

SEITEL INC  
Form 10-Q  
August 09, 2006

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549**

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**FORM 10-Q**

[ X ] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended June 30, 2006

OR

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

Commission File Number: 0-14488

**SEITEL, INC.**

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

76-0025431  
(I.R.S. Employer  
Identification No.)

10811 S. Westview Circle Drive  
Building C, Suite 100  
Houston, Texas  
(Address of principal executive offices)

77043  
(Zip Code)

Registrant's telephone number, including area code:

(713) 881-8900

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  [ X ] No  [ ]

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes

No

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

Yes

No

As of July 31, 2006, there were 155,343,662 shares of the Company's common stock, par value \$.01 per share outstanding.

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(INDEX)**PART I - FINANCIAL INFORMATION****Item 1. FINANCIAL STATEMENTS**

SEITEL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

*(In thousands, except share and per share amounts)*

	(Unaudited) June 30, 2006	December 31, 2005
<b>ASSETS</b>		
Cash and cash equivalents	\$ 88,328	\$ 78,097
Restricted cash	102	85
Receivables		
Trade, net of allowance for doubtful accounts of \$1,035 and \$900, respectively	43,668	27,385
Notes and other, net of allowance for doubtful accounts of \$275 and \$275, respectively	1,146	509
Net seismic data library, net of accumulated amortization of \$927,802 and \$879,365, respectively	123,778	111,946
Net property and equipment, net of accumulated depreciation and amortization of \$28,257 and \$27,552, respectively	8,622	9,456
Oil and gas operations held for sale	358	194
Investment in marketable securities	74	54
Prepaid expenses, deferred charges and other	14,008	13,071
Deferred income taxes	5,611	5,874
<b>TOTAL ASSETS</b>	<b>\$ 285,695</b>	<b>\$ 246,671</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>LIABILITIES</b>		
Accounts payable and accrued liabilities	\$ 38,383	\$ 25,666
Income taxes payable	43	276
Oil and gas operations held for sale	148	40
Debt		
Senior Notes	185,522	185,272
Notes payable	361	378
Obligations under capital leases	3,065	2,950
Deferred revenue	47,945	43,250
<b>TOTAL LIABILITIES</b>	<b>275,467</b>	<b>257,832</b>
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>STOCKHOLDERS' EQUITY</b>		
Preferred stock, par value \$.01 per share; authorized 5,000,000 shares; none issued	-	-
Common stock, par value \$.01 per share; authorized 400,000,000 shares; issued and outstanding 155,387,831 shares at June 30, 2006 and 153,604,345 shares at December 31, 2005	1,554	1,536
Additional paid-in capital	239,363	241,289
Retained deficit	(236,869)	(256,227)
Deferred compensation - restricted stock	-	(2,944)

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Notes receivable from officers and employees for stock purchases		-		(1)
Accumulated other comprehensive income		6,180		5,186
TOTAL STOCKHOLDERS' EQUITY (DEFICIT)		10,228		(11,161)
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$	285,695	\$	246,671

The accompanying notes are an integral part of these condensed consolidated financial statements.

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## SEITEL, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

*(In thousands, except per share amounts)*

	Three Months Ended June 30,	
	2006	2005
REVENUE	\$ 48,542	\$ 35,961
EXPENSES		
Depreciation and amortization	23,034	23,665
Loss on sale of seismic data	26	-
Cost of sales	55	49
Selling, general and administrative expenses	8,906	7,318
	32,021	31,032
INCOME FROM OPERATIONS	16,521	4,929
Interest expense, net	(4,989)	(6,029)
Foreign currency exchange gains (losses)	1,295	(625)
Loss on sale of security	-	(11)
Income (loss) from continuing operations before income taxes	12,827	(1,736)
Provision (benefit) for income taxes	199	(1,039)
Income (loss) from continuing operations	12,628	(697)
Income (loss) from discontinued operations	(9)	2
NET INCOME (LOSS)	\$ 12,619	\$ (695)
Income (loss) per share:		
Basic:		
Income (loss) from continuing operations	\$ .08	\$ -
Income (loss) from discontinued operations	-	-
Net income (loss)	\$ .08	\$ -
Diluted:		
Income (loss) from continuing operations	\$ .08	\$ -
Income (loss) from discontinued operations	-	-
Net income (loss)	\$ .08	\$ -
Weighted average number of common and common equivalent shares:		
Basic	150,857	152,276
Diluted	166,760	152,276

The accompanying notes are an integral part of these condensed consolidated financial statements.

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## SEITEL, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

*(In thousands, except per share amounts)*

	Six Months Ended June 30,	
	2006	2005
REVENUE	\$ 93,240	\$ 83,267
EXPENSES		
Depreciation and amortization	46,812	56,922
Gain on sale of seismic data	(231)	-
Cost of sales	163	88
Selling, general and administrative expenses	17,936	15,338
	64,680	72,348
INCOME FROM OPERATIONS	28,560	10,919
Interest expense, net	(9,897)	(11,979)
Foreign currency exchange gains (losses)	1,134	(817)
Loss on sale of security	-	(11)
Income (loss) from continuing operations before income taxes	19,797	(1,888)
Provision (benefit) for income taxes	383	(1,028)
Income (loss) from continuing operations	19,414	(860)
Income from discontinued operations	4	19
NET INCOME (LOSS)	\$ 19,418	\$ (841)
Income (loss) per share:		
Basic:		
Income (loss) from continuing operations	\$ .13	\$ (.01)
Income from discontinued operations	-	-
Net income (loss)	\$ .13	\$ (.01)
Diluted:		
Income (loss) from continuing operations	\$ .12	\$ (.01)
Income from discontinued operations	-	-
Net income (loss)	\$ .12	\$ (.01)
Weighted average number of common and common equivalent shares:		
Basic	150,790	152,065
Diluted	165,717	152,065

The accompanying notes are an integral part of these condensed consolidated financial statements.

