facilities. Due to the planned closures, the Company performed an impairment test in accordance with SFAS No. 144. As a result of the impairment tests, the Alvin facility, leasehold improvements of the Norwich geophone stringing facility and certain related manufacturing equipment were considered impaired and the Company recorded impairment charges of approximately $6.3 million in 2002. The method of determining their fair values was based upon quoted market prices for the facility and operating cash flows during the interim period prior to closure for the equipment and leasehold improvements. The Company had planned to dispose of the Alvin facility and related equipment by sale. In 2003, the Company assigned its right under the Norwich lease to a third party. In July 2003, the Company completed its closure of the Alvin facility,

INPUT/OUTPUT, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

reclassifying the facility and related land as Held for Sale (see Note 3 of *Notes to Consolidated Financial Statements*) and as of December 31, 2003 the Company is actively marketing the facility for sale.

(5) Investment in Energy Virtual Partners, Inc.

In April 2003, the Company invested $3.0 million in Series B Preferred securities of Energy Virtual Partners, Inc. (EVP) for 22% of the outstanding ownership interests and 12% of the outstanding voting interests. EVP provided asset management services to large oil and gas companies to enhance the value of their oil and gas properties. This investment is accounted for under the cost method for investment accounting. Robert P. Peebler, the Company s President and Chief Executive Officer, founded EVP in April 2001 and served as EVP s President and Chief Executive Officer until joining I/O in March 2003.

During the second quarter of 2003, EVP failed to close two anticipated asset management agreements, which resulted in EVP s management re-evaluating its business model and adequacy of capital. During August 2003, the board of directors of EVP voted to liquidate EVP. For that reason, the Company wrote its investment down to its approximate liquidation value of $1.0 million, resulting in a charge against earnings in 2003 of $2.1 million. In December 2003, the Company received a portion of its final liquidation payment of $0.7 million and expects to receive an additional $0.1 million in the first quarter of 2004. Mr. Peebler has offered, and the Company has agreed, that all proceeds Mr. Peebler receives from the liquidation of EVP will be paid to the Company. In December 2003, the Company received $0.1 million from Mr. Peebler and this amount has been included in the Company s estimate of liquidation value.

(6) Inventories

A summary of inventories, net of reserves, is as follows (in thousands):

	December 31, 2003	December 31, 2002
Raw materials and subassemblies	$32,675	$31,447
Work-in-process	5,872	5,781
Finished goods	15,004	12,782
Total	$53,551	$50,010

The Company provides for estimated obsolescence or excess inventory equal to the difference between the cost of inventory and its estimated market value based upon assumptions about future demand for the Company s products and market conditions. For the years ended December 31, 2003, 2002 and 2001 the Company recorded inventory obsolescence and excess inventory charges of approximately $1.0 million, $4.3 million and $3.6 million, respectively. The Company s reserve for obsolescence or excess inventory was $11.9 million and $18.2 million at December 31, 2003 and 2002, respectively. The reduction in reserves was primarily due to reserved inventory which was sold or scrapped during the year.

In October 2003, the Company purchased certain marine equipment for $3.2 million, which was for an anticipated sale to one customer. However, this potential customer ceased negotiations after it failed to be awarded an expected survey. In the fourth quarter of 2003, the Company sold, to other customers, approximately $0.6 million of this inventory and entered into a lease agreement for approximately $0.3 million. The Company expects to sell the remainder of this inventory in 2004.

As part of the Company s business plan, the Company is increasing the use of contract manufacturers as an alternative to in-house manufacturing. Under a few of the Company s outsourcing arrangements, its manufacturing outsourcers first utilize the Company s on-hand inventory, then directly purchase inventory at agreed-upon quantities and lead times in order to meet the Company s scheduled deliveries. If demand proves to be less than the Company originally forecasted (therefore allowing the Company to cancel its committed

INPUT/OUTPUT, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

purchase orders with its manufacturing outsourcer), its outsourcer has the right to require the Company to purchase inventory which it had purchased on the Company s behalf. However, since the Company now typically issues purchase orders to its outsourcers based upon its short-term forecast (usually three months or less), the Company has reduced the risk that it may be required to purchase inventory that it may never utilize.

(7) Accounts and Notes Receivable

A summary of accounts receivable is as follows (in thousands):

	December 31, 2003	December 31, 2002
Accounts receivable, principally trade	$35,820	$20,420
Less allowance for doubtful accounts	(1,550)	(1,675)
Accounts receivable, net	$34,270	$18,745

Approximately $4.5 million of the Company s total accounts receivable at December 31, 2003 related to a July 2003 sale of an Image land data acquisition system to a Chinese customer. This customer experienced certain reliability issues with the system which the Company is currently working to resolve. The Company expects to be paid in full once all reliability issues have been resolved. Therefore, no allowance has been established for this receivable.

Notes receivable are collateralized by the products sold, bear interest at contractual rates up to 12.7% per year and are due at various dates through 2006. The weighted average interest rate at December 31, 2003 was 7.4%. A summary of notes receivable, accrued interest and allowance for loan-loss is as follows (in thousands):

	December 31, 2003	December 31, 2002
Notes receivable and accrued interest	$23,442	$ 28,422
Less allowance for loan loss	(2,613)	(10,228)
Notes receivable, net	20,829	18,194
Less current portion notes receivable, net	14,420	6,137
Long-term notes receivable	$ 6,409	$ 12,057

Approximately $9.7 million of the Company s total notes receivable at December 31, 2003 related to one Russian customer. During 2003, this customer became delinquent on approximately $0.8 million of its scheduled principal and interest payments, in addition to becoming delinquent on $1.8 million of its trade receivables. In January 2004, the Company refinanced the delinquent portion of its notes and accounts receivable into a new note totaling $2.6 million, with payments due in equal installments over a twelve month period. The customer is expected to pay all of its obligations in full. Therefore, no allowance has been established for this customer.

