

SEITEL INC  
Form 10-Q  
November 02, 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 September 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  [ ]

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):

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Large accelerated filer[ ]

Accelerated filer[X]

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 [X]

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 [X] No [ ]

As of October 31, 2006, there were 155,272,250 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)<br>September 30,<br>2006 | December 31,<br>2005 |
|--|--------------------------------------|----------------------|
| <b>ASSETS</b>  |                                      |                      |
| Cash and cash equivalents  | \$ 96,973                            | \$ 78,097            |
| Restricted cash  | 103                                  | 85                   |
| Receivables  |                                      |                      |
| Trade, net of allowance for doubtful accounts of<br>\$1,035 and \$900, respectively                                    | 34,090                               | 27,385               |
| Notes and other, net of allowance for doubtful accounts<br>of \$275 and \$275, respectively                            | 454                                  | 509                  |
| Net seismic data library, net of accumulated amortization<br>of \$948,196 and \$879,365, respectively                  | 122,422                              | 111,946              |
| Net property and equipment, net of accumulated depreciation<br>and amortization of \$29,044 and \$27,552, respectively | 8,258                                | 9,456                |
| Oil and gas operations held for sale   | 29                                   | 194                  |
| Investment in marketable securities  | 60                                   | 54                   |
| Prepaid expenses, deferred charges and other   | 11,977                               | 13,071               |
| Deferred income taxes  | 6,097                                | 5,874                |
| <b>TOTAL ASSETS</b>  | <b>\$ 280,463</b>                    | <b>\$ 246,671</b>    |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                                      |                      |
| <b>LIABILITIES</b>   |                                      |                      |
| Accounts payable and accrued liabilities   | \$ 27,127                            | \$ 25,666            |
| Income taxes payable   | 61                                   | 276                  |
| Oil and gas operations held for sale   | 34                                   | 40                   |
| Debt   |                                      |                      |
| Senior Notes   | 185,653                              | 185,272              |
| Notes payable  | 349                                  | 378                  |
| Obligations under capital leases   | 3,054                                | 2,950                |
| Deferred revenue   | 39,635                               | 43,250               |
| <b>TOTAL LIABILITIES</b>   | <b>255,913</b>                       | <b>257,832</b>       |
| <b>COMMITMENTS AND CONTINGENCIES</b>   |                                      |                      |
| <b>STOCKHOLDERS' EQUITY</b>  |                                      |                      |
| Preferred stock, par value \$.01 per share; authorized<br>5,000,000 shares; none issued                                | -                                    | -                    |
| Common stock, par value \$.01 per share; authorized<br>400,000,000 shares; issued and outstanding 155,343,662 shares   |                                      |                      |

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|   |                   |                   |
|---|-------------------|-------------------|
| at September 30, 2006 and 153,604,345 shares at December 31, 2005 | 1,553             | 1,536             |
| Additional paid-in capital  | 239,918           | 241,289           |
| Retained deficit  | (223,109)         | (256,227)         |
| Deferred compensation - restricted stock                          | -                 | (2,944)           |
| Notes receivable from officers and employees for stock purchases  | -                 | (1)               |
| Accumulated other comprehensive income                            | 6,188             | 5,186             |
| <b>TOTAL STOCKHOLDERS' EQUITY (DEFICIT)</b>                       | <b>24,550</b>     | <b>(11,161)</b>   |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>                 | <b>\$ 280,463</b> | <b>\$ 246,671</b> |

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<br>September 30, |            |
|--|-------------------------------------|------------|
|  | 2006                                | 2005       |
| REVENUE  | \$ 45,877                           | \$ 24,550  |
| EXPENSES   |                                     |            |
| Depreciation and amortization                                      | 21,027                              | 19,441     |
| Cost of sales  | 40                                  | 55         |
| Selling, general and administrative expenses                       | 8,373                               | 7,680      |
|  | 29,440                              | 27,176     |
| INCOME (LOSS) FROM OPERATIONS                                      | 16,437                              | (2,626)    |
| Interest expense, net  | (4,873)                             | (5,593)    |
| Foreign currency exchange gains (losses)                           | (9)                                 | 1,978      |
| Loss on sale of security   | (1)                                 | -          |
| Income (loss) from continuing operations before income taxes       | 11,554                              | (6,241)    |
| Benefit for income taxes   | (2,462)                             | (3,878)    |
| Income (loss) from continuing operations                           | 14,016                              | (2,363)    |
| Income (loss) from discontinued operations                         | (146)                               | 22         |
| NET INCOME (LOSS)  | \$ 13,870                           | \$ (2,341) |
| Income (loss) per share:   |                                     |            |
| Basic:   |                                     |            |
| Income (loss) from continuing operations                           | \$ .09                              | \$ (.02)   |
| Income (loss) from discontinued operations                         | -                                   | -          |
| Net income (loss)  | \$ .09                              | \$ (.02)   |
| Diluted:   |                                     |            |
| Income (loss) from continuing operations                           | \$ .08                              | \$ (.02)   |
| Income (loss) from discontinued operations                         | -                                   | -          |
| Net income (loss)  | \$ .08                              | \$ (.02)   |
| Weighted average number of common and<br>common equivalent shares: |                                     |            |
| Basic  | 150,975                             | 152,745    |
| Diluted  | 166,569                             | 152,745    |

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)*

|  | Nine Months Ended<br>September 30, |            |
|--|------------------------------------|------------|
|  | 2006                               | 2005       |
| REVENUE  | \$ 139,117                         | \$ 107,817 |
| EXPENSES   |                                    |            |
| Depreciation and amortization                                      | 67,839                             | 76,363     |
| Gain on sale of seismic data                                       | (231)                              | -          |
| Cost of sales  | 203                                | 143        |
| Selling, general and administrative expenses                       | 26,309                             | 23,018     |
|  | 94,120                             | 99,524     |
| INCOME FROM OPERATIONS   | 44,997                             | 8,293      |
| Interest expense, net  | (14,770)                           | (17,572)   |
| Foreign currency exchange gains                                    | 1,125                              | 1,161      |
| Loss on sale of security   | (1)                                | (11)       |
| Income (loss) from continuing operations before income taxes       | 31,351                             | (8,129)    |
| Benefit for income taxes   | (2,079)                            | (4,906)    |
| Income (loss) from continuing operations                           | 33,430                             | (3,223)    |
| Income (loss) from discontinued operations                         | (142)                              | 41         |
| NET INCOME (LOSS)  | \$ 33,288                          | \$ (3,182) |
| Income (loss) per share:   |                                    |            |
| Basic:   |                                    |            |
| Income (loss) from continuing operations                           | \$ .22                             | \$ (.02)   |
| Income (loss) from discontinued operations                         | -                                  | -          |
| Net income (loss)  | \$ .22                             | \$ (.02)   |
| Diluted:   |                                    |            |
| Income (loss) from continuing operations                           | \$ .20                             | \$ (.02)   |
| Income (loss) from discontinued operations                         | -                                  | -          |
| Net income (loss)  | \$ .20                             | \$ (.02)   |
| Weighted average number of common and<br>common equivalent shares: |                                    |            |
| Basic  | 150,852                            | 152,294    |
| Diluted  | 166,019                            | 152,294    |

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<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|------------|------------------------------------|------------|
|  | 2006                                | 2005       | 2006                               | 2005       |
| Net income (loss)  | \$ 13,870                           | \$ (2,341) | \$ 33,288                          | \$ (3,182) |
| Unrealized gains (losses) on securities held as<br>available for sale: |                                     |            |                                    |            |
| Unrealized net holding gains arising<br>during period                  | -                                   | 30         | 19                                 | 40         |
| Less: Reclassification adjustment for<br>losses included in income     | 1                                   | -          | 1                                  | 11         |
| Foreign currency translation adjustments                               | 7                                   | 1,424      | 982                                | 1,241      |
| Comprehensive income (loss)  | \$ 13,878                           | \$ (887)   | \$ 34,290                          | \$ (1,890) |

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<br>Shares | Common Stock<br>Amount | Additional<br>Paid-In<br>Capital | Retained<br>Earnings<br>(Deficit) | Deferred<br>Compensation -<br>Restricted<br>Stock | Notes<br>Receivable<br>from<br>Officers &<br>Employees | Accumulated<br>Other<br>Comprehensive<br>Income |
|---|------------------------|------------------------|----------------------------------|-----------------------------------|---|--|---|
| Balance, December 31, 2005  | 153,604,345            | \$ 1,536               | \$ 241,289                       | \$ (256,227)                      | \$ (2,944)  | \$ (1)   | \$ 5,186  |
| Reclass of deferred<br>compensation - restricted<br>stock upon adoption of SFAS<br>No. 123(R) | -                      | -                      | (2,944)                          | -                                 | 2,944   | -  | -   |
| Issuance of restricted stock  | 1,840,522              | 18                     | (18)                             | -                                 | -   | -  | -   |
| Issuance of common stock to<br>employees  | 108,327                | 1                      | 225                              | -                                 | -   | -  | -   |
| Cancellation of restricted stock  | (17,202)               | -                      | (16)                             | -                                 | -   | -  | -   |
| Amortization of stock-based<br>compensation costs   | -                      | -                      | 1,349                            | -                                 | -   | -  | -   |
| Accrual for restricted stock<br>issuance  | -                      | -                      | 456                              | -                                 | -   | -  | -   |
| Retirement of stock to satisfy<br>employee<br>tax withholding                                 | (192,330)              | (2)                    | (423)                            | (170)                             | -   | -  | -   |
| Payments received on notes<br>receivable  | -                      | -                      | -                                | -                                 | -   | 1  | -   |
| Net income  | -                      | -                      | -                                | 33,288                            | -   | -  | -   |
| Foreign currency translation<br>adjustments   | -                      | -                      | -                                | -                                 | -   | -  | 982   |
| Unrealized gain on marketable<br>securities   | -                      | -                      | -                                | -                                 | -   | -  | 19  |
| Reclassification adjustment for<br>losses on<br>marketable securities<br>included in income   | -                      | -                      | -                                | -                                 | -   | -  | 1   |
| Balance, September 30, 2006   | 155,343,662            | \$ 1,553               | \$ 239,918                       | \$ (223,109)                      | \$ -  | \$ -   | \$ 6,188  |

