VERITAS DGC INC
Form 10-K
October 12, 2005

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

(Mark One)

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

For the fiscal year ended July 31, 2005

OR

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

For the transition period from to

Commission file number 1-7427

Veritas DGC Inc.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**76-0343152** (I.R.S. Employer Identification No.)
10300 Town Park **Houston, Texas** (Address of principal executive offices)	**77072** (Zip Code)

(832) 351-8300

(Registrant s telephone number, including area code)

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $.01 par value	New York Stock Exchange
Preferred Stock Purchase Rights	New York Stock Exchange

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 ý No o

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes ý No o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). o Yes ý No

The aggregate market value of the registrant s voting stock held by non-affiliates of the registrant was $845,216,178 as of January 31, 2005.

The number of shares of the Company s common stock, $.01 par value, outstanding at September 30, 2005 was 34,728,014 (including 142,228 Veritas Energy Services Inc. exchangeable shares which are identical to the Common Stock in all material respects).

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s definitive proxy statement to be filed in connection with the registrant s 2005 Annual Meeting of Stockholders are incorporated by reference into Part III of this annual report.

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FORM 10-K

This annual report on Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements include, among other things, business strategy and expectations concerning industry conditions, market position, future operations, margins, profitability, liquidity and capital resources. Forward-looking statements generally can be identified by the use of terminology such as may, will, expect, intend, estimate, anticipate o believe or similar expressions or the negatives thereof. These expectations are based on management s assumptions and current beliefs based on currently available information. Although we believe that the expectations reflected in such statements are reasonable, we can give no assurance that such expectations will be correct. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this annual report on Form 10-K. Our operations are subject to a number of uncertainties, risks and other influences, many of which are outside our control, and any one of which, or a combination of which, could cause our actual results of operations to differ materially from the forward-looking statements. Important factors that could cause actual results to differ materially from our expectations are disclosed in Item 1. Business and Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Risk Factors and elsewhere in this annual report on Form 10-K.

PART I

ITEM 1. Business

General

Veritas is a leading provider of integrated geophysical information and services to the petroleum industry worldwide. Our customers include major, national and independent oil and gas companies that utilize geophysical technologies to:

- identify new subsurface areas favorable for the production of hydrocarbons;
- determine the size, structure and stratigraphy of previously identified oil and gas fields; and
- optimize development and production of hydrocarbon reserves.

We acquire, process, interpret and market geophysical information that provides 2D and 3D images of the subsurface. We also produce 4D surveys, which record fluid movement in the reservoir, by repeating specific 3D surveys over time. Additionally, we use geophysical data for reservoir characterization to enable our customers to maximize their recovery of oil and natural gas.

Services and Markets

We conduct geophysical surveys on both a contract and a multi-client basis. When we conduct surveys on a contract basis, we acquire and process data for a single client who pays us to conduct the survey and owns the data we acquire. When we conduct surveys on a multi-client basis, we acquire and process data for our own account and license that data and associated products to multiple clients. The high cost of acquiring and processing geophysical data on an exclusive basis has prompted many oil and gas companies to license surveys on a multi-client basis. In response to this demand, we have built a large library of surveys consisting of over 200,000 line kilometers of 2D data and over 200,000 square kilometers of 3D data. Our marine data library includes surveys in the Gulf of Mexico, the North Atlantic, Southeast Asia, West Africa, North Africa, Canada and Brazil. Our land data library includes surveys in Texas, Mississippi, Oklahoma, Wyoming and Utah in the United States as well as Alberta and British Columbia in Canada. The portion of our revenue generated from the sale of multi-client data licenses is influenced by a number of factors, including government licensing of exploration and production rights, and as a result, will fluctuate from year to year.

The following tables describe our revenues by contract type and geographic area based on the location of the product or service provided:

Revenues by Contract Type	2005	2004	2003
	Years Ended July 31, (In thousands)		
Contract work	$ 389,046	$ 289,404	$ 283,873
Licensing of multi-client data	244,980	275,065	217,948
Total	$ 634,026	$ 564,469	$ 501,821

Revenues by Geographic Area	2005	2004	2003
	Years Ended July 31, (In thousands)		
United States	$ 287,993	$ 245,144	$ 190,898
Canada	92,639	88,283	71,911
Latin America	17,178	57,210	113,754
Europe	71,852	79,182	33,713
Middle East/Africa	62,515	32,513	54,201
Asia Pacific	101,849	62,137	37,344
Total	$ 634,026	$ 564,469	$ 501,821

In fiscal 2005, 2004 and 2003, 55%, 57% and 62%, respectively, of our revenues were attributable to non-U.S. operations and export sales. (See Note 12 of Notes to Consolidated Financial Statements for additional geographic and segment information.)

Principal Operating Assets

We acquire, process, and interpret geophysical information utilizing a wide array of assets as follows:

Land Acquisition

Our land acquisition activities are performed with technologically advanced geophysical equipment. As of July 31, 2005, our land survey equipment had a combined recording capacity of approximately 49,000 channels. We typically deploy equipment in North and South America and Oman by crews of varying size. Our crew count varies widely as land acquisition is a seasonal activity in many markets, primarily due to weather.