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SEITEL, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (Unaudited)  
 (In thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Net income (loss)	\$ 12,619	\$ (695)	\$ 19,418	\$ (841)
Unrealized gains (losses) on securities held as available for sale:				
Unrealized net holding gains (losses) arising during period	(15)	1	19	10
Less: Reclassification adjustment for losses included in income	-	11	-	11
Foreign currency translation adjustments	924	(173)	975	(183)
Comprehensive income (loss)	\$ 13,528	\$ (856)	\$ 20,412	\$ (1,003)

The accompanying notes are an integral part of these condensed consolidated financial statements.



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## SEITEL, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (Unaudited)

*(In thousands, except share amounts)*

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings (Deficit)	Deferred Compen- sation - Restricted Stock	Notes Receivable from Officers & Employees	Accum- ulated Other Compre- hensive Income
Balance, December 31, 2005	153,604,345	\$ 1,536	\$ 241,289	\$ (256,227)	\$ (2,944)	\$ (1)	\$ 5,186
Reclass of deferred compensation - restricted stock upon adoption of SFAS No. 123(R)	-	-	(2,944)	-	2,944	-	-
Issuance of restricted stock	1,840,522	18	(18)	-	-	-	-
Issuance of common stock to employees	108,327	1	225	-	-	-	-
Cancellation of restricted stock	(17,202)	-	(16)	-	-	-	-
Amortization of stock-based compensation costs	-	-	848	-	-	-	-
Accrual for restricted stock issuance for performance equity awards	-	-	340	-	-	-	-
Retirement of stock to satisfy employee tax withholding	(148,161)	(1)	(361)	(60)	-	-	-
Payments received on notes receivable from officers and employees	-	-	-	-	-	1	-
Net income	-	-	-	19,418	-	-	-
Foreign currency translation adjustments	-	-	-	-	-	-	975
Unrealized gain on marketable securities	-	-	-	-	-	-	19
Balance, June 30, 2006	155,387,831	\$ 1,554	\$ 239,363	\$ (236,869)	\$ -	\$ -	\$ 6,180

The accompanying notes are an integral part of these condensed consolidated financial statements.



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## SEITEL, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

*(in thousands)*

	Six Months Ended June 30,	
	2006	2005
Cash flows from operating activities:		
Reconciliation of net loss to net cash provided by operating activities		
of continuing operations:		
Net income (loss)	\$ 19,418	\$ (841)
Income from discontinued operations, net of tax	(4)	(19)
Depreciation and amortization	46,812	56,922
Deferred income tax provision (benefit)	509	(1,786)
Amortization of deferred financing costs	593	793
Amortization of debt discount	250	310
Amortization of deferred compensation	848	343
Allowance for collection of trade receivables	160	-
Non-cash compensation expense	550	401
Non-cash expense related to stock options	-	16
Non-cash revenue	(7,627)	(10,491)
Loss (gain) on sale of property and equipment	(4)	1
Gain on sale of seismic data	(231)	-
Loss on sale of security	-	11
Decrease (increase) in receivables	(16,332)	8,951
Decrease (increase) in other assets	(44)	1,171
Increase (decrease) in deferred revenue	5,692	(6,533)
Decrease in accounts payable and other liabilities	(371)	(3,396)
Net cash provided by operating activities of continuing operations	50,219	45,853
Cash flows from investing activities:		
Cash invested in seismic data	(37,987)	(36,424)
Cash paid to acquire property and equipment	(485)	(542)
Cash received from disposal of property and equipment	3	13
Cash from sale of security	-	4
Decrease (increase) in restricted cash	(17)	79
Net cash used in investing activities of continuing operations	(38,486)	(36,870)
Cash flows from financing activities:		
Principal payments on senior notes	-	(4,000)
Principal payments on notes payable	(17)	(219)
Principal payments on capital lease obligations	(19)	(864)
Borrowings on line of credit	25	-
Payments on line of credit	(25)	-
Costs of debt and equity transactions	-	(185)
Purchases of common stock subsequently retired	(422)	-
Payments on notes receivable from officers and employees	13	24
Net cash used in financing activities of continuing operations	(445)	(5,244)
Effect of exchange rate changes	(1,005)	609
Net cash provided by (used in) discontinued operations (revised):		
Cash provided by (used in) operating activities	(6)	132

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Cash used in investing activities	(46)	(1)
Net increase in cash and equivalents	10,231	4,479
Cash and equivalents at beginning of period	78,097	43,285
Cash and equivalents at end of period	\$ 88,328	\$ 47,764
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest	11,250	12,591
Income taxes	279	5
Income tax refunds received	137	-
Supplemental schedule of non-cash investing activities:		
Additions to seismic data library	6,812	4,789

The accompanying notes are an integral part of these condensed consolidated financial statements.



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**SEITEL, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Unaudited)**  
**June 30, 2006**

**NOTE A-BASIS OF PRESENTATION**

The accompanying unaudited financial statements of Seitel, Inc. and its subsidiaries (the "Company") have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions of Regulation S-X. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. In preparing the Company's financial statements, a number of estimates and assumptions are made by management that affect the accounting for and recognition of assets, liabilities, revenues and expenses. The Company has separately disclosed the operating and investing portion of the cash flows attributable to its discontinued operations, which in 2005 were reported on a combined basis as a single amount. The condensed consolidated balance sheet of the Company as of December 31, 2005, has been derived from the audited balance sheet of the Company as of that date. Operating results for the six months ended June 30, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006. These unaudited financial statements should be read in conjunction with the financial statements and notes thereto for the year ended December 31, 2005 contained in the Company's Annual Report filed on Form 10-K with the Securities and Exchange Commission ("SEC").