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)*

|   | Nine Months Ended<br>September 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)   | \$ 33,288                          | \$ (3,182) |
| Loss (income) from discontinued operations, net of tax  | 142                                | (41)       |
| Depreciation and amortization   | 67,839                             | 76,363     |
| Deferred income tax provision (benefit)   | 24                                 | (5,512)    |
| Amortization of deferred financing costs  | 889                                | 1,115      |
| Amortization of debt discount   | 381                                | 426        |
| Amortization of deferred compensation   | 1,349                              | 556        |
| Allowance for collection of trade receivables   | 160                                | 10         |
| Non-cash compensation expense   | 666                                | 904        |
| Non-cash expense related to stock options   | -                                  | 22         |
| Non-cash revenue  | (11,029)                           | (12,404)   |
| Loss (gain) on sale of property and equipment   | (5)                                | 1          |
| Gain on sale of seismic data  | (231)                              | -          |
| Loss on sale of security  | 1                                  | 11         |
| Decrease (increase) in receivables  | (4,533)                            | 10,485     |
| Decrease in other assets  | 184                                | 1,385      |
| Decrease in deferred revenue  | (859)                              | (4,275)    |
| Decrease in accounts payable and other liabilities  | (8,491)                            | (8,942)    |
| Net cash provided by operating activities of continuing operations                                | 79,775                             | 56,922     |
| Cash flows from investing activities:   |                                    |            |
| Cash invested in seismic data   | (58,624)                           | (43,614)   |
| Cash from sale of seismic data  | 231                                | -          |
| Cash paid to acquire property and equipment   | (912)                              | (670)      |
| Cash received from disposal of property and equipment   | 3                                  | 13         |
| Cash from sale of security  | 12                                 | 4          |
| Decrease (increase) in restricted cash  | (18)                               | 78         |
| Net cash used in investing activities of continuing operations                                    | (59,308)                           | (44,189)   |
| Cash flows from financing activities:   |                                    |            |
| Principal payments on senior notes  | -                                  | (4,000)    |
| Principal payments on notes payable   | (29)                               | (309)      |
| Principal payments on capital lease obligations   | (29)                               | (1,320)    |
| 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  | (595)                              | -          |
| Payments on notes receivable from officers and employees  | 14                                 | 38         |
| Net cash used in financing activities of continuing operations                                    | (639)                              | (5,776)    |
| Effect of exchange rate changes   | (969)                              | (840)      |
| Net cash provided by discontinued operations (revised):   |                                    |            |
| Cash provided by operating activities   | 8                                  | 151        |

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|   |           |           |
|---|-----------|-----------|
| Cash provided by investing activities                   | 9         | -         |
| Net increase in cash and equivalents                    | 18,876    | 6,268     |
| Cash and equivalents at beginning of period             | 78,097    | 43,285    |
| Cash and equivalents at end of period                   | \$ 96,973 | \$ 49,553 |
| Supplemental disclosure of cash flow information:       |           |           |
| Cash paid during the period for:                        |           |           |
| Interest  | 22,433    | 23,818    |
| Income taxes  | 284       | 8         |
| Income tax refunds received                             | 393       | -         |
| Supplemental schedule of non-cash investing activities: |           |           |
| Additions to seismic data library                       | 8,889     | 6,640     |

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)**  
**September 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 nine months ended September 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 September 30, 2006, the Company had approximately \$312.8 million of outstanding debt and lease obligations, with aggregate contractual cash obligations summarized as follows (in thousands):

| Contractual cash obligations             | Total      | Remainder of<br>2006 | Payments due by period |            |          | 2012 and<br>thereafter |
|--|------------|----------------------|------------------------|------------|----------|------------------------|
|  |            |                      | 2007-2009              | 2010-2011  |          |                        |
| Debt obligations <sup>(1)(2)</sup>       | \$ 300,517 | \$ 18                | \$ 66,838              | \$ 233,559 | \$ 102   |                        |
| Capital lease obligations <sup>(2)</sup> | 5,702      | 75                   | 987                    | 665        | 3,975    |                        |
| Operating lease obligations              | 6,560      | 285                  | 3,312                  | 2,072      | 891      |                        |
| Total contractual cash obligations       | \$ 312,779 | \$ 378               | \$ 71,137              | \$ 236,296 | \$ 4,968 |                        |

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

(2) Amounts include interest related to such 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.

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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:

- 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.

**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.
- 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<br>Ended September 30, |          | Nine Months<br>Ended September 30, |          |
|--|-------------------------------------|----------|------------------------------------|----------|
|  | 2006                                | 2005     | 2006                               | 2005     |
| Seismic data library additions   | \$ 2,077                            | \$ 1,851 | \$ 8,889                           | \$ 6,640 |
| Revenue recognized based on specific data licenses or selections of data | 2,998                               | 678      | 8,082                              | 10,472   |
| Revenue recognized related to acquisition contracts                      | 391                                 | 1,235    | 2,927                              | 1,932    |
| Revenue recognized related to data management services                   | 13                                  | -        | 20                                 | -        |
| <b><u>Revenue from Seitel Solutions</u></b>                              |                                     |          |                                    |          |

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, 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 \$464,000 and \$433,000 for the three months ended September 30, 2006 and 2005, respectively, and \$1,369,000 and \$1,274,000 for the nine months ended September 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 October 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 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 nine months ended September 30, 2006 or 2005.

**NOTE D-DEBT**

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

|                                     | September 30,<br>2006 | December 31,<br>2005 |
|-------------------------------------|-----------------------|----------------------|
| 11.75% Senior Notes                 | \$ 189,000            | \$ 189,000           |
| Revolving Credit Facility           | -                     | -                    |
| Subsidiary revolving line of credit | -                     | -                    |
| Note payable to former executive    | 349                   | 378                  |
|                                     | 189,349               | 189,378              |
| Less: Debt discount                 | (3,347)               | (3,728)              |
|                                     | \$ 186,002            | \$ 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 September 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.

**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.



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**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 interest rate applicable to borrowings is the bank's prime rate plus 0.35% per annum and 1.50% per annum for bankers' acceptances. 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 the Company 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 the Company, SEIC Partners' Limited Partnership or to any other U.S. subsidiary of the Company (approximately \$32.8 million (Canadian) at September 30, 2006) has been subordinated to the repayment of Olympic's obligations under 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 with remaining payments of \$6,000 per month until May 2013. 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<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|---|-------------------------------------|------------|------------------------------------|------------|
|   | 2006                                | 2005       | 2006                               | 2005       |
| Income (loss) from continuing operations      | \$ 14,016                           | \$ (2,363) | \$ 33,430                          | \$ (3,223) |
| Income (loss) from discontinued operations    | (146)                               | 22         | (142)                              | 41         |
| Net income (loss)                             | \$ 13,870                           | \$ (2,341) | \$ 33,288                          | \$ (3,182) |
| Basic weighted average shares                 | 150,975                             | 152,745    | 150,852                            | 152,294    |
| Effect of dilutive securities: <sup>(1)</sup> |                                     |            |                                    |            |
| Options and warrants                          | 12,228                              | -          | 12,000                             | -          |
| Employee restricted stock awards              | 3,366                               | -          | 3,167                              | -          |
| Diluted weighted average shares               | 166,569                             | 152,745    | 166,019                            | 152,294    |
| Income (loss) per share:                      |                                     |            |                                    |            |
| Basic:  |                                     |            |                                    |            |
| Income (loss) from continuing operations      | \$ .09                              | \$ (.02)   | \$ .22                             | \$ (.02)   |
| Income (loss) from discontinued operations    | -                                   | -          | -                                  | -          |
| Net income (loss)                             | \$ .09                              | \$ (.02)   | \$ .22                             | \$ (.02)   |
| Diluted:                                      |                                     |            |                                    |            |
| Income (loss) from continuing operations      | \$ .08                              | \$ (.02)   | \$ .20                             | \$ (.02)   |
| Income (loss) from discontinued operations    | -                                   | -          | -                                  | -          |
| Net income (loss)                             | \$ .08                              | \$ (.02)   | \$ .20                             | \$ (.02)   |

(1) A weighted average number of options and warrants to purchase 6,878,000 and 6,569,000 shares of common stock were outstanding during the three and nine months ended September 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**

The Company's board of directors and stockholders adopted the Seitel, Inc. 2004 Stock Option Plan (the "Stock Option Plan") on July 2, 2004 and December 15, 2004, respectively. 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 September 30, 2006, 2,570,481 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 September 30, 2006 and by \$1.9 million, or \$.01 per basic and diluted share, for the nine months ended September 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 \$0.6 million and \$0.7 million during the three months ended September 30, 2006 and 2005, respectively, and \$2.0 million and \$1.5 million during the nine months ended September 30, 2006 and 2005, respectively.



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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<br>Ended<br>September 30, 2005 | Nine Months Ended<br>September 30, 2005 |
|---|---|---|
| <b>Net loss:</b>  |   |   |
| As reported   | \$ (2,341)                                  | \$ (3,182)                              |
| Less: Total stock-based employee expense<br>determined under SFAS No. 123, net of tax | -   | -                                       |
| Pro forma   | \$ (2,341)                                  | \$ (3,182)                              |
| <b>Basic and diluted loss per share:</b>  |   |   |
| As reported   | \$ (.02)                                    | \$ (.02)                                |
| Pro forma   | \$ (.02)                                    | \$ (.02)                                |

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

|   | Options | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Life in Years | Aggregate<br>Intrinsic<br>Value<br>(000's) |
|---|---------|--|--|--|
| Outstanding at beginning of year                            | 100     | \$1.30                                   |  |  |
| Granted   | -       | -  |  |  |
| Exercised   | -       | -  |  |  |
| Cancelled   | -       | -  |  |  |
| Outstanding at September 30, 2006                           | 100     | \$1.30                                   | 7.75   | \$237                                      |
| Options exercisable at September 30, 2006                   | 100     | \$1.30                                   | 7.75   | \$237                                      |
| Options vested or expected to vest at<br>September 30, 2006 | 100     | \$1.30                                   | 7.75   | \$237                                      |

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 nonvested 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 nine months ended September 30, 2006 (shares in thousands):

|                                 | Shares | Weighted<br>Average Grant<br>Date Fair<br>Value |
|---------------------------------|--------|---|
| Non-vested at beginning of year | 2,965  | \$1.36  |

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|                                  |       |        |
|----------------------------------|-------|--------|
| Granted                          | 1,841 | \$2.92 |
| Vested                           | (443) | \$1.40 |
| Forfeited                        | (17)  | \$1.86 |
| Non-vested at September 30, 2006 | 4,346 | \$2.01 |

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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 September 30, 2006, there was \$4.1 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 1.99 years.

During the nine months ended September 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 September 30, 2006 and December 31, 2005 of \$103,000 and \$85,000, respectively, related to collateral on a seismic operations bond.