Our land operations include surveying crews, which lay out the lines to be recorded and mark the sites for shot-hole placement or equipment location, and recording crews, which use explosive or mechanical vibrating units to produce acoustic impulses and recording units to synchronize the shooting and capture the seismic signals via geophones. On a land survey where explosives are used, the recording crew is supported by several drill crews, which are typically furnished by third parties under short-term contracts. Drill crews operate in advance of the recording crew and bore shallow holes for explosive charges which, when detonated by the recording crew, produce the necessary acoustic impulse.

Marine Acquisition

Our marine acquisition crews operate from both owned and chartered vessels that have been modified or equipped to our specifications. All of the vessels we utilize are equipped to perform both 2D and 3D geophysical surveys. During the last several years, the majority of the marine geophysical data acquisition services we performed involved 3D surveys. The following table contains certain information concerning the geophysical vessels we operate.

Vessel	Year Entered Service	Length	Beam	Charter Expiration
Pacific Sword	1999	189 feet	40 feet	October 2006
Seisquest	2001	300 feet	60 feet	May 2006
Veritas Viking	1998	305 feet	72 feet	May 2011
Veritas Viking II	1999	305 feet	72 feet	May 2007
Veritas Vantage	2002	305 feet	72 feet	April 2010
Veritas Searcher	1982	217 feet	44 feet	Owned

We are replacing the Veritas Searcher with a new chartered vessel of greater capability, with expected delivery in mid-2006.

Each vessel is equipped with geophysical recording instrumentation, digital geophysical streamer cable, cable location and geophysical data location systems, multiple navigation systems, a source control system that controls the synchronization of the energy source and a firing system that generates the acoustic impulses. Streamer cables contain hydrophones that receive the acoustic impulses reflected by variations in the subsurface strata.

At present, five of our vessels are equipped with multiple streamers and multiple energy sources. These vessels acquire more lines of data with each pass, which reduces completion time and the acquisition cost. The Veritas Viking, Veritas Viking II and the Veritas Vantage are each capable of deploying 12 streamers simultaneously, although each is currently equipped to tow eight. The Veritas Viking, Veritas Viking II, Veritas Vantage and Veritas Searcher are equipped with solid streamers that offer numerous advantages over oil-filled streamers. The solid streamers allow these vessels to work in rougher seas and record more desirable frequencies with less noise and less downtime than is possible with oil-filled streamers.

Data Processing and Interpretation

We operate 15 data processing centers capable of processing 2D and 3D data. Most of our data processing services are performed on 3D seismic data. The centers process data received from the field, both from our own crews and from other geophysical companies, to produce an image of the earth s subsurface using proprietary computer software and techniques. We also reprocess older geophysical data using new techniques designed to enhance the quality of the data. Our data processing centers have opened at various times since 1966 and are at present located in:

North America	South America	Europe/Africa/ Middle East	Asia Pacific
Houston, Texas	Buenos Aires, Argentina	Crawley, England	Singapore
Calgary, Canada	Caracas, Venezuela	Stavanger, Norway	Perth, Australia
		Aberdeen, Scotland	Jakarta, Indonesia
		Lagos, Nigeria	Kuala Lumpur, Malaysia
		Luanda, Angola	
		Pau, France	
		Milan, Italy	

Our processing centers operate high capacity, advanced technology data processing systems on high-speed cluster CPUs. These systems run our proprietary data processing software. The marine and land data acquisition crews have software compatible with that utilized in the processing centers, allowing for ease in the movement of data from the field to the data processing centers. Our centers can generally process both land and marine data and we tailor the equipment and software deployed in an area to meet the local market demands.

We operate visualization centers in Houston, Calgary, Perth, and Crawley. These four centers allow teams of our customers geoscientists and engineers to view and interpret large volumes of complex 3D data. The visualization centers have imaging tools used for advanced interpretive techniques that enhance the understanding of regional as well as detailed reservoir geology. These visualization centers allow us to offer our expertise combined with the type of collaborative geophysical model building that is enabling oil companies to explore areas of complex geology such as the large sub-salt plays in the deepwater Gulf of Mexico.

We have groups of scientists and engineers located in Calgary, Houston, and Leoben, Austria who perform advanced geophysical and geological interpretation on a contract basis. These experts work around the world, using third party and our proprietary software to create subsurface models for our clients and advise our clients on how best to exploit their reservoirs. Their work is related to exploration as well as production activities. Additionally, we license our proprietary Hampson-Russell software to companies desiring to do their own geophysical interpretation.

Technology and Capital Expenditures

The geophysical industry is highly technical, and the requirements for the acquisition and processing of geophysical data have evolved continuously during the past 50 years. Accordingly, it is critical that our technological capabilities are comparable or superior to those of our competitors. We maintain our technological capabilities through continuing research and development, strategic alliances with equipment manufacturers, and by acquiring technology from others.