**Contractual Obligations:** As of June 30, 2006, the Company had approximately \$324.2 million of outstanding debt and lease obligations, with aggregate contractual cash obligations summarized as follows (in thousands):

	Total	Remainder of 2006	Payments due by period		2012 and thereafter
			2007-2009	2010-2011	
Contractual cash obligations					
Debt obligations <sup>(1)(2)</sup>	\$ 311,645	\$ 11,146	\$ 66,838	\$ 233,559	\$ 102
Capital lease obligations <sup>(2)</sup>	5,779	151	987	665	3,976
Operating lease obligations	6,746	562	3,269	2,044	871
Total contractual cash obligations	\$ 324,170	\$ 11,859	\$ 71,094	\$ 236,268	\$ 4,949

(1) Debt obligations include the face amount of the 11.75% senior notes totaling \$189.0 million.

(2) Amounts include interest related to debt and capital lease obligations.

**NOTE B-REVENUE RECOGNITION****Revenue from Data Acquisition**

The Company generates revenue when it creates a new seismic survey that is initially licensed by one or more of its customers to use the resulting data. The initial licenses usually provide the customer with a limited exclusivity period, which will normally last for six months after final delivery of the processed data. The payments for the initial exclusive licenses are sometimes referred to as underwriting or prefunding. Customers make periodic payments throughout the creation period, which generally correspond to

costs incurred and work performed. These payments are non-refundable.

Revenue from the creation of new seismic data is recognized throughout the creation period using the proportional performance method based upon costs incurred and work performed to date as a percentage of total estimated costs and work required. Management believes that this method is the most reliable and representative measure of progress for its data creation projects. The duration of most data creation projects is generally less than one year. Under these contracts, the Company creates new seismic data designed in conjunction with its customers and specifically suited to the geology of the area using the most appropriate technology available.

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The Company outsources the substantial majority of the work required to complete data acquisition projects to third party contractors. The Company's payments to these third party contractors comprise the substantial majority of the total estimated costs of the project and are paid throughout the creation period. A typical survey includes specific activities required to complete the survey; each activity has value to the customers. Typical activities, that often occur concurrently, include:

- permitting for land access, mineral rights, and regulatory approval;
- surveying;
- drilling for the placement of energy sources;
- recording the data in the field; and
- processing the data.

The customers paying for the initial exclusive licenses receive legally enforceable rights to any resulting product of each activity. The customers also receive access to and use of the newly acquired, processed data.

The customers' access to and use of the results of the work performed and of the newly acquired, processed data is governed by a license agreement, which is a separate agreement from the acquisition contract. The Company's acquisition contracts require the customer either to have a license agreement in place or to execute one at the time the acquisition contract is signed. The Company maintains sole ownership of the newly acquired data, which is added to its library, and is free to license the data to other customers when the original customers' exclusivity period ends.

**Revenue from Non-Exclusive Data Licenses**

The Company recognizes a substantial portion of its revenue from data licenses sold after any exclusive license period. These are sometimes referred to as resale licensing revenue, post acquisition license sales or shelf sales.

These sales fall under the following four basic forms of non-exclusive license contracts.

- Specific license contract - The customer licenses and selects data from the data library at the time the contract is entered into and holds this license for a long-term period.
- Library card license contract - The customer initially receives only access to data. The customer may then select specific data, from the collection of data to which it has access, to hold long-term under its license agreement. The length of the selection periods under the library card contracts is limited in time and varies from customer to customer.
- Review and possession license contract - The customer obtains the right to review a certain quantity of data for a limited period of time. During the review period, the customer may select specific data from that available for review to hold long-term under its license agreement. Any data not selected for long-term licensing must be returned to the Company at the end of the review period.
- Review only license contract - The customer obtains rights to review a certain quantity of data for a limited period of time, but does not obtain the right to select specific data to hold long-term.

The Company's non-exclusive license contracts specify the following:

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- that all customers must sign a license agreement governing the use of data;
  - the specific payment terms, generally ranging from 30 days to 18 months, and that such payments are non-cancelable and non-refundable;
  - the actual data that is accessible to the customer; and
  - that the data is licensed in its present form, where is and as is and the Company is under no obligation to make any enhancements, modifications or additions to the data unless specific terms to the contrary are included.
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Revenue from the non-exclusive licensing of seismic data is recognized when the following criteria are met:

- the Company has an arrangement with the customer that is validated by a signed contract;
- the sales price is fixed and determinable;
- collection is reasonably assured;
- the customer has selected the specific data or the contract has expired without full selection; and
- the license term has begun.

Copies of the data are available to the customer immediately upon request.

For licenses that have been invoiced but have not met the aforementioned criteria, the revenue is deferred along with the related direct costs (primarily sales commissions). This normally occurs under the library card license contracts, review and possession license contracts or review only license contracts because the data selection may occur over time. Additionally, if the contract allows licensing of data that is not currently available or enhancements, modifications or additions to the data are required per the contract, revenue is deferred until such time that the data is available for licensing.

**Revenue from Non-Monetary Exchanges**

In certain cases, the Company will take ownership of a customer's seismic data or revenue interest (collectively referred to as "data") in exchange for a non-exclusive license to selected seismic data from the Company's library. Occasionally, in connection with specific data acquisition contracts, the Company receives both cash and ownership of seismic data from the customer as consideration for the underwriting of new data acquisition. These exchanges are referred to as non-monetary exchanges. A non-monetary exchange always complies with the following criteria:

- the data license delivered is always distinct from the data received;
- the customer forfeits ownership of its data; and
- the Company retains ownership in its data.