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

|  | Nine Months Ended September 30, |          |
|--|---------------------------------|----------|
|  | 2006                            | 2005     |
| Non-monetary exchanges related to resale licensing revenue       | \$ 5,718                        | \$ 6,970 |
| Non-monetary exchanges from underwriting of new data acquisition | 1,430                           | 2,109    |
| Non-monetary exchanges related to data management services       | 52                              | -        |
| Completion of data in progress from prior non-monetary exchanges | 2,476                           | 1,964    |
| Less: Non-monetary exchanges for data in progress                | (787)                           | (4,403)  |
| Total non-cash additions to seismic data library                 | \$ 8,889                        | \$ 6,640 |

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

|  | Nine Months Ended September 30, |           |
|--|---------------------------------|-----------|
|  | 2006                            | 2005      |
| Acquisition revenue on underwriting from non-monetary exchange contracts                       | \$ 2,927                        | \$ 1,932  |
| Licensing revenue from specific data licenses or selections on non-monetary exchange contracts | 8,082                           | 10,472    |
| Data management revenue  | 20                              | -         |
| Total non-cash revenue   | \$ 11,029                       | \$ 12,404 |

**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 December 4, 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 September 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, the Company completed a private placement of Senior Notes in the aggregate principal amount of \$193.0 million, of which \$189.0 million was outstanding at September 30, 2006. Seitel, Inc.'s (the "Parent") 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) 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.

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The following consolidating condensed financial information presents: the consolidating condensed balance sheets as of September 30, 2006 and December 31, 2005, and the consolidating condensed statements of operations and statements of cash flows for the nine months ended September 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.

(INDEX)**CONSOLIDATING CONDENSED BALANCE SHEET**

As of September 30, 2006

(In thousands)

|  | Parent            | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Consolidating<br>Eliminations | Consolidated<br>Total |
|--|-------------------|---------------------------|-----------------------------------|-------------------------------|-----------------------|
| <b>ASSETS</b>  |                   |                           |                                   |                               |                       |
| Cash and cash equivalents                              | \$ -              | \$ 92,065                 | \$ 4,908                          | \$ -                          | \$ 96,973             |
| Restricted cash  | -                 | 103                       | -                                 | -                             | 103                   |
| Receivables  |                   |                           |                                   |                               |                       |
| Trade, net   | -                 | 25,282                    | 8,808                             | -                             | 34,090                |
| Notes and other, net                                   | 59                | 236                       | 159                               | -                             | 454                   |
| Intercompany receivables (payables)                    | 260,337           | (263,833)                 | 3,765                             | (269)                         | -                     |
| Investment in subsidiaries                             | (56,236)          | 249,985                   | 42,067                            | (235,816)                     | -                     |
| Net seismic data library                               | -                 | 84,159                    | 41,943                            | (3,680)                       | 122,422               |
| Net other property and equipment                       | -                 | 4,386                     | 3,872                             | -                             | 8,258                 |
| Oil and gas operations held for sale                   | -                 | 29                        | -                                 | -                             | 29                    |
| Investment in marketable securities                    | -                 | -                         | 60                                | -                             | 60                    |
| Prepaid expenses, deferred charges<br>and other assets | 4,943             | 6,290                     | 744                               | -                             | 11,977                |
| Deferred income taxes                                  | -                 | -                         | 6,097                             | -                             | 6,097                 |
| <b>TOTAL ASSETS</b>                                    | <b>\$ 209,103</b> | <b>\$ 198,702</b>         | <b>\$ 112,423</b>                 | <b>\$ (239,765)</b>           | <b>\$ 280,463</b>     |
| <b>LIABILITIES AND STOCKHOLDERS'</b>                   |                   |                           |                                   |                               |                       |
| <b>EQUITY</b>  |                   |                           |                                   |                               |                       |
| Accounts payable and accrued<br>liabilities            | \$ 4,726          | \$ 17,578                 | \$ 4,823                          | \$ -                          | \$ 27,127             |
| Income taxes payable                                   | 22                | -                         | 39                                | -                             | 61                    |
| Oil and gas operations held for sale                   | -                 | 34                        | -                                 | -                             | 34                    |
| Senior Notes   | 185,653           | -                         | -                                 | -                             | 185,653               |
| Notes payable  | 349               | -                         | -                                 | -                             | 349                   |
| Obligations under capital leases                       | -                 | -                         | 3,054                             | -                             | 3,054                 |
| Deferred revenue                                       | -                 | 29,168                    | 10,467                            | -                             | 39,635                |
| <b>TOTAL LIABILITIES</b>                               | <b>190,750</b>    | <b>46,780</b>             | <b>18,383</b>                     | <b>-</b>                      | <b>255,913</b>        |
| <b>STOCKHOLDERS' EQUITY</b>                            |                   |                           |                                   |                               |                       |
| Common stock   | 1,553             | -                         | -                                 | -                             | 1,553                 |
| Additional paid-in capital                             | 239,918           | -                         | -                                 | -                             | 239,918               |
| Parent investment                                      | -                 | 209,770                   | 22,158                            | (231,928)                     | -                     |
| Retained earnings (deficit)                            | (223,109)         | (57,839)                  | 65,712                            | (7,873)                       | (223,109)             |
| Accumulated other comprehensive<br>income (loss)       | (9)               | (9)                       | 6,170                             | 36                            | 6,188                 |
| <b>TOTAL STOCKHOLDERS' EQUITY</b>                      | <b>18,353</b>     | <b>151,922</b>            | <b>94,040</b>                     | <b>(239,765)</b>              | <b>24,550</b>         |
| <b>TOTAL LIABILITIES AND<br/>STOCKHOLDERS' EQUITY</b>  | <b>\$ 209,103</b> | <b>\$ 198,702</b>         | <b>\$ 112,423</b>                 | <b>\$ (239,765)</b>           | <b>\$ 280,463</b>     |

(INDEX)**CONSOLIDATING CONDENSED STATEMENT OF OPERATIONS****For the Nine Months Ended September 30, 2006**

(In thousands)

|   | Parent    | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Consolidating<br>Eliminations | Consolidated<br>Total |
|---|-----------|---------------------------|-----------------------------------|-------------------------------|-----------------------|
| REVENUE   | \$ -      | \$ 109,736                | \$ 31,038                         | \$ (1,657)                    | \$ 139,117            |
| EXPENSES:   |           |                           |                                   |                               |                       |
| Depreciation and amortization                               | -         | 45,950                    | 22,389                            | (500)                         | 67,839                |
| Gain on sale of seismic data                                | -         | (2,377)                   | -                                 | 2,146                         | (231)                 |
| Cost of sales   | -         | 183                       | 20                                | -                             | 203                   |
| Selling, general and<br>administrative expenses             | 1,571     | 16,777                    | 9,618                             | (1,657)                       | 26,309                |
|   | 1,571     | 60,533                    | 32,027                            | (11)                          | 94,120                |
| INCOME (LOSS) FROM<br>OPERATIONS                            | (1,571)   | 49,203                    | (989)                             | (1,646)                       | 44,997                |
| Interest expense, net                                       | (1,302)   | (12,441)                  | (1,027)                           | -                             | (14,770)              |
| Foreign currency exchange gains                             | -         | 63                        | 1,062                             | -                             | 1,125                 |
| Loss on sale of security                                    | -         | -                         | (1)                               | -                             | (1)                   |
| Income (loss) from continuing<br>operations                 |           |                           |                                   |                               |                       |
| before income taxes and equity in<br>income of subsidiaries | (2,873)   | 36,825                    | (955)                             | (1,646)                       | 31,351                |
| Benefit for income taxes                                    | -         | (1,909)                   | (170)                             | -                             | (2,079)               |
| Equity in income (loss) of subsidiaries                     | 36,161    | (784)                     | -                                 | (35,377)                      | -                     |
| Income (loss) from continuing<br>operations                 | 33,288    | 37,950                    | (785)                             | (37,023)                      | 33,430                |
| Loss from discontinued operations,<br>net of tax            | -         | (142)                     | -                                 | -                             | (142)                 |
| NET INCOME (LOSS)   | \$ 33,288 | \$ 37,808                 | \$ (785)                          | \$ (37,023)                   | \$ 33,288             |

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(INDEX)**CONSOLIDATING CONDENSED STATEMENT OF CASH FLOWS****For the Nine Months Ended September 30, 2006**

(In thousands)

|   | Parent      | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Consolidating<br>Eliminations | Consolidated<br>Total |
|---|-------------|---------------------------|-----------------------------------|-------------------------------|-----------------------|
| <b>Cash flows from operating activities:</b>                |             |                           |                                   |                               |                       |
| Net cash provided by (used<br>in)                           |             |                           |                                   |                               |                       |
| operating activities of<br>continuing operations            | \$ (25,683) | \$ 84,007                 | \$ 21,451                         | \$ -                          | \$ 79,775             |
| <b>Cash flows from investing activities:</b>                |             |                           |                                   |                               |                       |
| Cash invested in seismic data                               | -           | (46,613)                  | (14,157)                          | 2,146                         | (58,624)              |
| Cash from sale of seismic data                              | -           | 2,377                     | -                                 | (2,146)                       | 231                   |
| Cash paid to acquire property<br>and equipment              | -           | (703)                     | (209)                             | -                             | (912)                 |
| Cash received from disposal of<br>property<br>and equipment | -           | 3                         | -                                 | -                             | 3                     |
| Cash from sale of security                                  | -           | -                         | 12                                | -                             | 12                    |
| Increase in restricted cash                                 | -           | (18)                      | -                                 | -                             | (18)                  |
| Net cash used in investing<br>activities                    | -           | (44,954)                  | (14,354)                          | -                             | (59,308)              |
| of continuing operations                                    | -           | (44,954)                  | (14,354)                          | -                             | (59,308)              |
| <b>Cash flows from financing activities:</b>                |             |                           |                                   |                               |                       |
| Principal payments on notes<br>payable                      | (29)        | -                         | -                                 | -                             | (29)                  |
| Principal payments on capital<br>lease obligations          | -           | -                         | (29)                              | -                             | (29)                  |
| Borrowings on line of credit                                | -           | -                         | 25                                | -                             | 25                    |
| Payments on line of credit                                  | -           | -                         | (25)                              | -                             | (25)                  |
| Purchases of common stock<br>subsequently retired           | (595)       | -                         | -                                 | -                             | (595)                 |
| Payments on notes receivable<br>from                        |             |                           |                                   |                               |                       |
| officers and employees                                      | -           | 14                        | -                                 | -                             | 14                    |
| Intercompany transfers                                      | 26,307      | (18,449)                  | (7,858)                           | -                             | -                     |
| Net cash provided by (used<br>in)                           |             |                           |                                   |                               |                       |
| financing activities of<br>continuing operations            | 25,683      | (18,435)                  | (7,887)                           | -                             | (639)                 |
| Effect of exchange rate changes                             | -           | -                         | (969)                             | -                             | (969)                 |
| Net cash provided by discontinued<br>operations:            |             |                           |                                   |                               |                       |
| Cash provided by operating<br>activities                    | -           | 8                         | -                                 | -                             | 8                     |
| Cash provided by investing<br>activities                    | -           | 9                         | -                                 | -                             | 9                     |
|   | -           | 20,635                    | (1,759)                           | -                             | 18,875                |