INPUT/OUTPUT, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The activity in the allowance for notes receivable loan loss is as follows (in thousands):

	Years Ended December 31,		
	2003	2002	2001
Balance at beginning of period	$10,228	$10,735	$10,947
Additions charged to bad debt expense		158	1,597
Recoveries reducing bad debt expense	(1,291)	(664)	(1,609)
Write-offs charged against the allowance	(6,324)	(1)	(200)
Balance at end of period	$ 2,613	$10,228	$10,735

(8) Supplemental Cash Flow Information and Non-Cash Activity

Supplemental disclosure of cash flow information is as follows (in thousands):

	Years Ended December 31,		
	2003	2002	2001
Cash paid (received) during the period for:			
Interest	$3,304	$(137)	$(4,385)
Income taxes	(384)	15	5,551

In 2003, the Company transferred $2.4 million of inventory at cost to rental equipment in connection with leasing arrangements and sold previously leased marine rental equipment to a customer via a note agreement for $1.4 million. In addition, the Company financed $1.9 million of insurance costs through the execution of short-term notes payable. See further discussion at Note 13 of *Notes to Consolidated Financial Statements.*

In August 2002, the Company repurchased all outstanding shares of its Preferred Stock. In exchange for the Preferred Stock, the Company paid $30.0 million in cash at closing, issued a $31.0 million unsecured promissory note due May 7, 2004 and granted a warrant to purchase 2,673,517 shares of the Company s common stock at $8.00 per share through August 5, 2005. In December 2003, the Company terminated the warrant by exchanging 125,000 shares of its common stock for the warrant. See further discussion at Note 14 of *Notes to Consolidated Financial Statements.*

(9) Property, Plant and Equipment

A summary of property, plant and equipment, excluding net assets held for sale (see Note 3), is as follows (in thousands):

	December 31, 2003	December 31, 2002
Land	$ 51	$ 1,255

Buildings	21,848	28,751
Machinery and equipment	49,159	73,250
Leased equipment	13,288	4,047
Other	8,150	8,776
	92,496	116,079
Less accumulated depreciation	64,889	76,824
Property, plant and equipment, net	$27,607	$ 39,255

Total depreciation expense for the years ended December 31, 2003, 2002 and 2001 was $10.3 million, $11.8 million and $12.5 million, respectively. At December 31, 2003, there was $20.3 million of land and

INPUT/OUTPUT, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

buildings, less accumulated depreciation of $7.7 million, which are recorded pursuant to a twelve-year non-cancelable lease agreement (see Note 13 of *Notes to Consolidated Financial Statements*) and are being depreciated over the twelve-year lease term.

(10) Goodwill

In August 2003, the Company paid $1.3 million in additional consideration to the former shareholders of AXIS Geophysics, Inc. (AXIS) to settle all future contingent obligations. This additional consideration was recorded as an increase to goodwill. See further discussion at Note 15 of *Notes to Consolidated Financial Statements*.

During the third quarter of 2002, the Company performed an interim impairment test on the Company s analog land products reporting unit. This reporting unit represents the Company s traditional analog geophones, vehicles and vibrators, cables and connectors. The continuing weakness in the traditional analog land seismic markets and the financial condition of many of the seismic contractors, coupled with an anticipated decrease in demand for analog products, precipitated the need for this interim impairment. The results of the impairment test indicated that all of the goodwill associated with the Company s analog land products reporting unit was impaired. Therefore an impairment charge of $15.1 million was recorded in the third quarter of 2002. The annual impairment assessment performed at December 31, 2003 and 2002 resulted in no impairment of the Company s goodwill. The Company determines the fair value of the reporting units using a discounted future returns valuation method.

The following is a summary of the changes in the carrying amount of goodwill for the year ended December 31, 2003 and 2002:

	Land Division	Marine Division	Processing Division	Total
Balance as of January 1, 2002	$ 18,939	$ 26,645	$	$ 45,584
Goodwill acquired during the year			3,296	3,296
Impairment losses	(15,122)			(15,122)
Balance as of December 31, 2002	3,817	26,645	3,296	33,758
Goodwill acquired during the year			1,267	1,267
Balance as of December 31, 2003	$ 3,817	$ 26,645	$ 4,563	$ 35,025

The following is a reconciliation of reported net income to adjusted net income subsequent to the adoption of SFAS No. 142 (in thousands):

	Years Ended December 31,		
	2003	2002	2001
Reported net earnings (loss) applicable to common shares	$ (23,152)	$ (120,821)	$ 3,709
Elimination of goodwill amortization			3,873
Adjusted net earnings (loss) applicable to common shares	$ (23,152)	$ (120,821)	$ 7,582
Basic and diluted earnings (loss) per common share as reported	$ (0.45)	$ (2.37)	$ 0.07

Adjusted basic and diluted earnings (loss) per common share	$ (0.45)	$ (2.37)	$ 0.15

INPUT/OUTPUT, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(11) Intangible Assets

A summary of intangible assets, included in other assets, net, is as follows (in thousands):

	As of December 31, 2003			As of December 31, 2002		
	Gross Amount	Accumulated Amortization	Net	Gross Amount	Accumulated Amortization	Net
Proprietary technology	$ 7,317	$ (6,571)	$ 746	$ 7,317	$ (5,832)	$ 1,485
Patents	3,789	(1,688)	2,101	3,789	(890)	2,899
Customer list	300	(103)	197	300	(63)	237
Non-compete agreements	300	(300)		300	(266)	34
Total	$ 11,706	$ (8,662)	$ 3,044	$ 11,706	$ (7,051)	$ 4,655

Total amortization expense, excluding amortization of goodwill, for the years ended December 31, 2003, 2002 and 2001 was $1.1 million, $1.4 million and $1.1 million, respectively. A summary of the estimated amortization expense for the next five years is as follows (in thousands):

Years Ended December 31,	
2004	$ 561
2005	$ 552
2006	$ 424
2007	$ 275
2008	$ 267

(12) Accrued Expenses

A summary of accrued expenses is as follows (in thousands):

	December 31, 2003	December 31, 2002
Compensation, including compensation-related taxes and commissions	$ 6,223	$ 5,756
Product warranty	3,433	2,914
Severance (see Note 2)	192	1,009
Abandoned non-cancelable lease obligations (see Note 2)	640	1,345
Accrued property tax	1,691	1,916
Other	3,654	4,270
Total accrued expenses	$ 15,833	$ 17,210

The Company warrants that all manufactured equipment will be free from defects in workmanship, materials and parts. Warranty periods range from 90 days to three years from the date of original purchase, depending on the product. The Company provides for estimated warranty as a charge to cost of sales at time of sale, which is when estimated future expenditures associated with such contingencies become probable and reasonably estimated. However, new information may become available, or circumstances (such as applicable laws and regulations) may change, thereby resulting in an increase or decrease in the amount required to be

INPUT/OUTPUT, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

accrued for such matters (and therefore a decrease or increase in reported net income in the period of such change). A summary of warranty activity is as follows (in thousands):

	Years Ended December 31,		
	2003	**2002**	**2001**
Balance at beginning of period	$ 2,914	$ 4,669	$ 6,302
Accruals for warranties issued during the period	2,885	1,679	2,132
Settlements made (in cash or in kind) during the period	(2,366)	(3,434)	(3,765)
Balance at end of period	$ 3,433	$ 2,914	$ 4,669

(13) Notes Payable, Long-term Debt and Lease Obligations

In December 2003, the Company issued $60.0 million of convertible senior notes, which mature on December 15, 2008. The notes bear interest at an annual rate per annum of 5.5%, payable semi-annually. The notes, which are not redeemable prior to their maturity, are convertible into the Company s common stock at an initial conversion rate of 231.4815 shares per $1,000 principal amount of notes (a conversion price of $4.32), which represents 13,888,888 total common shares. The Company paid $3.5 million in underwriting and professional fees, which have been recorded as deferred financing costs and are being amortized over the term of the notes.