In non-monetary exchange transactions, the Company records a data library asset for the seismic data received at the time the contract is entered into and recognizes revenue on the transaction in equal value in accordance with its policy on revenue from data licenses, which is, when the data is selected by the customer, or revenue from data acquisition, as applicable. The data license to the customer is in the form of one of the four basic forms of contracts discussed above. These transactions are valued at the fair value of the data received or delivered, whichever is more readily determinable.

Fair value of the data exchanged is determined using a multi-step process as follows.

- First, the Company considers the value of the data received from the customer. In determining the value of the data received, the Company considers the age, quality, current demand and future marketability of the data and, in the case of 3D seismic data, the cost that would be required to create the data. In addition, the Company applies a limitation on the value it assigns per square mile on the data received.
- Second, the Company determines the value of the license granted to the customer. The range of cash transactions by the Company for licenses of similar data during the prior six months are evaluated. In evaluating the range of cash transactions, the Company does not consider transactions that are disproportionately high or low.

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- Third, the Company obtains concurrence from an independent third party on the portfolio of all non-monetary exchanges of \$500,000 or more in order to support the Company's valuation of the data received. The Company obtains this concurrence on an annual basis, usually in connection with the preparation of its annual financial statements.
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Due to the Company's revenue recognition policies, revenue recognized on non-monetary exchange transactions may not occur at the same time the seismic data acquired is recorded as an asset. The activity related to non-monetary exchanges was as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Seismic data library additions	\$ 4,753	\$ 3,797	\$ 6,812	\$ 4,789
Revenue recognized based on specific data licenses or selections of data	3,011	5,037	5,084	9,794
Revenue recognized related to acquisition contracts	701	310	2,536	697
Revenue recognized related to data management services	7	-	7	-

**Revenue from Seitel Solutions**

Revenue from Seitel Solutions ("Solutions") is recognized as the services for reproduction and delivery of seismic data are provided to customers.

**NOTE C-SEISMIC DATA LIBRARY**

The Company's seismic data library consists of seismic surveys that are offered for license to customers on a non-exclusive basis. Costs associated with creating, acquiring or purchasing the seismic data library are capitalized and amortized principally on the income forecast method subject to a straight-line amortization period of four years, applied on a quarterly basis at the individual survey level.

*Costs of Seismic Data Library*

For purchased seismic data, the Company capitalizes the purchase price of the acquired data.

For data received through a non-monetary exchange, the Company capitalizes an amount equal to the fair value of the data received by the Company or the fair value of the license granted to the customer, whichever is more readily determinable. See Note B for discussion of the process used to determine fair value.

For internally created data, the capitalized costs include costs paid to third parties for the acquisition of data and related permitting,

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surveying and other activities associated with the data creation activity. In addition, the Company capitalizes certain internal costs related to processing the created data. Such costs include salaries and benefits of the Company's processing personnel and certain other costs incurred for the benefit of the processing activity. The Company believes that the internal processing costs capitalized are not greater than, and generally are less than, those that would be incurred and capitalized if such activity were performed by a third party. Capitalized costs for internal data processing were \$473,000 and \$427,000 for the three months ended June 30, 2006 and 2005, respectively, and \$905,000 and \$841,000 for the six months ended June 30, 2006 and 2005, respectively.

### *Data Library Amortization*

The Company amortizes its seismic data library investment using the greater of the amortization that would result from the application of the income forecast method subject to a minimum amortization rate or a straight-line basis over the useful life of the data. With respect to each survey in the data library, the useful life policy is applied from the time such survey is available for licensing to customers on a non-exclusive basis, since some data in the library may not be licensed until an exclusivity period (usually six months) has lapsed.

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The Company applies the income forecast method by forecasting the ultimate revenue expected to be derived from a particular data library component over the estimated useful life of each survey comprising part of such component. This forecast is made by the Company annually and reviewed quarterly. If, during any such review, the Company determines that the ultimate revenue for a library component is expected to be significantly different than the original estimate of total revenue for such library component, the Company revises the amortization rate attributable to future revenue from each survey in such component. The lowest amortization rate the Company applies using the income forecast method is 70%. In addition, in connection with the forecast reviews and updates, the Company evaluates the recoverability of its seismic data library investment, and if required under Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment and Disposal of Long-Lived Assets," records an impairment charge with respect to such investment. See discussion on "*Seismic Data Library Impairment*" below.

The actual aggregate rate of amortization depends on the specific seismic surveys licensed and selected by the Company's customers during the period. As of July 1, 2006, the amortization rate utilized under the income forecast method for all components is 70%. Additionally, certain seismic surveys have been fully amortized; consequently, no amortization expense is required on revenue recorded for these seismic surveys.

The greater of the income forecast or straight-line amortization policy is applied quarterly on a cumulative basis at the individual survey level. Under this policy, the Company first records amortization using the income forecast method. The cumulative amortization recorded for each survey is then compared with the cumulative straight-line amortization. If the cumulative straight-line amortization is higher for any specific survey, additional amortization expense is recorded, resulting in accumulated amortization being equal to the cumulative straight-line amortization for such survey. This requirement is applied regardless of future-year revenue estimates for the library component of which the survey is a part and does not consider the existence of deferred revenue with respect to the library component or to any survey.