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Net increase in cash and  
equivalents

|   |    |        |       |    |    |        |
|---|----|--------|-------|----|----|--------|
| Cash and equivalents at beginning of period |    |        |       |    |    |        |
| Cash and equivalents at end of period       | \$ | \$     | \$    | \$ | \$ | \$     |
|   | -  | 71,430 | 6,667 | -  | -  | 78,097 |
|   |    | 92,065 | 4,908 |    |    | 96,973 |

(INDEX)**CONSOLIDATING CONDENSED BALANCE SHEET**

As of December 31, 2005

(In thousands)

|   | Parent            | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Consolidating<br>Eliminations | Consolidated<br>Total |
|---|-------------------|---------------------------|-----------------------------------|-------------------------------|-----------------------|
| <b>ASSETS</b>                                       |                   |                           |                                   |                               |                       |
| Cash and cash equivalents                           | \$ -              | \$ 71,430                 | \$ 6,667                          | \$ -                          | \$ 78,097             |
| Restricted cash                                     | -                 | 85                        | -                                 | -                             | 85                    |
| Receivables   |                   |                           |                                   |                               |                       |
| Trade, net  | -                 | 17,150                    | 10,235                            | -                             | 27,385                |
| Notes and other, net                                | 59                | 40                        | 410                               | -                             | 509                   |
| Intercompany receivables<br>(payables)              | 268,213           | (269,191)                 | 978                               | -                             | -                     |
| Investment in subsidiaries                          | (92,421)          | 251,704                   | 41,454                            | (200,737)                     | -                     |
| Net seismic data library                            | -                 | 69,056                    | 44,950                            | (2,060)                       | 111,946               |
| Net property and equipment                          | -                 | 4,825                     | 4,631                             | -                             | 9,456                 |
| Oil and gas operations held for sale                | -                 | 194                       | -                                 | -                             | 194                   |
| Investment in marketable securities                 | -                 | -                         | 54                                | -                             | 54                    |
| Prepaid expenses, deferred charges<br>and other     | 5,794             | 6,559                     | 718                               | -                             | 13,071                |
| Deferred income taxes                               | -                 | -                         | 5,874                             | -                             | 5,874                 |
| <b>TOTAL ASSETS</b>                                 | <b>\$ 181,645</b> | <b>\$ 151,852</b>         | <b>\$ 115,971</b>                 | <b>\$ (202,797)</b>           | <b>\$ 246,671</b>     |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>         |                   |                           |                                   |                               |                       |
| <b>EQUITY</b>                                       |                   |                           |                                   |                               |                       |
| <b>LIABILITIES</b>                                  |                   |                           |                                   |                               |                       |
| Accounts payable and accrued<br>liabilities         | \$ 12,350         | \$ 8,947                  | \$ 4,369                          | \$ -                          | \$ 25,666             |
| Income taxes payable                                | -                 | -                         | 276                               | -                             | 276                   |
| Oil and gas operations held for<br>sale             | -                 | 40                        | -                                 | -                             | 40                    |
| Senior Notes  | 185,272           | -                         | -                                 | -                             | 185,272               |
| Notes payable                                       | 378               | -                         | -                                 | -                             | 378                   |
| Obligations under capital leases                    | -                 | -                         | 2,950                             | -                             | 2,950                 |
| Deferred revenue                                    | -                 | 28,752                    | 14,498                            | -                             | 43,250                |
| <b>TOTAL LIABILITIES</b>                            | <b>198,000</b>    | <b>37,739</b>             | <b>22,093</b>                     | <b>-</b>                      | <b>257,832</b>        |
| <b>STOCKHOLDERS' EQUITY</b>                         |                   |                           |                                   |                               |                       |
| Common stock  | 1,536             | -                         | -                                 | -                             | 1,536                 |
| Additional paid-in capital                          | 241,289           | -                         | -                                 | -                             | 241,289               |
| Parent investment                                   | -                 | 209,770                   | 22,186                            | (231,956)                     | -                     |
| Retained earnings (deficit)                         | (256,227)         | (95,647)                  | 66,497                            | 29,150                        | (256,227)             |
| Deferred compensation -<br>restricted stock         | (2,944)           | -                         | -                                 | -                             | (2,944)               |
| Notes receivable from officers<br>and employees     | -                 | (1)                       | -                                 | -                             | (1)                   |
| Accumulated other<br>comprehensive<br>income (loss) | (9)               | (9)                       | 5,195                             | 9                             | 5,186                 |
| <b>TOTAL STOCKHOLDERS' EQUITY</b>                   |                   |                           |                                   |                               |                       |



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|                       |            |            |            |              |            |
|-----------------------|------------|------------|------------|--------------|------------|
| (DEFICIT)             | (16,355)   | 114,113    | 93,878     | (202,797)    | (11,161)   |
| TOTAL LIABILITIES AND |            |            |            |              |            |
| STOCKHOLDERS' EQUITY  | \$ 181,645 | \$ 151,852 | \$ 115,971 | \$ (202,797) | \$ 246,671 |

(INDEX)**CONSOLIDATING CONDENSED STATEMENT OF OPERATIONS****For the Nine Months Ended September 30, 2005**

(In thousands)

|   | Parent     | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Consolidating<br>Eliminations | Consolidated<br>Total |
|---|------------|---------------------------|-----------------------------------|-------------------------------|-----------------------|
| REVENUE   | \$ -       | \$ 70,315                 | \$ 40,772                         | \$ (3,270)                    | \$ 107,817            |
| EXPENSES:   |            |                           |                                   |                               |                       |
| Depreciation and amortization                               | -          | 48,208                    | 28,428                            | (273)                         | 76,363                |
| Cost of sales   | -          | 123                       | 20                                | -                             | 143                   |
| Selling, general and<br>administrative expenses             | 1,504      | 14,836                    | 9,948                             | (3,270)                       | 23,018                |
|   | 1,504      | 63,167                    | 38,396                            | (3,543)                       | 99,524                |
| INCOME (LOSS) FROM<br>OPERATIONS                            | (1,504)    | 7,148                     | 2,376                             | 273                           | 8,293                 |
| Interest expense, net                                       | (1,517)    | (14,696)                  | (1,359)                           | -                             | (17,572)              |
| Foreign currency exchange gains<br>(losses)                 | -          | 5                         | 1,156                             | -                             | 1,161                 |
| Loss on sale of security                                    | -          | -                         | (11)                              | -                             | (11)                  |
| Dividend income from subsidiary                             | -          | 96                        | -                                 | (96)                          | -                     |
| Income (loss) from continuing<br>operations                 |            |                           |                                   |                               |                       |
| before income taxes and equity in<br>income of subsidiaries | (3,021)    | (7,447)                   | 2,162                             | 177                           | (8,129)               |
| Provision (benefit) for income taxes                        | -          | 230                       | (5,136)                           | -                             | (4,906)               |
| Equity in income of subsidiaries                            | (161)      | 7,306                     | -                                 | (7,145)                       | -                     |
| Income (loss) from continuing<br>operations                 | (3,182)    | (371)                     | 7,298                             | (6,968)                       | (3,223)               |
| Income from discontinued operations,<br>net of tax          | -          | 41                        | -                                 | -                             | 41                    |
| NET INCOME (LOSS)   | \$ (3,182) | \$ (330)                  | \$ 7,298                          | \$ (6,968)                    | \$ (3,182)            |

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(INDEX)**CONSOLIDATING CONDENSED STATEMENT OF CASH FLOWS****For the Nine Months Ended September 30, 2005**

(In thousands)

|   | Parent      | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Consolidating<br>Eliminations | Consolidated<br>Total |
|---|-------------|---------------------------|-----------------------------------|-------------------------------|-----------------------|
| <b>Cash flows from operating activities:</b>                                |             |                           |                                   |                               |                       |
| Net cash provided by (used<br>in)   |             |                           |                                   |                               |                       |
| operating activities of<br>continuing operations                            | \$ (24,959) | \$ 51,903                 | \$ 29,978                         | \$ -                          | \$ 56,922             |
| <b>Cash flows from investing activities:</b>                                |             |                           |                                   |                               |                       |
| Cash invested in seismic data   | -           | (21,281)                  | (22,333)                          | -                             | (43,614)              |
| Cash paid to acquire property<br>and equipment                              | -           | (494)                     | (176)                             | -                             | (670)                 |
| Cash received from disposal of<br>property<br>and equipment                 | -           | -                         | 13                                | -                             | 13                    |
| Cash from sale of security  | -           | -                         | 4                                 | -                             | 4                     |
| Decrease in restricted cash   | -           | 78                        | -                                 | -                             | 78                    |
| Net cash used in investing<br>activities of<br>continuing operations        | -           | (21,697)                  | (22,492)                          | -                             | (44,189)              |
| <b>Cash flows from financing activities:</b>                                |             |                           |                                   |                               |                       |
| Principal payments on senior<br>notes                                       | (4,000)     | -                         | -                                 | -                             | (4,000)               |
| Principal payments on notes<br>payable                                      | (27)        | (282)                     | -                                 | -                             | (309)                 |
| Principal payments on capital<br>lease obligations                          | (1,295)     | -                         | (25)                              | -                             | (1,320)               |
| Costs of debt and equity<br>transactions                                    | (185)       | -                         | -                                 | -                             | (185)                 |
| Payments on notes receivable<br>from<br>officers, employees and<br>director | -           | 38                        | -                                 | -                             | 38                    |
| Intercompany transfers  | 30,466      | (22,521)                  | (7,945)                           | -                             | -                     |
| Net cash provided by (used<br>in)   |             |                           |                                   |                               |                       |
| financing activities of<br>continuing operations                            | 24,959      | (22,765)                  | (7,970)                           | -                             | (5,776)               |
| Effect of exchange rate changes   | -           | -                         | (840)                             | -                             | (840)                 |
| Net cash provided by discontinued<br>operations (revised):                  |             |                           |                                   |                               |                       |
| Cash provided by operating<br>activities                                    | -           | 151                       | -                                 | -                             | 151                   |
| Net increase (decrease) in cash<br>and equivalents                          | -           | 7,592                     | (1,324)                           | -                             | 6,268                 |
|   | -           | 30,745                    | 12,540                            | -                             | 43,285                |