In May 2003, the Company financed $0.5 million of insurance costs through the execution of a short-term note payable. The principal and interest are due on a monthly basis bearing an interest rate of 5.75%, with final payment due in February 2004. In August 2003, the Company financed an additional $1.4 million of insurance costs with similar terms except final payment is due in May 2004. The unpaid balance under these notes payable at December 31, 2003 was $0.9 million.

In August 2002, in connection with the repurchase of Preferred Stock, the Company issued a $31.0 million unsecured promissory note due May 7, 2004, which bore interest at 8% per year until May 7, 2003, at which time the interest rate increased to 13%. Interest was payable in quarterly payments, with all principal and unpaid interest due on May 7, 2004. The Company recorded interest on this note at an effective rate of approximately 11% per year over the life of the note. In May 2003, the Company repaid $15.0 million of the note and in December 2003, the Company repaid, in full, the remaining outstanding principal of $16.0 million. The note restricted cash dividends in excess of $5.0 million per year while the note was outstanding.

In July 2002, in connection with the acquisition of AXIS, the Company entered into a $2.5 million three-year unsecured promissory note payable to the former shareholders of AXIS, bearing interest at 4.34% per year. Principal is payable in quarterly payments of $0.2 million plus interest, with final payment due in July 2005. The unpaid balance at December 31, 2003 was $1.5 million.

In August 2001, the Company sold its corporate headquarters and manufacturing facility located in Stafford, Texas for $21.0 million. Simultaneous to the sale, the Company entered into a non-cancelable lease with the purchaser of the property. The lease has a twelve-year term with three consecutive options to extend the lease for five years each. The Company has no purchase option pursuant to the lease. As a result of the lease terms, the commitment was recorded as a twelve-year $21.0 million lease obligation with an implicit interest rate of 9.1%. The unpaid balance at December 31, 2003 was $18.8 million. The Company paid $1.7 million in commissions and professional fees, which have been recorded as deferred financing costs and are being amortized over the twelve-year term of the obligation. At June 30, 2003, the Company failed to meet the tangible net worth requirement under this lease. Therefore, in the third quarter of 2003, the Company provided a letter of credit to the landlord of the property in the amount of $1.5 million. To secure the issuance of the letter of credit, the Company was required to deposit $1.5 million with the issuing bank. This letter of

INPUT/OUTPUT, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

credit will remain outstanding until the Company is back in compliance with the tangible net worth requirement for eight consecutive quarters, or until the expiration of the eighth year of the lease, which is in 2009. The deposit has been classified as a long-term other asset.

In January 2001, in connection with the acquisition of Pelton Company, Inc. (Pelton), the Company entered into a $3.0 million two-year unsecured promissory note payable to a former shareholder of Pelton, bearing interest at 8.5% per year. This note was paid in full in February 2003.

A summary of future principal obligations under the notes payable, long-term debt and lease obligations is as follows (in thousands):

Years Ended December 31,	
2004	$ 2,687
2005	1,840
2006	1,470
2007	1,610
2008	61,763
2009 and thereafter	11,833
Total	$81,203

(14) Stockholders Equity

Series B and Series C Preferred Stock. In 1999, SCF-IV L.P., (SCF), a Houston-based private equity fund specializing in oil service investments, purchased, in a privately negotiated transaction, 40,000 shares of Series B Cumulative Preferred stock and 15,000 shares of Series C Convertible Preferred Stock (the Preferred Stock) at a purchase price of $1,000 per share (the Stated Value), for an aggregate of $55.0 million. The Preferred Stock earned an 8% dividend, of which the Company paid 1% quarterly in cash and accrued the balance to increase the Adjusted Stated Value ($1,000 per share Stated Value plus accrued and unpaid dividends) of the Preferred Stock.

The Preferred Stock became convertible at the option of SCF on May 7, 2002. Under its terms, the number of shares into which the Preferred Stock would have been convertible was the greater of (i) Stated Value divided by approximately $8.14 per share or (ii) Adjusted Stated Value divided by the average market price of common stock during the ten-day trading period immediately prior to conversion. The Company had the right, without the holder s consent, to redeem for cash up to one-half of any Preferred Stock tendered for conversion based on the Adjusted Stated Value of such Preferred Stock on the conversion date.

On August 6, 2002, the Company repurchased all Preferred Stock from SCF. If SCF had converted all of the Preferred Stock on August 6, 2002, and the Company had declined to exercise their redemption rights, SCF would have received about 9.2 million shares of common stock, representing 15.3% of the Company s total outstanding common stock after giving effect to the conversion. In exchange for the Preferred Stock, the Company paid SCF $30.0 million in cash at closing, issued SCF a $31.0 million unsecured promissory note due May 7, 2004 and granted SCF a warrant to purchase 2,673,517 shares of common stock at $8.00 per share through August 5, 2005. The Note bore interest at 8% per annum until May 7, 2003, at which time the interest rate increased to 13%. The Company recorded interest on this note at an effective rate of approximately 11% per year. In December 2003, the Company paid the Note in full and terminated the warrant by exchanging 125,000 of its common stock for the warrant. The difference in the fair value of the consideration granted to SCF and the carrying value of the Preferred Stock on the Company s balance sheet ($68.8 million) was added to net earnings available to common shareholders in the calculation of earnings per share. The difference represents the foregone return to the preferred shareholder and is treated similarly as a dividend;

INPUT/OUTPUT, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

accordingly, a negative dividend of $2.5 million was recognized upon the repurchase. Immediately preceding the closing of this transaction, David C. Baldwin, the elected representative of the holder of the Preferred Stock, resigned from the board of directors.

Under the terms of a registration rights agreement, SCF had the right to demand that the Company file a registration statement for the resale of the shares of common stock SCF acquired upon exercise of the warrant. If the Company was acquired in a business combination pursuant to which the stockholders received less than 60% of the aggregate consideration in the form of publicly traded common equity, then the holder of the warrant had the option to require the Company to acquire the warrant at its fair value as determined by the Black-Scholes valuation model as further refined by the terms of the warrant agreement. Because the Company might have been required to repurchase the warrant in these limited circumstances, the warrant was classified as a current liability on the balance sheet and the Company recorded any change in value as a credit or charge to the consolidated statement of operations. The change in the fair value of the warrant in 2003 until its termination and in 2002 from the date of its issuance resulted in other income of $1.8 million and $3.3 million, respectively. Fair value was determined using the Black-Scholes valuation model. The key variables used in valuing the warrant were contractually specified and were as follows: risk-free rate of return of Treasury notes having an approximate duration of the remaining term of the warrant and expected stock price volatility of 60%.