*Seismic Data Library Impairment*

The Company evaluates its seismic data library investment by grouping individual surveys into components based on its operations and geological and geographical trends, resulting in the following data library segments for purposes of evaluating impairments: (I) Gulf of Mexico offshore comprised of the following components: (a) multi-component data, (b) ocean bottom cable data, (c) shelf data, (d) deep water data, and (e) value-added products; (II) North America onshore comprised of the following components: (a) Texas Gulf Coast, (b) northern, eastern and western Texas, (c) southern Louisiana/Mississippi, (d) northern Louisiana, (e) Rocky Mountains, (f) North Dakota, (g) other United States, (h) Canada and (i) value-added products, and (III) international data outside North America. The Company believes that these library components constitute the lowest levels of independently identifiable cash flows.

As events or conditions require, the Company evaluates the recoverability of its seismic data library investment in accordance with SFAS No. 144. The Company evaluates its seismic data library investment for impairment whenever events or changes in circumstances indicate that the carrying amounts may not be recoverable. The Company considers the level of sales performance in each component compared to projected sales, as well as industry conditions, among others, to be key factors in determining when its seismic data investment should be evaluated for impairment. In evaluating sales performance of each component, the Company generally considers three consecutive quarters of actual performance below forecasted sales, among other things, to be an indicator of potential impairment.

In accordance with SFAS No. 144, the impairment evaluation is based first on a comparison of the undiscounted future cash flows over each component's remaining estimated useful life with the carrying value of each library component. If the undiscounted cash flows are equal to or greater than the carrying value of such component, no impairment is recorded. If undiscounted cash flows are less than the carrying value of any component, the forecast of future cash flows related to such component is discounted to fair

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value and compared with such component's carrying amount. The difference between the library component's carrying amount and the discounted future value of the expected revenue stream is recorded as an impairment charge.

For purposes of evaluating potential impairment losses, the Company estimates the future cash flows attributable to a library component by evaluating, among other factors, historical and recent revenue trends, oil and gas prospectivity in particular regions, general economic conditions affecting its customer base and expected changes in technology and other factors that the Company deems relevant. The cash flow estimates exclude expected future revenues attributable to non-monetary data exchanges and future data creation projects.

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The estimation of future cash flows and fair value is highly subjective and inherently imprecise. Estimates can change materially from period to period based on many factors, including those described in the preceding paragraph. Accordingly, if conditions change in the future, the Company may record further impairment losses relative to its seismic data library investment, which could be material to any particular reporting period.

The Company did not have any impairment charges during the six months ended June 30, 2006 or 2005.

**NOTE D-DEBT**

The following is a summary of the Company's debt (in thousands):

	June 30, 2006	December 31, 2005
11.75% Senior Notes	\$ 189,000	\$ 189,000
Revolving Credit Facility	-	-
Subsidiary revolving line of credit	-	-
Note payable to former executive	361	378
	189,361	189,378
Less: Debt discount	(3,478)	(3,728)
	\$ 185,883	\$ 185,650

**11.75% Senior Unsecured Notes:** On July 2, 2004, the Company issued, in a private placement, \$193.0 million aggregate principal amount, of 11.75% Senior Unsecured Notes ("Senior Notes"). The Senior Notes were offered at a discount of 2.325% from their principal amount and mature July 15, 2011. As required by their terms, the Senior Notes were exchanged for senior notes of like amounts and terms in a publicly registered exchange offer in February 2005. As of June 30, 2006, \$189.0 million aggregate principal amount of Senior Notes is outstanding. Interest on the Senior Notes is payable semi-annually in arrears on January 15 and July 15 of each year. The Senior Notes are unsecured and are guaranteed by substantially all of the Company's U.S. subsidiaries on a senior basis. The Senior Notes contain restrictive covenants that limit the Company's ability to, among other things, incur additional indebtedness, make capital expenditures in excess of specified amounts, pay dividends and complete mergers, acquisition and sales of assets.

From time to time on or before July 15, 2007, the Company may redeem up to 35% of the aggregate principal amount of the Senior Notes with the net proceeds of equity offerings at a redemption price equal to 111.75% of the principal amount, plus accrued and unpaid interest. Subject to certain conditions, if at the end of each fiscal year the Company has excess cash flow (as defined in the indenture) in excess of \$5.0 million, the Company is required to use 50% of the excess cash flow to fund an offer to repurchase the Senior Notes on a pro rata basis at 100% of its principal amount, plus accrued and unpaid interest. If the Company has less than \$5.0 million in excess cash flow at the end of any fiscal year, such excess cash flow will be carried forward to succeeding years, and such repurchase offer is required to be made in the first year in which the cumulative excess cash flow for all years in which there has not been an offer is at least \$5.0 million. Such repurchase offer is required only if there is no event of default under the Company's revolving credit facilities prior to and after giving effect to the repurchase payment. Because of excess cash flow generated for the year ended December 31, 2005, in the first quarter of 2006, the Company made a repurchase offer for up to \$8.5 million aggregate principal amount of Senior Notes. No Senior Notes were tendered in the 2005 excess cash flow offer. In connection with the 2004 excess cash flow offer, \$4.0 million aggregate principal amount of Senior Notes were tendered and

accepted. Upon a change of control (as defined in the indenture), each holder of the Senior Notes will have the right to require the Company to offer to purchase all of such holder's notes at a price equal to 101% of the principal amount, plus accrued and unpaid interest.