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Cash and equivalents at beginning of period

|                                       |    |   |    |        |    |        |    |   |    |        |
|---------------------------------------|----|---|----|--------|----|--------|----|---|----|--------|
| Cash and equivalents at end of period | \$ | - | \$ | 38,337 | \$ | 11,216 | \$ | - | \$ | 49,553 |
|---------------------------------------|----|---|----|--------|----|--------|----|---|----|--------|

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(INDEX)**NOTE K-RECENT ACCOUNTING PRONOUNCEMENTS**

In December 2004, the FASB issued SFAS No. 123(R), "Share-Based Payment," which supersedes SFAS No. 148 - "Accounting for Stock-Based Compensation - Transition and Disclosure - an amendment of FASB Statement No. 123." SFAS No. 123(R) establishes standards for transactions in which an entity exchanges its equity instruments for goods or services. This standard requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. This eliminates the exception to account for such awards using the intrinsic method previously allowable under APB Opinion No. 25. The Company adopted SFAS No. 123(R) effective January 1, 2006. Adoption of this standard increased the Company's net income by \$1.9 million for the nine months ended September 30, 2006.

In December 2004, the FASB issued SFAS No. 153, "Exchanges of Nonmonetary Assets - an amendment of APB Opinion No. 29". This statement addresses the measurement of exchanges of nonmonetary assets. It eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets in paragraph 21(b) of APB Opinion No. 29, "Accounting for Nonmonetary Transactions," and replaces it with an exception for exchanges that do not have commercial substance. This statement specifies that a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. The Company adopted SFAS No. 153 effective January 1, 2006. Adoption of this standard did not have any financial impact on the Company.

In June 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20, Accounting Changes, and Statement No. 3, Reporting Accounting Changes in Interim Financial Statements." SFAS No. 154 changes the requirements for the accounting for and reporting of a change in accounting principle. Previously, most voluntary changes in accounting principles required recognition via a cumulative effect adjustment within net income of the period of the change. SFAS No. 154 requires retrospective application to prior periods' financial statements, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. Other than the adoption of SFAS No. 123(R), the Company did not have any accounting changes or error corrections; therefore, the adoption of SFAS No. 154 on January 1, 2006 did not have an impact on the Company's consolidated financial position, results of operations or cash flows.

In July 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109," ("FIN 48") which clarifies the accounting for uncertainty in tax positions. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Additionally, FIN 48 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods and disclosure requirements for uncertain tax positions. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. The Company is currently assessing the impact of adopting FIN 48 on its consolidated financial position, results of operations and cash flows.

In September 2006, the SEC staff issued Staff Accounting Bulletin ("SAB") 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements." SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a potential current year misstatement. Prior to SAB 108, companies might evaluate the materiality of financial-statement misstatements using either the income statement or balance approach, with the income statement approach focusing on new misstatements added in the current year, and the balance sheet approach focusing on the cumulative amount of misstatement present in a company's balance sheet. Misstatements that would be material under one approach could be viewed as immaterial under another approach, and not be corrected. SAB 108 now requires that companies view financial statement misstatements as material if they are material according to either the income statement or balance sheet approach. The guidance in SAB 108 must be applied to annual financial statements for fiscal years ending after November 15, 2006. The Company is currently assessing the impact of adopting SAB 108 but does not expect that it will have a material effect on its consolidated financial position, results of operations or cash flows.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosure about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company is currently assessing the impact of adopting SFAS No. 157 but does not expect that it will have a material effect on its consolidated financial position, results of operations or cash flows.



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**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**CAUTIONARY STATEMENTS CONCERNING FORWARD-LOOKING INFORMATION**

This Quarterly Report on Form 10-Q contains forward-looking statements. Statements contained in this report about Seitel, Inc.'s future outlook, prospects, strategies and plans, and about industry conditions, demand for seismic services and the future economic life of our seismic data are forward-looking. All statements that express belief, expectation, estimates or intentions, as well as those that are not statements of historical fact, are forward looking. The words "proposed," "anticipates," "anticipated," "will," "would," "should," "estimates" and similar expressions are intended to identify forward-looking statements. Forward-looking statements represent our reasonable present belief and are based on our current expectations and assumptions with respect to future events. While we believe our expectations and assumptions are reasonable, they involve risks and uncertainties beyond our control that could cause the actual results or outcome to differ materially from the expected results or outcome reflected in our forward-looking statements. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this quarterly report may not occur. Such risks and uncertainties include, without limitation, our ability to comply with the terms of our final judgment of permanent injunction by the SEC, the impact on our results of operations of our significant amount of debt service and interest expense, our ability to obtain and maintain normal terms with our vendors and service providers, our ability to maintain contracts that are critical to our operations, changes in the oil and gas industry or the economy generally, changes in the exploration budgets of our customers, actual customer demand for our seismic data and related services, the timing and extent of changes in commodity prices for natural gas, crude oil and condensate and natural gas liquids and conditions in the capital markets during the periods covered by the forward-looking statements. The foregoing and other risk factors are identified in our Annual Report on Form 10-K filed with the SEC for the fiscal year ended December 31, 2005.

The forward-looking statements contained in this report speak only as of the date hereof. Except as required by federal, state and securities law, we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or any other reason. All forward-looking statements attributable to Seitel, Inc. or any person acting on its behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in our Annual Report filed on Form 10-K and in our future periodic reports filed with the SEC.

**Overview**

**General**

We have ownership in an extensive library of onshore and offshore seismic data that we offer for license to oil and gas companies. Oil and gas companies use seismic data in oil and gas exploration and development efforts to increase the probability of drilling success. We believe that our library of onshore seismic data is one of the largest, if not the largest, available for licensing in the United States and Canada. Our library of offshore data covers parts of the U.S. Gulf of Mexico shelf and certain deep water areas in the western and central U.S. Gulf of Mexico. We generate revenue primarily by licensing data from our data library and from new data creation projects, which are substantially underwritten or paid for by clients. By participating in underwritten, nonexclusive surveys or purchasing licenses to existing data, oil and gas companies can obtain access to surveys at reduced costs as compared to acquiring seismic data on a proprietary basis.

Our primary areas of focus are onshore U.S. and Canada and, to a lesser extent, offshore U.S. Gulf of Mexico. These markets continue to experience major changes. Having spent several years increasing their focus on international exploration opportunities, several major oil companies are becoming more active in the U.S. market than in the past few years. Independent oil and gas companies continue to be responsible for a significant portion of current U.S. drilling activity. Production decline rates are accelerating worldwide and are the most pronounced in mature fields of North America, while commodity prices for oil and natural



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gas remain a positive driver. We expect demand for natural gas to continue to increase exploration activity over the next two to three years in the U.S. and Canada.

Since 2002, we have focused on our core business activities of seismic data licensing, improved our capital spending discipline and reduced operating costs. We believe our operating cost structure is aligned with our current level of business. The principal amount of our outstanding indebtedness has been reduced to \$188.9 million at September 30, 2006 and our cash balance has grown to \$97.0 million at September 30, 2006.



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Over the last two years, we have achieved an average return on investment in excess of 40% on newly created data. In addition, during 2006, we have added significant amounts of data through purchases and trades as compared to recent years. We believe that this data will meet the expected returns for purchased data. We determine return on investment by dividing the amount of non-exclusive data license revenue earned on data added to our library by the amount of the gross investment in the data, net of underwriting. This percentage is useful because it reflects our ability to recover the capital investment on data added to our library, but should not be considered as an alternative to net income, as an indicator of our operating performance or as a measure of liquidity, including as an alternative to cash flows from operating activities. We believe that we will be able to sustain the improvement of our return on investment over the next year provided the overall demand for seismic data remains strong. Our clients continue to seek our services to create data in the U.S. and in Canada. Our current commitment for underwriting on new data creation projects is \$20.5 million. Licensing data "off the shelf" does not require the longer planning and lead times like new data creation and thus is more likely to fluctuate quarter to quarter.

### **Principal Factors Affecting Our Business**

Our business is dependent upon a variety of factors, many of which are beyond our control. The following are those that we consider to be principal factors affecting our business.

***Demand for Seismic Data.*** Demand for our products and services is cyclical due to the nature of the energy industry. In particular, demand for our seismic data services depends upon exploration, production, development and field management spending by oil and gas companies and, in the case of new data creation, their willingness to forgo ownership in the seismic data. Capital expenditures by oil and gas companies depend upon several factors, including actual and forecasted oil and natural gas commodity prices, prospect availability and the companies' own short-term and strategic plans. These capital expenditures may also be affected by worldwide economic or industry-wide conditions. Demand for our seismic data is more likely to be influenced by natural gas prices rather than crude oil prices due to the geographic areas covered by our seismic data.

***Availability of Capital for Our Customers.*** Many of our customers consist of independent oil and gas companies and private prospect-generating companies that rely primarily on private capital markets to fund their exploration, production, development and field management activities. Significant changes in the private capital market and the availability of capital could have a material impact on the ability of these companies to obtain funding necessary to purchase our seismic data.

***Merger and Acquisition Activity.*** In recent years, there has been an increase in the level of merger and acquisition activity within our client base. This activity could have a negative impact on seismic companies that operate in markets with a limited number of participating clients. However, we believe that, over time, this activity could have a positive impact on our business, as it should generate re-licensing fees, result in increased vitality in the trading of mineral interests and result in the creation of new independent customers through the rationalization of staff within those companies affected by this activity.

***Natural Gas Reserve Replacement.*** Oil and gas reserves are currently being depleted at a rate estimated by industry analysts of 5% to 10% per year for the major oil and gas operators. As a result, we believe there is an increasing need in the oil and gas industry to replace these reserves, which we anticipate will increase the demand for our seismic data.

**Government Regulation.** Our operations are subject to a variety of federal, provincial, state, foreign and local laws and regulations, including environmental and health and safety laws. We invest financial and managerial resources to comply with these laws and related permit requirements. Modification of existing laws or regulations and the adoption of new laws or regulations limiting or increasing exploration or production activities by oil and gas companies may have a material effect on our business operations.