Stockholders Rights Plan. The Company s board of directors has adopted a stockholder rights plan. The stockholder rights plan was adopted to give the Company s board of directors increased power to negotiate in the Company s best interests and to discourage appropriation of control of the Company at a price that is unfair to its stockholders. It is not intended to prevent fair offers for acquisition of control determined by the Company s board of directors to be in the best interest of the Company and its stockholders, nor is it intended to prevent a person or group from obtaining representation on or control of the Company s board of directors through a proxy contest, or to relieve the Company s board of directors of its fiduciary duty to consider any proposal for acquisition in good faith.

The stockholder rights plan involved the distribution of one preferred share purchase right as a dividend on each outstanding share of the Company s common stock to all holders of record on January 27, 1997. Each right will entitle the holder to purchase one one-thousandth of a share of the Company s Series A Preferred Stock at an purchase price of $200 per one one-thousandth of a share of Series A Preferred Stock, subject to adjustment. The rights trade in tandem with the Company s common stock until, and become exercisable following, the occurrence of certain triggering events. The board of directors retains the right to discontinue the stockholder rights plan through the redemption of all rights or to amend the stockholder rights plan in any respect prior to the Company s announcement of the occurrence of any such triggering event, including the acquisition of 20% or more of the Company s voting stock by an acquirer. The rights will expire at the close of business on January 27, 2007, unless earlier redeemed by the Company.

Treasury Stock. In October 2001, the Company s Board of Directors authorized the repurchase of up to 1,000,000 shares of common stock in the open market and privately negotiated transactions at such prices and at such times as management deems appropriate. Under this repurchase program the Company had repurchased 40,000 shares of common stock for a total purchase price of $0.2 million at an average price of $3.97 per share for the year ended December 31, 2002. During 2003, the Company purchased 16,939 shares at an average price of $4.78 per share and issued 22,814 of treasury shares to the Board of Directors in lieu of directors fees. At December 31, 2003, the Company owned 777,423 shares of treasury stock.

Stock Option Plans. The Company has adopted a stock option plan for eligible employees, which, together with previous plans, provides for the granting of options to purchase a maximum of 11,200,000 shares of common stock. The options under these plans generally vest in equal annual installments over a four-year period beginning on the anniversary of the date of grant and have a term of ten years. The Company has also adopted a director s stock option plan, which provides for the granting of options to purchase a maximum of

INPUT/OUTPUT, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

700,000 shares of common stock by non-employee directors. The vesting schedule under this plan is determined based upon the years of service. The maximum vesting period is equal annual installments over a three-year period beginning on the anniversary of the date of grant. The options have a term of ten years.

Effective March 31, 2003, the Company granted its President and Chief Executive Officer stock options to purchase 1,325,000 shares of common stock of the Company at an exercise price of $6.00 per share. The options vest in equal monthly installments over a three-year period beginning on the anniversary of the date of grant and have a term of ten years. The market price of the Company s common stock at the close of business on March 31, 2003 was $3.60.

At December 31, 2003, 353,358 shares remained available for issuance pursuant to these plans. Transactions under the stock option plans are summarized as follows:

	Option Price Per Share	Outstanding	Vested	Available for Grant
January 1, 2001	$2.03 - $30.00	4,778,478	2,322,559	2,993,572
Granted	8.45 - 12.45	929,000		(929,000)
Vested			860,632	
Exercised	2.03 - 11.00	(326,921)	(326,921)	
Canceled/forfeited	2.03 - 29.69	(519,757)	(404,508)	(617,464)
December 31, 2001	3.50 - 30.00	4,860,800	2,451,762	1,447,108
Granted	4.35 - 9.50	870,500		(870,500)
Vested			923,706	
Exercised	3.50 - 8.19	(163,234)	(163,234)	
Canceled/forfeited	3.50 - 23.88	(570,023)	(165,100)	233,500
December 31, 2002	3.91 - 30.00	4,998,043	3,047,134	810,108
Increase in shares authorized				1,500,000
Granted	3.30 - 6.00	2,425,500		(2,425,500)
Vested			1,154,970	
Canceled/forfeited	3.35 - 29.69	(1,834,711)	(1,732,509)	468,750
December 31, 2003	$3.30 - $30.00	5,588,832	2,469,595	353,358

INPUT/OUTPUT, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Stock options outstanding at December 31, 2003 are summarized as follows:

Option Price Per Share	Outstanding	Weighted Average Exercise Price of Outstanding Options	Weighted Average Remaining Contract Life	Vested	Weighted Average Exercise Price of Vested Options
$3.30 - $3.93	769,500	3.36	9.1	10,000	3.81
3.94 - 7.85	2,747,714	5.85	7.7	1,041,394	5.91
7.86 - 11.78	1,295,750	9.80	7.2	659,333	9.73
11.79 - 15.70	119,100	13.11	4.4	102,100	13.23
15.71 - 19.63	272,218	17.71	2.9	272,218	17.71
19.64 - 23.55	257,150	21.71	3.5	257,150	21.71
23.56 - 27.48	17,200	24.62	4.3	17,200	24.62
27.49 - 30.00	110,200	29.35	3.0	110,200	29.35
$3.30 - $30.00	5,588,832	8.40	7.2	2,469,595	11.35

The Company has elected to continue to follow the intrinsic value method of accounting as prescribed by APB Opinion No. 25. See Note 1 of *Notes to Consolidated Financial Statements* for a summary of the net earnings (loss) impact if the Company had adopted the fair value method of accounting for stock-based compensation of SFAS No. 123.

Restricted Stock Plans. The Company has adopted restricted stock option plans which provide for the award of up to 300,000 shares of common stock to key officers and employees. Ownership of the common stock will vest over a period as determined by the Company in its sole direction. Shares awarded may not be sold, assigned, transferred, pledged or otherwise encumbered by the grantee during the vesting period. Except for these restrictions, the grantee of an award of shares has all the rights of a common stockholder, including the right to receive dividends and the right to vote such shares. At December 31, 2003, there were 158,515 shares outstanding, which are scheduled to vest over a period through June 7, 2006. At December 31, 2003 there are 87,652 shares available for future awards under these plans.

The market value of shares of common stock granted under the restricted stock plans were recorded as unamortized restricted stock compensation and reported as a separate component of stockholders equity. The restricted stock compensation is amortized over the vesting period. For the years ended December 31, 2003, 2002 and 2001 the Company recognized amortization of restricted stock of $(0.2) million, $0.4 million and $0.2 million, respectively. The restricted stock credit for the year ended December 31, 2003 related to the cancellation of unvested restricted stock associated with the Company s former President and Chief Operating Officer and its former Vice President of Business Development.

Employee Stock Purchase Plan. In April 1997, the Company adopted the Employee Stock Purchase Plan, which allows all eligible employees to authorize payroll deductions at a rate of 1% to 15% of base compensation for the purchase of the Company s common stock. The purchase price of the common stock will be the lesser of 85% of the closing price on the first day of the applicable offering period (or most recently preceding trading day) or 85% of the closing price on the last day of the offering period (or most recently preceding trading day). Each offering period is six months and commences on January 1 and July 1 of each year. There were 127,122; 117,876 and 102,186 shares purchased by employees during the years ended December 31, 2003, 2002 and 2001, respectively.