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**Revolving Credit Facility:** On April 16, 2004, the Company entered into a revolving credit facility with Wells Fargo Foothill, Inc., as lender, to which a revolving loan commitment of \$30.0 million, subject to borrowing base limitations, was made available on July 2, 2004. Interest is payable at an applicable margin above either LIBOR or the prime rate. Borrowings under the revolving credit facility are secured by a first priority, perfected security interest in and lien on substantially all of the Company's U.S. assets and a pledge of all of the issued and outstanding capital stock of the Company's U.S. subsidiaries. The facility expires on July 2, 2007. The revolving credit facility contains covenants requiring the Company to achieve and maintain certain financial results, and restricts, among other things, the amount of capital expenditures, the ability to incur additional indebtedness and the ability to grant additional liens. The revolving credit facility requires the payment of an unused line fee of .375% per annum payable in arrears.

**Subsidiary Revolving Line of Credit:** The Company's wholly owned subsidiary, Olympic Seismic Ltd. ("Olympic"), has a revolving credit facility, which allows it to borrow up to \$5.0 million (Canadian) subject to an availability formula by way of prime-based loans, bankers' acceptances or letters of credit. The rate applicable to borrowings is the bank's prime rate plus 0.35% per annum and the bankers' acceptances is 1.50% per annum. Letter of credit fees are based on scheduled rates in effect at the time of issuance. The facility is secured by the assets of Olympic, SEIC Trust Administration Ltd. (as sole trustee of, and for and on behalf of, SEIC Business Trust) and SEIC Holdings, Ltd., but is not guaranteed by Seitel, Inc. or any of its other U.S. subsidiaries. However, all intercompany debt owing by Olympic, SEIC Trust Administration Ltd., SEIC Business Trust or SEIC Holdings, Ltd. to Seitel, SEIC Partners' Limited Partnership or to any Seitel U.S. subsidiary (approximately \$36.8 million (Canadian) at June 30, 2006) has been subordinated to the repayment of the revolving credit facility. Available borrowings under the facility are equivalent to a maximum of \$5.0 million (Canadian), subject to a requirement that such borrowings may not exceed 75% of good accounts receivable (as defined in the agreement) of SEIC Trust Administration, less prior-ranking claims, if any, relating to inventory or accounts. The facility is subject to repayment upon demand and is available from time to time at the bank's sole discretion.

**Note Payable to Former Executive:** In connection with the settlement of certain litigation, the Company entered into a note payable to a former executive consisting of payments of \$6,417 per month for 36 months commencing June 2003, and payments of \$6,000 per month for 84 months commencing June 2006. The note is non-interest bearing. The note is guaranteed by Olympic.

**NOTE E-EARNINGS PER SHARE**

In accordance with SFAS No. 128, "Earnings per Share," basic earnings per share is computed based on the weighted average shares of common stock outstanding during the periods. Diluted earnings per share is computed based on the weighted average shares of common stock plus the assumed issuance of common stock for all potentially dilutive securities. The computations for basic and diluted net income (loss) per share consist of the following (in thousands, except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Income (loss) from continuing operations	\$ 12,628	\$ (697)	\$ 19,414	\$ (860)
Income (loss) from discontinued operations	(9)	2	4	19
Net income (loss)	\$ 12,619	\$ (695)	\$ 19,418	\$ (841)
Basic weighted average shares	150,857	152,276	150,790	152,065
Effect of dilutive securities: <sup>(1)</sup>				
Options and warrants	12,409	-	11,871	-
Employee restricted stock awards	3,494	-	3,056	-

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Diluted weighted average shares	166,760	152,276	165,717	152,065
Income (loss) per share:				
Basic:				
Income (loss) from continuing operations	\$ .08	\$ -	\$ .13	\$ (.01)
Income (loss) from discontinued operations	-	-	-	-
Net income (loss)	\$ .08	\$ -	\$ .13	\$ (.01)
Diluted:				
Income (loss) from continuing operations	\$ .08	\$ -	\$ .12	\$ (.01)
Income (loss) from discontinued operations	-	-	-	-
Net income (loss)	\$ .08	\$ -	\$ .12	\$ (.01)

(1) A weighted average number of options and warrants to purchase 6,453,000 and 6,385,000 shares of common stock were outstanding during the three and six months ended June 30, 2005, respectively, but were not included in the computation of diluted per share net income because they were anti-dilutive.



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## **NOTE F-STOCK-BASED COMPENSATION**

On July 2, 2004, the Company's board of directors adopted the Seitel, Inc. 2004 Stock Option Plan (the "Stock Option Plan") and on December 15, 2004, the Company's stockholders approved and adopted it. Under the Stock Option Plan, 7,500,000 shares of common stock were initially reserved and available for stock-based awards, including options, restricted stock or other stock-based awards. The exercise price, term and other conditions applicable to each award granted under the Stock Option Plan are generally determined by the Compensation Committee at the time of grant and may vary with each award granted. As of June 30, 2006, 2,526,312 shares remain available for issuance under the Stock Option Plan.

On July 2, 2004, the Company granted its chairman of the board ten-year non-statutory options to purchase 100,000 shares of its common stock at an exercise price of \$1.30, the market price of the common stock on such date. Such options became exercisable on July 2, 2005. Such options were not granted under the Company's Stock Option Plan. These options were subject to variable plan accounting.

Prior to January 1, 2006, as permitted under SFAS No. 123, "Accounting for Stock-Based Compensation," the Company accounted for its stock option plans following the recognition and measurement principles of Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. Accordingly, no stock-based compensation was reflected in net income (loss) on stock options granted with an exercise price at least equal to the market price of the stock on the date of grant.

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123(R), "Share-Based Payment." This Statement revised SFAS No. 123 by eliminating the option to account for employee stock options under APB No. 25 and requires companies to recognize the cost of employee services received in exchange for awards of equity instruments based on the grant-date fair value of those awards (the "fair-value-based" method).

Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123(R) using the modified prospective application method. The adoption of SFAS No. 123(R) increased the Company's net income by \$0.6 million, or less than \$.01 per basic and diluted share, for the three months ended June 30, 2006 and by \$1.3 million, or \$.01 per basic and diluted share, for the six months ended June 30, 2006.

Compensation expense related to the amortization of restricted stock awards was recognized prior to the implementation of SFAS No. 123(R). Upon implementation of SFAS 123(R), the Company modified the amortization period over which it recognizes compensation expense for its restricted stock issuances related to key executive awards and performance equity awards. Prior to January 1, 2006, the Company recognized compensation expense for these restricted stock issuances over the service period. Beginning in 2006, the Company now recognizes compensation expense for these restricted stock issuances beginning with the service inception date through the end of the vesting period resulting in a longer amortization period (less expense recognition) in 2006 than in the prior year.

Total stock based compensation expense totaled \$0.8 million and \$0.4 million during the three months ended June 30, 2006 and 2005, respectively, and \$1.4 million and \$0.8 million during the six months ended June 30, 2006 and 2005, respectively.

## **NOTE D-DEBT**



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Under the modified prospective application method, results for prior periods have not been restated to reflect the effects of implementing SFAS No. 123(R). The following pro-forma information, as required by SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure, an amendment of FASB Statement No. 123," is presented for comparative purposes and illustrates the effect on net loss and net loss per common share for the period presented as if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation prior to January 1, 2006 (in thousands, except per share data):

	Three Months Ended	Six Months Ended
	June 30, 2005	June 30, 2005
Net loss:		
As reported	\$ (695)	\$ (841)
Less: Total stock-based employee expense determined under SFAS No. 123, net of tax	-	-
Pro forma	\$ (695)	\$ (841)
Basic and diluted loss per share:		
As reported	\$ -	\$ (.01)
Pro forma	\$ -	\$ (.01)

The following summarizes stock option activity during the six months ended June 30, 2006 (shares in thousands):

	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life in Years	Aggregate Intrinsic Value (000's)
Outstanding at beginning of year	100	\$1.30		
Granted	-	-		
Exercised	-	-		
Cancelled	-	-		
Outstanding at June 30, 2006	100	\$1.30	8.0	\$226
Options exercisable at June 30, 2006	100	\$1.30	8.0	\$226
Options vested or expected to vest at June 30, 2006	100	\$1.30	8.0	\$226

The Company grants shares of its common stock to its employees and directors that are subject to restrictions on transfer and risk of forfeiture until fulfillment of applicable service conditions and, in certain cases, holding periods ("Restricted Stock"). For the year ended December 31, 2005, the Company recorded the grant date fair value of unvested shares of Restricted Stock as unearned stock-based compensation ("Deferred Compensation"). In accordance with SFAS No. 123(R), on January 1, 2006, the Company reclassified the balance of Deferred Compensation against additional paid-in capital.

The following table summarizes the activity of non-vested Restricted Stock during the six months ended June 30, 2006 (shares in thousands):

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	Shares	Weighted Average Grant Date Fair Value
Non-vested at beginning of year	2,965	\$1.36
Granted	1,841	\$2.92
Vested	(259)	\$1.39
Forfeited	(17)	\$1.86
Non-vested at June 30, 2006	4,530	\$1.99

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The fair value of non-vested shares is determined based on the closing stock price on the grant date. As of June 30, 2006, there was \$4.6 million of total unrecognized compensation cost related to non-vested restricted stock-based compensation, which is expected to be recognized over a weighted average period of 2.2 years.

During the six months ended June 30, 2006, 108,327 shares of common stock were awarded to employees at an average fair value of \$2.99.

**NOTE G-STATEMENT OF CASH FLOW INFORMATION**

The Company had restricted cash at June 30, 2006 and December 31, 2005 of \$102,000 and \$85,000, respectively, related to collateral on a seismic operations bond.

During the six months ended June 30, 2006 and 2005, the Company had non-cash additions to its seismic data library comprised of the following (in thousands):

	Six Months Ended June 30,	
	2006	2005
Non-monetary exchanges related to resale licensing revenue	\$ 4,279	\$ 6,841
Non-monetary exchanges from underwriting of new data acquisition	1,430	386
Non-monetary exchanges related to data management services	52	-
Completion of data in progress from prior non-monetary exchanges	1,238	1,965
Less: Non-monetary exchanges for data in progress	(187)	(4,403)
Total non-cash additions to seismic data library	\$ 6,812	\$ 4,789

Non-cash revenue consisted of the following for the six months ended June 30, 2006 and 2005 (in thousands):

	Six Months Ended June 30,	
	2006	2005
Acquisition revenue on underwriting from non-monetary exchange contracts	\$ 2,536	\$ 697
Licensing revenue from specific data licenses or selections on non-monetary exchange contracts	5,084	9,794
Data management revenue	7	-
Total non-cash revenue	\$ 7,627	\$ 10,491

**NOTE H-COMMITMENTS AND CONTINGENCIES**

**Litigation**

On July 18, 2002, Paul Frame, the Company's former chief executive officer, sued the Company in the 113<sup>th</sup> Judicial District Court of Harris County, No. 2002-35891. Mr. Frame alleged a breach of his employment contract and defamation. He also sought a declaratory judgment that certain funds he received from the Company were proper and do not have to be repaid. Mr. Frame filed claims totaling \$20.2 million in the Company's chapter 11 cases, which have been disallowed by order of the Bankruptcy Court. On April 1, 2005, the Company filed a motion for summary judgment seeking dismissal of Mr. Frame's complaint in the District Court.