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### Seasonality and Timing Factors

Our results of operations fluctuate from quarter to quarter due to a number of factors. Our results are influenced by oil and gas industry capital expenditure budgets and spending patterns. These budgets are not necessarily spent in equal or progressive increments during the year, with spending patterns affected by individual oil and gas company requirements as well as industry-wide conditions. In addition, under our revenue recognition policy, when we recognize revenue from data licensing contracts is dependent, among other things, upon when the customer selects the data. As a result, our seismic data revenue does not necessarily flow evenly or progressively during a year or from year to year. Although the majority of our data licensing transactions provide for fees to us of under \$500,000 per transaction, occasionally a single data license transaction from our library, including those resulting from the merger and acquisition of our oil and gas company customers, may be substantially larger. Such large license transactions or an unusually large number of, or reduction in, data selections by customers can materially impact our results during a quarter, creating an impression of a revenue trend that may not be repeated in subsequent periods. In our data creation activities, weather-related or other events outside our control may impact or delay surveys during any given quarter.

### Key Performance Measures

Management considers a variety of performance measures in evaluating and managing our financial condition and operating performance at various times and from time to time. Certain of these performance measures are non-GAAP financial measures. Generally, a non-GAAP financial measure is a numerical measure of a company's performance, financial position or cash flows that either excludes or includes amounts that are not normally excluded or included in the most directly comparable measure calculated and presented in accordance with United States generally accepted accounting principles, or GAAP. These non-GAAP measures are not in accordance with, nor are they a substitute for, GAAP measures. These non-GAAP measures are intended to supplement our presentation of our financial results that are prepared in accordance with GAAP.

The following are the key performance measures considered by management.

#### Cash Resales

Cash resales represent new contracts for data licenses from our library, payable in cash. We expect cash resales to generally follow a consistent trend over several quarters, while considering our normal seasonality. Volatility in this trend over several consecutive quarters could indicate changing market conditions. The following is a reconciliation of this non-GAAP financial measure to the most directly comparable GAAP financial measure, total revenue (in thousands):

|                           | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|---------------------------|-------------------------------------|-----------|------------------------------------|-----------|
|                           | 2006                                | 2005      | 2006                               | 2005      |
| Cash resales              | \$ 26,280                           | \$ 20,278 | \$ 86,864                          | \$ 65,510 |
| Other revenue components: |                                     |           |                                    |           |
| Acquisition revenue       | 12,199                              | 3,643     | 36,193                             | 19,482    |
| Non-monetary exchanges    | 1,439                               | 129       | 5,718                              | 6,970     |
| Revenue deferred          | (5,224)                             | (8,948)   | (33,202)                           | (33,672)  |

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|  |           |           |            |            |
|--|-----------|-----------|------------|------------|
| Recognition of revenue previously deferred | 9,794     | 8,216     | 37,341     | 45,629     |
| Solutions and other                        | 1,389     | 1,232     | 6,203      | 3,898      |
| Total revenue, as reported                 | \$ 45,877 | \$ 24,550 | \$ 139,117 | \$ 107,817 |





(INDEX)**Cash Margin**

Cash margin includes cash resales plus all other cash revenues other than from data acquisitions, gain on sale of seismic data, less cash selling, general and administrative expenses and cost of goods sold. We believe this measure is helpful in determining the level of cash from operations we have available for debt service and funding of capital expenditures (net of the portion funded or underwritten by our customers). The following is a reconciliation of this non-GAAP financial measure to the most directly comparable GAAP financial measure, operating income (in thousands):

|  | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |           |
|--|-------------------------------------|------------|------------------------------------|-----------|
|  | 2006                                | 2005       | 2006                               | 2005      |
| Cash margin  | \$ 19,861                           | \$ 14,497  | \$ 68,782                          | \$ 47,729 |
| Add (subtract) other revenue components not included in cash margin: |                                     |            |                                    |           |
| Acquisition revenue  | 12,199                              | 3,643      | 36,193                             | 19,482    |
| Non-monetary exchanges   | 1,439                               | 129        | 5,718                              | 6,970     |
| Revenue deferred   | (5,224)                             | (8,948)    | (33,202)                           | (33,672)  |
| Recognition of revenue previously deferred                           | 9,794                               | 8,216      | 37,341                             | 45,629    |
| Non-cash Solutions revenue   | 13                                  | -          | 20                                 | -         |
| Less:  |                                     |            |                                    |           |
| Depreciation and amortization  | (21,027)                            | (19,441)   | (67,839)                           | (76,363)  |
| Non-cash operating expenses  | (618)                               | (722)      | (2,016)                            | (1,482)   |
| Operating income (loss), as reported                                 | \$ 16,437                           | \$ (2,626) | \$ 44,997                          | \$ 8,293  |

**Growth of our Seismic Data Library**

We regularly add to our seismic data library through four different methods: (1) recording new data; (2) buying ownership of existing data for cash; (3) obtaining ownership of existing data sets through non-monetary exchanges; and (4) creating new value-added products from existing data within our library. For the period from January 1, 2006 to October 31, 2006, we completed the addition of approximately 2,100 square miles of seismic data to our library, including a purchase of approximately 600 square miles of seismic data. For the year ended December 31, 2005, we completed the addition of approximately 2,100 square miles of seismic data to our library. As of October 31, 2006, we had approximately 670 square miles of seismic data in progress.

**Critical Accounting Policies**

We operate in one business segment, which is made up of seismic data acquisition, seismic data licensing, seismic data processing and seismic reproduction services.

As of January 1, 2006, we adopted SFAS No. 123(R), "Share-Based Payment," to account for stock based employee compensation. SFAS 123(R) requires us to record the cost of stock options and other equity-based compensation in our income statement based upon the estimated fair value of those awards. Other than the adoption of SFAS No. 123(R), there have not been any changes in our critical accounting policies since December 31, 2005. See "- Recent Accounting Pronouncements" for more on SFAS No. 123(R).





(INDEX)**Results of Operations**

The following table summarizes the components of our revenue for the three and nine months ended September 30, 2006 and 2005 (in thousands):

|  | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|-----------|------------------------------------|------------|
|  | 2006                                | 2005      | 2006                               | 2005       |
| <b>Acquisition revenue:</b>                |                                     |           |                                    |            |
| Cash underwriting                          | \$ 11,808                           | \$ 2,408  | \$ 33,266                          | \$ 17,550  |
| Underwriting from non-monetary exchanges   | 391                                 | 1,235     | 2,927                              | 1,932      |
| Total acquisition revenue                  | 12,199                              | 3,643     | 36,193                             | 19,482     |
| <b>Licensing revenue:</b>                  |                                     |           |                                    |            |
| Cash resales                               | 26,280                              | 20,278    | 86,864                             | 65,510     |
| Non-monetary exchanges                     | 1,439                               | 129       | 5,718                              | 6,970      |
| Revenue deferred                           | (5,224)                             | (8,948)   | (33,202)                           | (33,672)   |
| Recognition of revenue previously deferred | 9,794                               | 8,216     | 37,341                             | 45,629     |
| Total resale revenue                       | 32,289                              | 19,675    | 96,721                             | 84,437     |
| Solutions and other                        | 1,389                               | 1,232     | 6,203                              | 3,898      |
| Total revenue                              | \$ 45,877                           | \$ 24,550 | \$ 139,117                         | \$ 107,817 |

Total revenue increased 87% in the third quarter of 2006 compared to the same period of 2005 and was driven by an increase in acquisition revenue on new seismic shoots as well as an increase in licensing revenue from our data library. Acquisition revenue in the third quarter of 2006 increased 235% from that recorded in the third quarter of 2005. This increase was the result of the increase in the number and size of seismic surveys being shot in the 2006 period as compared to the 2005 period. The increase in licensing revenue was primarily the result of a 30% increase in the level of cash resales between the quarters reflecting the continued strong demand for our seismic data as drilling activity has remained strong throughout North America. Non-monetary exchanges fluctuate quarter to quarter depending upon the data available for trade and were higher in the third quarter of 2006 compared to 2005. In the third quarter of 2006, the level of timing of revenue recognition (i.e., revenue deferred and recognition of revenue previously deferred) increased to \$4.6 million compared to \$(0.7) million in the third quarter of 2005. Solutions and other revenue increased in the third quarter of 2006 by 13% from the third quarter of 2005 primarily due to an increase in the level of reproduction and delivery services provided and the types of products delivered.

Total revenue for the first nine months of 2006 increased 29% compared to the 2005 period and was primarily due to the increase in acquisition revenue as discussed above as well as an increase in licensing revenue from our data library. Cash resales increased 33% between the nine month periods. This increase was offset by a reduction of \$7.8 million in the level of timing of revenue recognition (i.e., revenue deferred and recognition of revenue previously deferred). The first nine months of 2005 included an unusually high level of revenue recognized from previously deferred contracts, or selections, resulting in an \$8.3 million decrease between periods. Solutions and other revenue increased by 59% during the first nine months of 2006 primarily resulting from the level of licensing activity and the types of products delivered.

At September 30, 2006, we had a deferred revenue balance of \$39.6 million, compared to the December 31, 2005 balance of \$43.3 million. The deferred revenue will be recognized when selection of the data is made by the customer or upon expiration of the selection period, whichever occurs first.

Seismic data library amortization amounted to \$20.3 million in the third quarter of 2006 compared to \$18.8 million in the third quarter of 2005 and \$65.8 million for the first nine months of 2006 compared to \$73.9 million for the first nine months of 2005. The amount of seismic data library amortization fluctuates based on the level and location of specific seismic surveys licensed (including licensing resulting from new data acquisition) and selected by our customers during any period as well as the amount of straight-line amortization required under our accounting policy.





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Seismic data amortization as a percentage of seismic licensing revenue is summarized as follows (in thousands):

| Components of Amortization | Three Months Ended<br>September 30, |           | Percentage of<br>Revenue |      |
|----------------------------|-------------------------------------|-----------|--------------------------|------|
|                            | 2006                                | 2005      | 2006                     | 2005 |
| Income forecast            | \$ 13,053                           | \$ 7,347  | 29%                      | 31%  |
| Straight-line              | 7,290                               | 11,408    | 16%                      | 49%  |
| Total                      | \$ 20,343                           | \$ 18,755 | 45%                      | 80%  |

| Components of Amortization | Nine Months Ended<br>September 30, |           | Percentage of<br>Revenue |      |
|----------------------------|------------------------------------|-----------|--------------------------|------|
|                            | 2006                               | 2005      | 2006                     | 2005 |
| Income forecast            | \$ 44,509                          | \$ 40,121 | 34%                      | 39%  |
| Straight-line              | 21,304                             | 33,807    | 16%                      | 32%  |
| Total                      | \$ 65,813                          | \$ 73,928 | 50%                      | 71%  |

The decrease in the percentage of income forecast amortization to revenue in 2006 is primarily due to the mix of data being licensed, including the effects of the level of revenue recognized on fully amortized data. In the third quarter of 2006, 79% of resale revenue recognized was from data whose costs were fully amortized as compared to 64% in the third quarter of 2005. This percentage was 71% in the first nine months of 2006 compared to 54% for the same period of 2005. The decrease in the amount of straight-line amortization principally comes from surveys that were less than four years of age at the time of the revision in useful life; the majority of these surveys have become fully amortized.