INPUT/OUTPUT, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(15) Acquisitions

In July 2002, the Company acquired all of the outstanding capital stock of AXIS for $2.5 million of cash and issued a $2.5 million three-year unsecured promissory note. Under the terms of the agreement the Company was obligated to pay additional consideration to the former shareholders of AXIS at an amount equal to 33.33% of AXIS adjusted EBITDA for the years ended December 31, 2003, 2004 and 2005, exceeding a minimum threshold of $1.0 million. There was no limitation to the maximum additional consideration which could have been paid. In August 2003, the Company paid $1.3 million in additional consideration to the former shareholders of AXIS to settle all future contingent obligations. This additional consideration was recorded as an increase to goodwill.

AXIS is a seismic data service company based in Denver, Colorado, which provides specialized seismic data processing and integration services to major and independent exploration and production companies. The Company acquired AXIS as part of its strategy of deploying VectorSeis technology for land, in-well and ocean bottom environments, by allowing the Company to offer both its VectorSeis technology and a related service of interpreting multi-component data.

In May 2002, the Company acquired certain assets of S/ N Technologies (S/ N) for $0.7 million of cash. The assets acquired from S/ N included proprietary technology applicable to solid streamer products used to acquire 2D, 3D and high-resolution marine seismic data. However, in May 2003 the Company determined that it would no longer continue the internal development of the solid streamer project. As such, the acquired assets of S/ N were impaired and other assets associated with this project were written off as of March 31, 2003. See further discussion of this impairment at Note 4 of *Notes to Consolidated Financial Statements.*

In January 2001, the Company acquired all the outstanding capital stock of Pelton for approximately $6.0 million in cash and a $3.0 million two-year unsecured promissory note. Pelton is based in Ponca City, Oklahoma and designs, manufactures and sells seismic vibrator control systems, vibrator positioning systems and explosive energy control systems.

The acquisitions were accounted for by the purchase method, with the purchase price allocated to the fair value of assets purchased and liabilities assumed. The allocation of the purchase price, including related direct costs, for the acquisition of AXIS, S/ N and Pelton are as follows (in thousands):

	Acquired in 2002		Acquired in 2001
	AXIS	**S/N**	**Pelton**
Fair values of assets and liabilities			
Net current assets	$ 395	$	$ 5,266
Property, plant and equipment	354	85	373
Intangible assets	1,142	603	2,985
Goodwill	4,563		1,984
Long-term liabilities	(224)		
Total allocated purchase price	6,230	688	10,608
Less non-cash consideration note payable	2,500		3,000
Less cash of acquired business	501		2,032
Cash paid for acquisition, net of cash acquired	$3,229	$688	$ 5,576

The consolidated results of operations of the Company include the results of AXIS, S/ N and Pelton from the date of acquisition. Pro-forma results prior to the acquisition date were not material to the Company s consolidated results of operations. The intangible asset of AXIS relates to proprietary technology, which is

INPUT/OUTPUT, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

being amortized over a 4-year period. The intangible assets of Pelton primarily relate to acquired patents and are being amortized over a weighted-average useful life of 11 years. The goodwill of AXIS was assigned to the Processing reporting unit and is fully deductible for tax purposes. The goodwill of Pelton was assigned to the analog land products reporting unit, a reporting unit within the Company s Land Imaging segment.

(16) Segment and Geographic Information

The Company evaluates and reviews results based on three segments, Land Imaging, Marine Imaging and Processing, to allow for increased visibility and accountability of costs and more focused customer service and product development. The Company measures segment operating results based on earnings (loss) from operations.

Prior to December 31, 2003, the Company included Processing within the Land Imaging segment due to its relatively low contribution to their operations. However, during 2003 as the Company re-evaluated its business strategies, the Company believes it will be an increasing portion of their business and should be reported as a separate segment. A summary of segment information, restated for prior years to reflect the Processing segment, is as follows (in thousands):

	Years Ended December 31,		
	2003	2002	2001
Net sales:			
Land Imaging	$108,545	$ 63,032	$162,256
Marine Imaging	35,694	53,357	49,794
Processing	5,794	2,194	
	$150,033	$118,583	$212,050
Earnings (loss) from operations			
Land Imaging	$ (2,568)	$ (46,450)	$ 13,718
Marine Imaging	(778)	6,878	5,662
Processing	977	(938)	
Corporate	(18,925)	(23,055)	(11,475)
	$ (21,294)	$ (63,565)	$ 7,905
Depreciation and amortization			
Land Imaging	$ 4,222	$ 7,260	$ 8,685
Marine Imaging	2,891	1,701	3,537
Processing	689	417	
Corporate	3,642	3,859	5,313
	$ 11,444	$ 13,237	$ 17,535

INPUT/OUTPUT, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	December 31, 2003	December 31, 2002
Total assets:		
Land Imaging	$ 99,174	$ 96,754
Marine Imaging	63,123	62,359
Processing	8,133	7,203
Corporate	77,625	82,129
	$248,055	$248,445
Total assets by geographic area:		
North America	$215,612	$205,640
Europe	26,842	41,679
Middle East	5,601	1,126
	$248,055	$248,445

Intersegment sales are insignificant for all periods presented. Corporate assets include all assets specifically related to corporate personnel and operations, a majority of cash and cash equivalents, and all facilities that are jointly utilized by segments. Depreciation and amortization expense is allocated to segments based upon use of the underlying assets.

A summary of net sales by geographic area follows (in thousands):

	Years Ended December 31,		
	2003	2002	2001
North America	$ 34,813	$ 34,295	$ 79,115
Middle East	10,231	2,013	46,189
Europe	19,976	34,151	27,034
Asia Pacific	44,693	15,312	25,530
Commonwealth of Independent States	19,991	21,178	23,544
Latin America	15,438	7,227	3,772
Africa	4,876	4,050	6,865
Other	15	357	
	$150,033	$118,583	$212,050

Net sales are attributed to individual countries on the basis of the ultimate destination of the equipment, if known; if the ultimate destination is not known, it is based on the geographical location of initial shipment.