In late April 2005, Mr. Frame filed a motion for leave to file an amended complaint in the District Court. Hearing dates have not been set for these April 2005 motions. In 2002, the Company filed a counter suit to recover approximately \$4.2 million in corporate funds that the Company believes Mr. Frame inappropriately caused the Company to pay him or for his benefit plus over \$800,000 due on two notes that were accelerated pursuant to their respective terms. The Company also holds a judgment against Mr. Frame in the amount of at least \$590,000 relating to a loan made to Mr. Frame by Bank One N.A. and guaranteed by the Company. The parties filed a joint motion to abate the above proceedings. The case continues to remain in abatement.

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The Company and its subsidiary, Seitel Data, Ltd., were parties to a class action lawsuit for geophysical trespass entitled *Juan O. Villarreal v. Grant Geophysical, Inc., et al.*, Cause No. DC-00-214, in the 229<sup>th</sup> District Court of Starr County, Texas that was initiated on April 1, 2002. The plaintiffs sued a number of defendants, including the Company and Seitel Data, Ltd. The plaintiffs alleged that certain defendants conducted unauthorized 3-D seismic exploration of the mineral interests by obtaining seismic data on adjoining property, and sold the information obtained to other defendants. The plaintiffs sought an unspecified amount of damages. All defendants obtained summary judgments dismissing the plaintiffs' claims, and the plaintiffs appealed to the San Antonio Court of Appeals under Cause No. 04-02-00674-CV. During the pendency of the Company's bankruptcy proceedings, the San Antonio Court of Appeals affirmed the trial court's decision as to the Company's co-defendants and stayed the appeal as to the Company. The Texas Supreme Court denied plaintiffs Petition for Certiorari, refusing to hear the matter. The plaintiffs filed an unliquidated claim (amount unspecified) in the chapter 11 cases. The Company objected to this claim, which was withdrawn by order of the Bankruptcy Court dated June 29, 2005. This June 2005 order includes the plaintiffs' agreement to dismiss their appeal. The parties' joint motion for dismissal with the San Antonio Court of Appeals is pending.

On February 21, 2003, the Company sued its former in-house counsel and law firm in *Seitel, Inc. v. Cynthia Moulton and Franklin Cardwell & Jones, P.C.*, Cause No. 2003-09151 in the 127<sup>th</sup> Judicial District Court of Harris County, Texas. The suit alleges negligence, breach of fiduciary duty, breach of contract and fraud in relation to the Company's engagement of the law firm Franklin Cardwell & Jones to manage its legal matters and surrounding the settlement of a personal lawsuit against the former chief executive officer and other aspects of representation. The Company is seeking recovery for fees paid of approximately \$750,000, disgorgement of attorneys' fees, and related expenses. The parties' attempt at mediation was not successful. Discovery is underway and the trial has been reset to September 18, 2006. The defendants have joined Paul Frame and Kevin Fiur, both of whom were former chief executive officers of the Company, in the action.

In addition to the lawsuits described above, the Company is involved from time to time in ordinary, routine claims and lawsuits incidental to its business. In the opinion of management, uninsured losses, if any, resulting from the ultimate resolutions of these matters should not be material to the Company's financial position or results of operation.

It is not possible to predict or determine the outcomes of the legal actions brought against it or by it, or to provide an estimate of all additional losses, if any, that may arise. At June 30, 2006, the Company did not have any amounts accrued related to the claims set forth above, as the Company believes it is not probable that any amounts will be paid relative to such litigation and claims. However, if one or more of the parties were to prevail against the Company in one or more of the cases described above that have not been settled, the amounts of any judgments against the Company or settlements that the Company may enter into, could be material to the Company's financial statements for any particular reporting period.

**NOTE I-SUPPLEMENTAL GUARANTORS CONSOLIDATING CONDENSED FINANCIAL INFORMATION**

On July 2, 2004, Seitel, Inc. (the "Parent") completed a private placement of Senior Notes in the aggregate principal amount of \$193.0 million, of which \$189.0 million was outstanding at June 30, 2006. Seitel, Inc.'s payment obligations under the Senior Notes are jointly and severally guaranteed by certain of its 100% owned U.S. subsidiaries ("Guarantor Subsidiaries"). All subsidiaries of Seitel, Inc. that do not guaranty the Senior Notes are referred to as Non-Guarantor Subsidiaries.

The consolidating condensed financial statements are presented below and should be read in connection with the Condensed Consolidated Financial Statements of the Company. Separate financial statements of the Guarantors are not presented because (i)

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the Guarantors are wholly-owned and have fully and unconditionally guaranteed the Senior Notes on a joint and several basis, and (ii) the Company's management has determined such separate financial statements are not material to investors.

The following consolidating condensed financial information presents: the consolidating condensed balance sheets as of June 30, 2006 and December 31, 2005, and the consolidating condensed statements of operations and statements of cash flows for the six months ended June 30, 2006 and 2005 of (a) the Parent; (b) the Guarantor Subsidiaries; (c) the Non-Guarantor Subsidiaries; (d) elimination entries; and (e) the Parent, the Guarantor Subsidiaries and the Non-Guarantor Subsidiaries on a consolidated basis.

Investments in subsidiaries are accounted for on the equity method. The principal elimination entries eliminate investments in subsidiaries, intercompany balances, intercompany transactions and intercompany sales.

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**CONSOLIDATING CONDENSED BALANCE SHEET**

**As of June 30, 2006**

(In thousands)

	<b>Parent</b>	<b>Guarantor Subsidiaries</b>	<b>Non- Guarantor Subsidiaries</b>	<b>Consolidating Eliminations</b>	<b>Consolidated Total</b>
<b>ASSETS</b>					
Cash and equivalents	\$ -	\$ 81,560	\$ 6,768	\$	