In January of 2006, we sold certain seismic surveys located in Canada as required by an agreement entered into in 1993. We recorded a gain of \$231,000 related to such sale for the nine months ended September 30, 2006.

Selling, general and administrative ("SG&A") expenses were \$8.4 million in the third quarter of 2006 compared to \$7.7 million in the third quarter of 2005 and \$26.3 million in the first nine months of 2006 compared to \$23.0 million in the first nine months of 2005. The increase in SG&A expenses in the third quarter was principally due to (1) an increase in commission expense resulting from the higher level of revenue in the 2006 third quarter and (2) an increase in professional fees incurred. The increase in SG&A expenses for the nine month period was primarily due to (1) an increase in compensation expense resulting from performance based compensation expense associated with the Company's incentive compensation plan as well as expense related to restricted stock awards and (2) an increase in professional fees incurred.

Interest expense, net, was \$4.9 million and \$5.6 million in the third quarters of 2006 and 2005, respectively, and was \$14.8 million and \$17.6 million for the nine months ended September 30, 2006 and 2005, respectively. The decrease in expense is due to a higher level of interest income resulting from increased cash balances as well as improved rates of return.

Income tax benefit was \$2.5 million and \$3.9 million in the third quarters of 2006 and 2005, respectively, and \$2.1 million and \$4.9 million for the nine months ended September 30, 2006 and 2005, respectively. The benefit in the 2006 periods resulted from (1) the reversal of a reserve totaling \$2 million on a U.S. tax position which we no longer deemed necessary and (2) a benefit on Canadian operations. Additionally, in the 2006 periods the income tax expense recorded on our U.S. operations was substantially offset by a reduction in our deferred tax asset valuation allowance resulting in \$22,000 tax expense in the U.S. for estimated alternative minimum tax for the 2006 periods. In 2005, we determined that it was more likely than not that a portion of the deferred tax asset related to the Canadian operations would be realized. Therefore, in the third quarter and first nine months of 2005, \$3.8 million and \$6.2 million, respectively, of the valuation allowance previously provided against this deferred tax asset was reversed resulting in the tax benefit.

In the third quarter of 2006, we disposed of our remaining oil and gas properties. As a result, we recorded a loss from discontinued operations of \$146,000 in the third quarter of 2006 and \$142,000 for the nine months ended September 30, 2006.







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## Liquidity and Capital Resources

### Sources and Uses of Liquidity

**U.S. Credit Facility.** We have a revolving credit facility and can borrow up to \$30.0 million, subject to borrowing base limitations. The borrowing base is determined from time to time based on the lesser of:

- \$30.0 million,
- 0.75 times our U.S. cash operating income (defined as cash revenue, derived primarily from seismic data acquisition revenue, cash library licensing revenue and Solutions revenue, less cost of sales and SG&A, before depreciation and amortization expense for the trailing 12-month period), or
- the sum of (1) 85% of eligible U.S. short term accounts (defined as accounts that are not long term accounts and within 90 days of invoice date), (2) 50% of eligible U.S. long term accounts (defined as accounts with contracts for periods of performance from one month to 18 months, where the account debtor makes payments over the term of the contract), and (3) \$20.0 million.

Interest is payable at an applicable margin above either LIBOR or the prime rate. The facility is secured by a first priority, perfected security interest in substantially all of our U.S. assets and a pledge of all of the issued and outstanding capital stock of our U.S. subsidiaries. The facility expires on July 2, 2007. At October 30, 2006, there was no outstanding balance under the facility and we could borrow up to \$30.0 million. Covenants in the agreement limit our ability to, among other things, incur additional indebtedness, pay dividends, and complete mergers, acquisitions and sales of assets. In addition, the agreement requires us to maintain certain financial ratios. We were in compliance with all covenants and financial ratios as of September 30, 2006.

**Canadian Credit Facility.** Our 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 interest rate applicable to borrowings is the bank's prime rate plus 0.35% per annum and 1.50% per annum for bankers' acceptances. 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 us or any of our other U.S. subsidiaries. However, all intercompany debt owing by Olympic, SEIC Trust Administration Ltd., SEIC Business Trust or SEIC Holdings, Ltd. to us, SEIC Partners Limited Partnership or to any of our U.S. subsidiaries (approximately \$32.8 million (Canadian) at September 30, 2006) has been subordinated to the repayment of Olympic's obligations under 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. As of October 31, 2006, no amounts were outstanding on this revolving credit facility and \$3.9 million (Canadian) was available on the revolving credit facility. Olympic is not a party to any of the debt issued by us other than the note payable to a former executive.

**11.75% Senior Unsecured Notes.** On July 2, 2004, we issued, in a private placement, \$193.0 million aggregate principal amount of 11.75% senior unsecured notes. These notes were offered at a discount of 2.325% from their principal amount and mature on July 15, 2011. As required by their terms, our 11.75% senior notes were exchanged for senior notes of like amounts and terms in a publicly registered exchange offer in February 2005. As of October 31, 2006, \$189.0 million aggregate principal amount was outstanding. Interest is payable in cash, semi-annually in arrears on January 15 and July 15 of each year, commencing on January 15, 2005. The 11.75% senior notes are unsecured and are guaranteed by substantially all of our domestic subsidiaries on a senior basis. The 11.75% senior notes contain restrictive covenants which limit our and our subsidiaries' ability to, among other things, incur additional indebtedness, make capital expenditures in excess of specified amounts, pay dividends and complete mergers, acquisitions and sales of assets.



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From time to time on or before July 15, 2007, we may redeem up to 35% of the aggregate principal amount of our 11.75% 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 we have excess cash flow (as defined in the indenture) in excess of \$5.0 million, we are required to use 50% of the excess cash flow to fund an offer to repurchase our 11.75% senior notes on a pro rata basis at 100% of its principal amount, plus accrued and unpaid interest. If we have 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 will be 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. We are required to make a repurchase offer only if there is no event of default under our revolving credit facilities prior to and after giving effect to the repurchase payment. In March 2006, we made a repurchase offer for up to \$8.5 million aggregate principal amount of senior notes under the excess cash flow requirement. No notes were tendered in connection with this offer. In connection with our 2004 excess cash flow offer in March 2005, \$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 our 11.75% senior notes will have the right to require us 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.

As of September 30, 2006, we had outstanding debt and lease obligations, with aggregate contractual cash obligations summarized as follows (in thousands):

| Contractual cash obligations             | Total      | Remainder of<br>2006 | Payments due by period |            |                        |
|--|------------|----------------------|------------------------|------------|------------------------|
|  |            |                      | 2007-2009              | 2010-2011  | 2012 and<br>thereafter |
| Debt obligations <sup>(1)(2)</sup>       | \$ 300,517 | \$ 18                | \$ 66,838              | \$ 233,559 | \$ 102                 |
| Capital lease obligations <sup>(2)</sup> | 5,702      | 75                   | 987                    | 665        | 3,975                  |
| Operating lease obligations              | 6,560      | 285                  | 3,312                  | 2,072      | 891                    |
| Total contractual cash obligations       | \$ 312,779 | \$ 378               | \$ 71,137              | \$ 236,296 | \$ 4,968               |

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

(2) Amounts include interest related to such obligations.

**Operating Activities.** Cash flows provided by operating activities from continuing operations were \$79.8 million and \$56.9 million for the nine months ended September 30, 2006 and 2005, respectively. The increase from 2005 to 2006 was primarily due to an increase in the amount of cash received from customers, an increase in interest income and a decrease in interest paid.

**Investing Activities.** Cash flows used in investing activities from continuing operations were \$59.3 million and \$44.2 million for the nine months ended September 30, 2006 and 2005, respectively. Cash expenditures for seismic data were \$58.6 million and \$43.6 million for the nine months ended September 30, 2006 and 2005, respectively.

**Financing Activities.** Cash flows used in financing activities were \$0.6 million and \$5.8 million for the nine months ended September 30, 2006 and 2005, respectively. During the nine months ended September 30, 2006 payments on senior notes, term loans and capital leases equaled \$58,000, as compared to \$5.6 million in the 2005 period. The decrease between periods is primarily due to the 2005 period including payments on our Senior Notes totaling \$4.0 million in connection with our 2004 excess cash flow offer.

**Anticipated Liquidity.** Our ability to make required payments of principal and interest on our 11.75% senior notes, and comply with our various debt covenants, will depend primarily on our ability to generate substantial operating cash flows. Over the next 12 months, we expect to obtain the funds necessary to pay our operating, capital and other expenses and principal and interest on our 11.75% senior notes and our other indebtedness, from our operating cash flows, cash and cash equivalents on hand and, if required, from additional borrowings (to the extent available under our revolving credit facilities and otherwise subject to the borrowing base). Our ability to satisfy our payment obligations depends substantially on our future operating and financial performance, which necessarily will be affected by, and subject to, industry, market, economic and other factors. We will not be able to predict or control many of these factors, such as economic conditions in the markets where we operate and competitive pressures.



(INDEX)**Deferred Taxes**

As of September 30, 2006, we had a net deferred tax asset of \$6.1 million attributable to our Canadian operations, which was partially offset by a valuation allowance of \$51,000. In the U.S., we had a net deferred tax asset of \$80.3 million, all of which was fully offset by a valuation allowance. The recognition of the U.S. deferred tax asset will not occur until such time that it is more likely than not that some portion or all of the deferred tax asset will be realized. As of September 30, 2006, the recovery of the U.S. deferred tax asset is not assured of realization.

Section 382 of the Internal Revenue Code places a limit on certain tax attributes which were in existence prior to a greater than 50% change in ownership. The rules use a rolling three-year period for determination of such change. We do not believe an ownership change occurred prior to 2006. However, significant share transfers have taken place during 2006, potentially causing an ownership change when analyzed over a three-year period. Any limitation on the net operating loss carryforwards as a result of an ownership change during 2006 should not materially impact our ability to offset future taxable income.