Net sales to individual customers representing 10% or more of net sales were as follows:

Years Ended

Customer	December 31, 2003	2002	2001
A	3%	11%	37%
B	4%	10%	1%
C	28%	3%	2%

INPUT/OUTPUT, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(17) Income Taxes

Components of income taxes follows (in thousands):

	Years Ended December 31,		
	2003	**2002**	**2001**
Federal	$(1,968)	$ 8	$(1,116)
Foreign	1,914	(2,484)	4,917
State and local	402	403	303
Deferred		59,992	(976)
Total income tax expense	$ 348	$57,919	$ 3,128

A reconciliation of the expected income tax expense on earnings (loss) before income taxes using the statutory Federal income tax rate of 35% for the years ended December 31, 2003, 2002 and 2001 to income tax expense is as follows (in thousands):

	Years Ended December 31,		
	2003	**2002**	**2001**
Expected income tax (benefit) expense at 35%	$(8,012)	$(21,684)	$ 4,365
Foreign taxes, net	(1,487)	(1,547)	1,729
State and local taxes	261	262	197
Return to provision	5,106	(5,221)	
Deferred tax asset valuation allowance	4,289	85,868	(3,991)
Nondeductible amortization	165	266	979
Other	26	(25)	(151)
Total income tax expense	$ 348	$ 57,919	$ 3,128

The tax effects of the cumulative temporary differences resulting in the net deferred income tax asset (liability) are as follows (in thousands):

	December 31, 2003	**December 31, 2002**
Current deferred:		
Deferred income tax assets:		
Accrued expenses	$ 767	$ 1,790
Allowance accounts	5,786	12,279
Inventory	396	512

Total current deferred income tax asset	6,950	14,581
Valuation allowance	(6,950)	(14,581)
Net current deferred income tax asset	$	$

F-28

INPUT/OUTPUT, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	December 31, 2003	December 31, 2002
Noncurrent deferred:		
Deferred income tax assets:		
Basis in identified intangibles	$ 10,372	$ 12,239
Net operating loss carryforward	53,574	50,890
Basis in research and development	29,908	20,620
Alternative minimum tax credit	1,336	1,336
Other	1,664	1,504
Total deferred income tax asset	96,854	86,589
Valuation allowance	(96,071)	(84,151)
Net non-current deferred income tax asset	783	2,438
Deferred income tax liabilities:		
Basis in property, plant and equipment	(783)	(2,438)
Net non-current deferred income tax asset (liability)	$	$

In 2002, the Company recorded an additional valuation allowance of $85.9 million, resulting in a net charge to income tax expense of $60.0 million for its net deferred tax assets, which are primarily net operating loss carryforwards. The Company currently does not recognize a benefit from net operating losses. The establishment of this valuation allowance does not affect the Company s ability to reduce future tax expense through utilization of prior years net operating losses.

The valuation allowance was calculated in accordance with the provisions of SFAS No. 109, *Accounting for Income Taxes,* which places primary importance on the Company s cumulative operating results in the most recent three-year period when assessing the need for a valuation allowance. The Company s results for those periods were heavily affected by both industry conditions, and deliberate and planned business restructuring activities in response to the prolonged downturn in the seismic equipment market, as well as heavy expenditures on research and development. Nevertheless, recent losses represented sufficient negative evidence to establish an additional valuation allowance. The Company has continued to reserve all net deferred tax assets and will continue until there is sufficient evidence to warrant reversal. At December 31, 2003, the Company had net operating loss carry-forwards of $153 million, which expire over the next 16 to 20 years.

Included within Other Long-Term Liabilities on the Consolidated Balance Sheets at December 31, 2002 is $4.2 million which primarily consists of reserves for various foreign and state tax matters. As of December 31, 2003, that balance had been decreased to $3.1 million due to closure of certain state tax matters.

(18) Operating Leases

Lessee. The Company leases certain equipment, offices and warehouse space under non-cancelable operating leases. Rental expense was $1.4 million, $2.1 million and $1.8 million for the years ended December 31, 2003, 2002 and 2001, respectively.

INPUT/OUTPUT, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

A summary of future rental commitments under non-cancelable operating leases is as follows (in thousands):

Years Ended December 31,	
2004	$2,453
2005	806
2006	559
2007	374
2008	928
Total	$5,120

Lessor. The Company leases seismic equipment to customers under operating leases of two years or less. At December 31, 2003, the total cost of equipment leased or held for lease was $13.3 million, less accumulated depreciation of $8.6 million. The Company also leases under-utilized facilities under various lease and sub-lease agreements. A summary of lease revenues is as follows (in thousands):

	Years Ended December 31,		
	2003	2002	2001
Equipment rental	$4,348	$2,750	$3,749
Facility rental	981	1,297	736
Total rentals	$5,329	$4,047	$4,485

A summary of future minimum non-cancelable lease and sublease income is as follows (in thousands):

Years Ended December 31,	Equipment Rental	Sublease
2004	$2,219	$1,557
2005	106	337
2006		162
2007		14
Total	$2,325	$2,070

(19) Benefit Plans

401(k). The Company has a 401(k) retirement savings plan which covers substantially all employees. Employees may voluntarily contribute up to 60% of their compensation, as defined, to the plan. The Company, effective June 1, 2000, adopted a company matching contribution to the 401(k) plan. The Company matches the employee contribution at a rate of 50% of the first 6% of compensation contributed to the plan. Company contributions to the plan were $1.0 million, $0.8 million and $0.9 million, during the years ended December 31, 2003, 2002 and 2001, respectively.

Supplemental executive retirement plan. The Company had a non-qualified, supplemental executive retirement plan (SERP). The SERP provided for certain compensation to become payable on the participants death, retirement or total disability as set forth in the plan. The only remaining obligations under this plan are the scheduled benefit payments to the spouse of a deceased former executive.

Directors Plan. The Company had also adopted a non-qualified, unfunded outside directors retirement plan. The plan provides for certain compensation to become payable on the participants death, retirement or total disability as set forth in the plan. The consolidated financial statements include pension expense of $0,

INPUT/OUTPUT, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

$0.2 million and $0 for the years ended December 31, 2003, 2002 and 2001, respectively. All benefits under this plan have previously been frozen.

(20) Selected Quarterly Information (Unaudited)

A summary of selected quarterly information is as follows (in thousands, except per share amounts):

	Three Months Ended			
Year Ended December 31, 2003	**March 31**	**June 30**	**September 30**	**December 31**
Net sales	$41,177	$ 34,562	$30,307	$43,987
Gross profit	8,457	2,974	5,219	11,191
Earnings (loss) from operations	(5,057)	(10,368)	(6,613)	744
Interest expense	(1,345)	(843)	(954)	(945)
Interest and other income	840	976	785	278
Fair value adjustment and exchange of warrant obligation	871	(1,712)	1,829	769
Impairment of investment		(2,036)		(23)
Income tax expense (benefit)	588	(297)	(133)	190
Net earnings (loss) applicable to common shares	$ (5,279)	$(13,686)	$ (4,820)	$ 633
Basic loss per share	$ (0.10)	$ (0.27)	$ (0.09)	$ 0.01
Diluted loss per share	$ (0.10)	$ (0.27)	$ (0.09)	$ 0.01

	Three Months Ended			
Year Ended December 31, 2002	**March 31**	**June 30**	**September 30**	**December 31**
Net sales	$30,213	$ 22,850	$ 28,539	$36,981
Gross profit	6,645	2,164	3,402	5,354
Loss from operations	(7,533)	(13,987)	(32,331)	(9,714)
Interest expense	(35)	(461)	(1,247)	(1,381)
Interest and other income (expense)	355	546	(10)	591
Fair value adjustment of warrant obligation			2,345	907
Income tax expense (benefit)	(2,671)	63,511	157	(3,078)
Net loss applicable to common shares	$ (5,997)	$(78,892)	$(29,413)	$ (6,519)
Basic loss per share	$ (.12)	$ (1.55)	$ (.58)	$ (.13)
Diluted loss per share	$ (.12)	$ (1.55)	$ (.58)	$ (.13)

INPUT/OUTPUT, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(21) Summary of Significant Charges

The table below summarizes the significant charges during the periods presented (in thousands):

	Inventory Related Charges	Long-Lived Asset and Goodwill Related Charges	Personnel/ Facility and Other Charges	Tax Valuation Allowance	Impairment of Investment	Total
Charges for the year ended December 31, 2001 by business segment:						
Land Imaging	$1,784	$	$	$	$	$ 1,784
Marine Imaging	1,834					1,834
	$3,618	$	$	$	$	$ 3,618
Charges for year ended December 31, 2001 by category:						
Cost of sales	$3,618	$	$	$	$	$ 3,618
Charges for year ended December 31, 2002 by business segment:						
Land Imaging	$2,958	$15,946	$3,030	$	$	$21,934
Marine Imaging	1,384	244	576			2,204
Processing			674			674
Corporate		5,206	1,072	59,992		66,270
	$4,342	$21,396	$5,352	$59,992	$	$91,082
Charges for year ended December 31, 2002 by category:						
Cost of sales	$4,342	$	$1,924	$	$	$ 6,266
Research & development			2,171			2,171
Sales & marketing			182			182
General and administrative			1,075			1,075
Impairment of long-lived assets		6,274				6,274
Goodwill impairment		15,122				15,122
Income tax expense					59,992	59,992
	$4,342	$21,396	$5,352	$59,992	$	$91,082

INPUT/OUTPUT, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Inventory Related Charges	Long-Lived Asset and Goodwill Related Charges	Personnel/ Facility and Other Charges	Tax Valuation Allowance	Impairment of Investment	Total
Charges for year ended December 31, 2003 by business segment:						
Land Imaging	$ 957	$2,500	$ 709	$	$	$4,166
Marine Imaging	267	1,120	345			1,732
Corporate			249		2,059	2,308
	$1,224	$3,620	$1,303	$	$2,059	$8,206
Charges for year ended December 31, 2003 by category:						
Cost of sales	$1,054	$2,500	$ 691	$	$	$4,245
Research & development	170		471			641
Sales & marketing			(26)			(26)
General and administrative			167			167
Impairment of long-lived assets		1,120				1,120
Impairment of investment					2,059	2,059
	$1,224	$3,620	$1,303	$	$2,059	$8,206

(22) Legal Matters

In the ordinary course of business, the Company has been named in various lawsuits. While the final resolution of these matters could have an impact on the consolidated financial results for a particular reporting period, the Company believes that the ultimate resolution of these matters will not have a material adverse impact on the financial position or liquidity of the Company.

(23) Related Parties

In April 2003, the Company invested in Energy Virtual Partners, an entity for whom the Company s president was founder, president and Chief Executive Officer. See Note 5 of *Notes to Consolidated Financial Statements*.

Mr. Lapeyre is the chairman and a significant equity owner of Laitram, L.L.C. (Laitram) and has served as president of Laitram and its predecessors since 1989. Laitram is a privately owned, New Orleans-based manufacturer of food processing equipment and modular conveyor belts. Mr. Lapeyre and Laitram together owned 15.2% of the Company s outstanding common stock as of December 31, 2003.

The Company acquired DigiCourse, Inc., the Company s marine positioning products business, from Laitram in 1998 and renamed it I/O Marine Systems, Inc. In connection with that acquisition, the Company entered into a Continued Services Agreement with Laitram under which Laitram agreed to provide the Company certain accounting, software, manufacturing and maintenance services. Manufacturing services consist primarily of machining of parts for the Company s marine positioning systems. The term of this

F-33

INPUT/OUTPUT, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

agreement expired in September 2001 but the Company continues to operate under its terms. In addition, when the Company requests, the legal staff of Laitram advises the Company on certain intellectual property matters with regard to the Company s marine positioning systems. During 2003, the Company paid Laitram a total of $1.2 million, which consisted of $0.6 million of manufacturing services and $0.6 million of rent and other facilities charges. In the opinion of the Company s management, the terms of these services are fair and reasonable and as favorable to the Company as those that could have been obtained from unrelated third parties at the time of their performance.

In March 2000, the Company s board of directors established an executive matching program under which the Company issued one share of restricted stock for each share purchased by the Company s senior executives in open-market transactions in March and April of 2000. In connection with this program, the Company issued 33,000 shares of restricted stock to C. Robert Bunch; a former executive officer of I/O. Mr. Bunch funded his purchase through a loan from a commercial bank in the amount of $200,000. The Company guaranteed this indebtedness in 2000 and would have been liable for the entire amount outstanding under this loan if Mr. Bunch had defaulted on his obligation under the loan. The Company s guarantee of Mr. Bunch s indebtedness expired by its terms in March 2003. Mr. Bunch left the Company s employment in May 2003.

(24) Subsequent Event

On February 24, 2004, the Company purchased all the share capital of Concept Holdings Systems Limited, a provider of software, systems and services for towed streamer, seabed and land seismic operations based in Edinburgh, Scotland, in a privately negotiated transaction. The purchase price was approximately US$36 million in cash and 1,680,000 shares of the Company s common stock. The price of the Company s common stock on February 24, 2004 was $6.41.