**Off-Balance Sheet Transactions**

Other than operating leases, we do not maintain any off-balance sheet transactions, arrangements, obligations or other relationships with unconsolidated entities or others that are reasonably likely to have a material current or future effect on our financial condition, changes in financial condition, revenue or expense, results of operations, liquidity, capital expenditures or capital resources.

**Capital Expenditures**

During the first nine months of 2006, capital expenditures for seismic data and other property and equipment amounted to \$75.5 million. Our capital expenditures for the remainder of 2006 are presently estimated to be \$21.7 million. The first nine months of 2006 actual and 2006 estimated remaining capital expenditures are comprised of the following (in thousands):

|   | Actual for<br>Nine Months<br>Ended<br>September 30,<br>2006 | Estimate For<br>Remainder of<br>2006 | Total<br>Estimate<br>for 2006 |
|---|---|--------------------------------------|-------------------------------|
| New data acquisition                        | \$ 49,357   | \$ 15,000                            | \$ 64,357                     |
| Cash purchases of seismic data and other    | 16,351  | 1,200                                | 17,551                        |
| Non-monetary exchanges                      | 8,889   | 5,200                                | 14,089                        |
| Other property and equipment                | 949   | 300                                  | 1,249                         |
| Total capital expenditures                  | 75,546  | 21,700                               | 97,246                        |
| Less: Non-monetary exchanges                | (8,889)   | (5,200)                              | (14,089)                      |
| Changes in working capital                  | (7,121)   | -                                    | (7,121)                       |
| Cash investment per statement of cash flows | \$ 59,536   | \$ 16,500                            | \$ 76,036                     |

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The capital expenditures discussed above are within the capital expenditure limitations imposed by our 11.75% senior notes and U.S. revolving credit facility.

Capital expenditures funded from operating cash flow are as follows (in thousands):

|   | Actual for<br>Nine Months<br>Ended<br>September 30,<br>2006 | Estimate For<br>Remainder of<br>2006 | Total<br>Estimate<br>for 2006 |
|---|---|--------------------------------------|-------------------------------|
| Total capital expenditures                  | \$ 75,546   | \$ 21,700                            | \$ 97,246                     |
| Less:                                       |   |                                      |                               |
| Non-cash additions                          | (8,889)   | (5,200)                              | (14,089)                      |
| Cash underwriting                           | (33,266)  | (10,100)                             | (43,366)                      |
| Capital expenditures funded from operations | \$ 33,391   | \$ 6,400                             | \$ 39,791                     |

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As of October 31, 2006, we had capital expenditure commitments related to data acquisition projects for an estimated \$28.2 million for which we have obtained approximately \$19.4 million of cash underwriting and \$1.1 million of underwriting from non-monetary exchanges.

**Recent Accounting Pronouncements**

In December 2004, the FASB issued SFAS No. 123(R), "Share-Based Payment," which supersedes SFAS No. 148 - "Accounting for Stock-Based Compensation - Transition and Disclosure - an amendment of FASB Statement No. 123." SFAS No. 123(R) establishes standards for transactions in which an entity exchanges its equity instruments for goods or services. This standard requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. This eliminates the exception to account for such awards using the intrinsic method previously allowable under APB Opinion No. 25. We adopted SFAS No. 123(R) effective January 1, 2006. Adoption of this standard increased our net income by \$1.9 million for the nine months ended September 30, 2006.

In December 2004, the FASB issued SFAS No. 153, "Exchanges of Nonmonetary Assets - an amendment of APB Opinion No. 29". This statement addresses the measurement of exchanges of nonmonetary assets. It eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets in paragraph 21(b) of APB Opinion No. 29, "Accounting for Nonmonetary Transactions", and replaces it with an exception for exchanges that do not have commercial substance. This statement specifies that a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. We adopted SFAS No. 153 effective January 1, 2006. We did not have any financial impact upon adoption of this standard.

In September 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20, Accounting Changes, and Statement No. 3, Reporting Accounting Changes in Interim Financial Statements." SFAS No. 154 changes the requirements for the accounting for and reporting of a change in accounting principle. Previously, most voluntary changes in accounting principles required recognition via a cumulative effect adjustment within net income of the period of the change. SFAS No. 154 requires retrospective application to prior periods' financial statements, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. Other than the adoption of SFAS No. 123(R), we did not have any accounting changes or error corrections; therefore, the adoption of SFAS No. 154 on January 1, 2006 did not have an impact on our consolidated financial position, results of operations or cash flows.

In July 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109," ("FIN 48") which clarifies the accounting for uncertainty in tax positions. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Additionally, FIN 48 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods and disclosure requirements for uncertain tax positions. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. We are currently assessing the impact of adopting FIN 48 on our consolidated financial position, results of operations and cash flows.

In September 2006, the SEC staff issued Staff Accounting Bulletin ("SAB") 108 "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements." SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a potential current year misstatement. Prior to SAB 108, Companies might evaluate the materiality of financial-statement misstatements using either the income statement or balance approach, with the income statement approach focusing on new misstatements added in the current year, and the balance sheet approach focusing on the cumulative amount of misstatement present in a company's balance sheet. Misstatements that would be material under one approach could be viewed as immaterial under another approach, and not be corrected. SAB 108 now requires that companies view financial statement misstatements as material if they are material according to either the income statement or balance sheet approach. The guidance in SAB 108 must be applied to annual financial statements for fiscal years ending after November 15, 2006. We are currently assessing the impact of adopting SAB 108 but do not expect that it will have a material effect on our consolidated financial position, results of operations or cash flows.



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In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosure about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. We are currently assessing the impact of adopting SFAS No. 157 but do not expect that it will have a material effect on our consolidated financial position, results of operations or cash flows.

**Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We are exposed to market risk, including adverse changes in interest rates and foreign currency exchange rates.

**Interest Rate Risk**

We may enter into various financial instruments, such as interest rate swaps, to manage the impact of changes in interest rates. As of September 30, 2006, we did not have any open interest rate swap or interest rate lock agreements. Therefore, our exposure to changes in interest rates primarily results from our short-term and long-term debt with both fixed and floating interest rates.

**Foreign Currency Exchange Rate Risk**

Our Canadian subsidiaries conduct business in the Canadian dollar and are therefore subject to foreign currency exchange rate risk on cash flows related to sales, expenses, financing and investing transactions in currencies other than the U.S. dollar. Currently, we do not have any open forward exchange contracts.

We have not had any significant changes in our market risk exposures during the quarter ended September 30, 2006.

**Item 4. CONTROLS AND PROCEDURES**

**(a) Evaluation of Disclosure Controls and Procedures**

As of the end of the period covered by this report, our management carried out an evaluation, under the supervision and with the participation of our President and Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act), pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, our President and Chief Executive Officer along with our Chief Financial Officer concluded that the Company's disclosure controls and procedures as of September 30, 2006 are effective in ensuring that information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the rules and forms of the SEC, and that such information is accumulated and communicated to our management, including our President and Chief Executive Officer and our Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures.

**(b) Changes in Internal Control Over Financial Reporting**

There have been no changes in our internal controls over financial reporting during the quarter ended September 30, 2006 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

**PART II - OTHER INFORMATION**

**Item 1. LEGAL PROCEEDINGS**

See Part I, Item 1, Note I to Consolidated Financial Statements, which is incorporated herein by reference.

**Item 1.A. RISK FACTORS**

There have been no material changes from the risk factors as previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2005.



(INDEX)**Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

The following table contains information about our purchases of equity securities for the periods indicated:

| Period                                 | Total Number of Shares Purchased <sup>(1)</sup> | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs |
|--|---|------------------------------|--|--|
| July 1, 2006 - July 31, 2006           | 44,169  | \$3.89                       | -  | -  |
| August 1, 2006 - August 31, 2006       | -   | -                            | -  | -  |
| September 1, 2006 - September 30, 2006 | -   | -                            | -  | -  |
| Total                                  | 44,169  | \$3.89                       | -  | -  |

(1) Represents shares that were withheld by or returned to us to satisfy tax withholding obligations that arose upon the issuance of common stock to employees or the vesting of restricted stock previously granted to employees. Such shares have been retired.

**Item 3., 4. and 5.** Not applicable.

**Item 6. EXHIBITS**

- 3.1 Amended and Restated Certificate of Incorporation of the Company (incorporated by reference from Exhibit 3.1 to Post Effective Amendment No. 1 to the Registration Statement on Form S-1, No. 333-113446, as filed with the SEC on July 2, 2004).
- 3.2 Certificate of Amendment to Certificate of Incorporation dated December 15, 2004 (incorporated by reference from Exhibit 3.2 to the Registration Statement on Form S-4, No. 333-121476, as filed with the SEC on December 21, 2004).
- 3.3 Amended and Restated Bylaws of Seitel, Inc., adopted October 19, 2005 (incorporated by reference from Exhibit 3.1 to the quarterly report on Form 10-Q for the quarter ended September 30, 2005, as filed with the SEC on November 9, 2005).
- 31.1\* Certification of Robert D. Monson pursuant to Rule 13a-14(a)/15d-14(a).
- 31.2\* Certification of William J. Restrepo pursuant to Rule 13a-14(a)/15d-14(a).
- 32.1\*\* Certification of Robert D. Monson pursuant to Section 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes–Oxley Act of 2002.
- 32.2\*\* Certification of William J. Restrepo pursuant to Section 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes–Oxley Act of 2002.

\* Filed herewith.

\*\* Furnished, not filed, pursuant to 601(b)(32) of Regulation S-K.





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**SIGNATURES**

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**SEITEL, INC.**

Dated: November 1, 2006

/s/

Robert D. Monson  
Robert D. Monson  
Chief Executive Officer and President

Dated: November 1, 2006

/s/

William J. Restrepo  
William J. Restrepo  
Chief Financial Officer



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EXHIBIT

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| Exhibit | Title   | Page Number |
|---------|---|-------------|
| 31.1*   | Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 302 Of The Sarbanes-Oxley Act of 2002 | 41          |
| 31.2*   | Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 302 Of The Sarbanes-Oxley Act of 2002 | 43          |
| 32.1**  | Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 Of The Sarbanes-Oxley Act of 2002 | 45          |
| 32.2**  | Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 Of The Sarbanes-Oxley Act of 2002 | 47          |

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\* Filed herewith.

\*\* Furnished, not filed, pursuant to Item 601(b)(32) of Regulation S-K.

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