INDEX TO EXHIBITS

Exhibit Number	Description
3.1	Amended and Restated Certificate of Incorporation filed as Exhibit 3.1 to the Company s Transition Report on Form 10-K for the seven months ended December 31, 2000, and incorporated herein by reference.
*3.2	Certificate of Amendment to the Amended and Restated Certificate of Incorporation, dated October 10, 1996.
3.3	Amended and Restated Bylaws filed as Exhibit 4.3 to the Company s Current Report on Form 8-K filed with the Securities and Exchange Commission on March 8, 2002, and incorporated herein by reference.
4.1	Form of Certificate of Designation, Preference and Rights of Series A Preferred Stock of Input/Output, Inc., filed as Exhibit 2 to the Company s Registration Statement on Form 8-A dated January 27, 1997 (attached as Exhibit 1 to the Rights Agreement referenced in Exhibit 10.5), and incorporated herein by reference.
4.2	Indenture of Input/Output, Inc. dated as of December 10, 2003, filed as Exhibit 4.1 to the Company s Registration Statement on Form S-3 dated January 27, 2004, and incorporated herein by reference.
**10.1	Amended and Restated 1990 Stock Option Plan, filed as Exhibit 4.2 to the Company s Registration Statement on Form S-8 (Registration No. 333-80299), filed with the Securities and Exchange Commission on June 9, 1999, and incorporated herein by reference.
10.2	Lease Agreement dated as of August 20, 2001, between NL Ventures III Stafford L.P. and Input/Output, Inc. filed as Exhibit 10.28 to the Company s Quarterly Report on Form 10-Q for the quarter ended September 30, 2001, and incorporated herein by reference.
**10.3	Input/Output, Inc. Amended and Restated 1996 Non-Employee Director Stock Option Plan, filed as Exhibit 4.3 to the Company s Registration Statement on Form S-8 (Registration No. 333-80299), filed with the Securities and Exchange Commission on June 9, 1999, and incorporated herein by reference.
10.4	Rights Agreement, dated as of January 17, 1997, by and between Input/Output, Inc. and Harris Trust and Savings Bank, as Rights Agent, including exhibits thereto, filed as Exhibit 4 to the Company s Form 8-A dated January 27, 1997, and incorporated herein by reference.
**10.5	Input/Output, Inc. Employee Stock Purchase Plan, filed as Exhibit 4.4 to the Company s Registration Statement on Form S-8 (Registration No. 333-24125) filed with the Securities and Exchange Commission on March 18, 1997, and incorporated herein by reference.
10.6	First Amendment to Rights Agreement by and between the Company and Harris Trust and Savings Bank as Rights Agent, dated April 21, 1999, filed as Exhibit 10.3 to the Company s Form 8-K dated April 21, 1999, and incorporated herein by reference.
*10.7	Registration Rights Agreement by and among the Company and The Laitram Corporation, dated November 16, 1998.
**10.8	Input/Output, Inc. 1998 Restricted Stock Plan, filed as Exhibit 4.7 to the Company s Registration Statement on S-8 (Registration No. 333-80297), filed with the Securities and Exchange Commission on June 9, 1999, and incorporated herein by reference.
**10.9	Input/Output Inc. Non-qualified Deferred Compensation Plan, filed as Exhibit 10.14 to the Company s Annual Report on Form 10-K for the year ended December 31, 2001, and incorporated herein by reference.
**10.10	Amendment No. 1 to the Input/Output, Inc. Amended and Restated 1996 Non-Employee Director Stock Option Plan, dated September 13, 1999, filed as Exhibit 10.4 to the Company s Quarterly Report on Form 10-Q for the fiscal quarter ended August 31, 1999, and incorporated herein by reference.
**10.11	Employment Agreement by and between the Company and Bjarte Fageraas dated effective as of February 4, 2003, filed as Exhibit 10.14 to the Company s Annual Report on Form 10-K for the year ended December 31, 2002, and incorporated herein by reference.
**10.12	Employment Agreement by and between the Company and Laura Guthrie dated effective as of February 4, 2003, filed as Exhibit 10.16 to the Company s Annual Report on Form 10-K for the year ended December 31, 2002, and incorporated herein by reference.

Exhibit Number	Description
**10.13	Input/Output, Inc. 2000 Restricted Stock Plan, effective as of March 13, 2000 filed as Exhibit 10.27 to the Company s Annual Report on Form 10-K for the fiscal year ended May 31, 2000, and incorporated herein by reference.
**10.14	Input/Output, Inc. 2000 Long-Term Stock Plan, filed as Exhibit 4.7 to the Company s Registration Statement on Form S-8 (No. 333-49382) dated November 6, 2000 and incorporated by reference herein.
**10.15	Amended and Restated 1991 Directors Stock Option Plan, filed as Exhibit 4.3 to the Company s Registration Statement on Form S-8 on October 19, 1994, and incorporated herein by reference.
**10.16	Amendment to the Amended and Restated 1991 Directors Stock Option Plan, filed as Exhibit 10.9 to the Company s Annual Report on Form 10-K for the fiscal year ended May 31, 1997, and incorporated herein by reference.
**10.17	Amendment No. 2 to the Input/Output, Inc. Amended and Restated 1991 Director Stock Option Plan, dated September 13, 1999, filed as Exhibit 10.3 to the Company s Quarterly Report on Form 10-Q for the fiscal quarter ended August 31, 1999, and incorporated herein by reference.
10.18	Registration Rights Agreement dated as of December 10, 2003, between Input/Output, Inc. and Morgan Stanley & Co. Incorporated, filed as Exhibit 4.2 to the Company s Registration Statement on Form S-3 dated January 27, 2004, and incorporated herein by reference.
**10.19	Employment Agreement by and between the Company and Robert P. Peebler dated effective as of March 31, 2003, filed as Exhibit 10.1 to the Company s Current Report on Form 8-K dated March 31, 2003, and incorporated herein by reference.
**10.20	Employment Agreement by and between the Company and Jorge Machnizh dated effective as of April 23, 2003, filed as Exhibit 10.28 to the Company s Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2003, and incorporated herein by reference.
* **10.21	Employment Agreement by and between the Company and J. Michael Kirksey dated effective as of January 1, 2004.
10.22	Share Acquisition Agreement dated February 23, 2004 filed as Exhibit 2.1 to the Company s Current Report on Form 8-K filed with the Securities and Exchange Commission on March 5, 2004, and incorporated herein by reference.
10.23	Registration Rights Agreement dated February 23, 2004 filed as Exhibit 4.1 to the Company s Current Report on Form 8-K filed with the Securities and Exchange Commission on March 5, 2004, and incorporated herein by reference.
10.24	Input/Output, Inc. Non-Employee Directors Retainer Plan, filed as Exhibit 4.7 to the Company s Registration Statement on Form S-8 dated May 15, 2001 (Registration No. 333-60950), and incorporated herein by reference.
*21.1	Subsidiaries of the Company.
23.1	Consent of PricewaterhouseCoopers LLP.
*24.1	The Power of Attorney is set forth on the signature page hereof.
31.1	Certification of Robert P. Peebler, President and Chief Executive Officer, under Section 302 of the Sarbanes-Oxley Act.
31.2	Certification of J. Michael Kirksey, Executive Vice President and Chief Financial Officer, under Section 302 of the Sarbanes-Oxley Act.
32.1	Certification of Robert P. Peebler, President and Chief Executive Officer, pursuant to 18 U.S.C. sec. 1350.
32.2	Certification of J. Michael Kirksey, Executive Vice President and Chief Financial Officer, pursuant to 18 U.S.C. sec. 1350.

* Filed with the Company s Annual Report on Form 10-K for the year ended December 31, 2003, filed with the Securities and Exchange Commission on March 12, 2004.

** Management contract or compensatory plan or arrangement.

Filed herewith.