Our research and development staff includes scientists, engineers or programmers. Our research and development efforts focus on new acquisition technologies and processes and on our core processing and imaging software. In 2004, we formed a group to develop and apply technologies to record, process and interpret multi-component waveforms, an area of growing interest among our customers. During fiscal 2005, 2004 and 2003, research and development expenditures were $18.9 million, $15.5 million and $11.6 million, respectively. Our research and development budget for fiscal 2006 is approximately $19 million.

During fiscal 2005, 2004 and 2003, capital expenditures for equipment were $62.4 million, $30.5 million and $30.5 million, respectively. Capital expenditures for fiscal 2005 included approximately $14.8 million for replacement equipment for equipment lost or damaged on the Veritas Viking in January 2005. A majority of the cost of this equipment will be reimbursed to us by our insurance carrier. Because the insurance reimbursement is greater than the book value of the equipment, we have recorded a gain on the involuntary conversion. We expect to invest approximately $61 million in capital equipment during fiscal 2006. Most of our fiscal 2006 capital budget is allocated to replacement and upgrading of existing equipment.

During fiscal 2005, 2004 and 2003, our cash multi-client investment, net of capitalized depreciation, was $148.4 million, $126.3 million and $151.8 million, respectively. For fiscal 2006, we are planning a cash multi-client investment of approximately $162 million. Our total planned cash investment in the company of $223 million is significantly less than our planned cash flow from operations and, therefore, we expect to generate an increase in our cash balance during fiscal 2006.

Competition

The acquisition and processing of geophysical data for the oil and gas industry has historically been highly competitive worldwide. Success in marketing geophysical services is based on several factors, including price, crew experience, equipment availability, technological expertise, reputation for quality and dependability and, in the case of multi-client surveys, availability of surveys in the area of current customer interest.

Our largest global competitors are Western-Geco (a joint venture between Schlumberger and Baker Hughes), Compagnie Générale de Géophysique S.A. and Petroleum Geo-Services ASA. Additionally, there are a large number of seismic companies, mostly small and local, in the land acquisition and land data processing areas where financial and technical barriers to entry are minimal. In the multi-client library business, we compete with the full-service seismic companies mentioned above, as well as with specialty library companies such as TGS Nopec Geophysical Company ASA and Seitel Inc.

We compete to a lesser degree with large, state-affiliated companies such as BGP of China. These companies are large providers of seismic services in their home countries and have recently been expanding their operations to include other parts of the world. They are particularly aggressive in price sensitive markets, such as those involving large tenders to national oil companies, where low price is of paramount importance.

Due to the constantly changing configurations of seismic crews and the immense numbers of channels in the market, it is impossible to discuss the global competition in land acquisition in any quantitative fashion. Tracking our competition is more feasible in the marine acquisition market. According to a September 15, 2005 report by Enskilda Securities, a third party industry analyst, there are a total of 60 towed-streamer vessels working in the world, including 44 3D vessels and 16 2D vessels. In fiscal 2005, there were temporary and local shortages of vessels of specific capability, which allowed us to increase seismic acquisition margins in certain regions.

Backlog

At July 31, 2005, our backlog of commitments for future revenue was $301.8 million, compared with $146.6 million at July 31, 2004. Approximately 29% of this backlog is related to multi-client surveys. We anticipate that most of the July 31, 2005 backlog will be completed over the next twelve months. This backlog consists of written orders or firm commitments. Contracts for services are subject to modification by mutual consent and in certain instances are cancelable by the customer on short notice without penalty. As a result of these factors, our backlog as of any particular date may not be indicative of our actual operating results for any succeeding period.

Significant Customers

Our customers include major oil and gas companies, national oil companies and independent oil and gas companies. In fiscal 2005, a single, large multi-national oil company represented 12% of our revenues primarily due to the increased revenue generated by a large 3D survey acquired in the Gulf of Mexico. In fiscal 2004 and 2003, no customer accounted for 10% or more of our total revenue.

Employees

During fiscal 2005, we employed an average of 2,794 people on a full-time basis. Our number of employees varies greatly due to activity changes in our land acquisition business, and during fiscal 2005 ranged from a low of 2,381 to a high of 3,471. This variation typically occurs on a seasonal basis, with higher employee counts and higher revenues occurring during our second and third fiscal quarters, coinciding with the winter seismic acquisition seasons in Alaska and Canada. However, performance of large land surveys in South America or other locales can cause a marked shift from this pattern. A total of 31 employees in Singapore are subject to collective bargaining agreements. We consider our relations with our employees to be good.

Our SEC Reporting

We electronically file certain documents with the SEC. We file annual reports on Form 10-K; quarterly reports on Form 10-Q; current reports on Form 8-K (as appropriate) and proxy statements; along with any related amendments and supplements thereto. From time-to-time, we may also file registration statements pertaining to equity or debt offerings. You may read and copy any materials we file with the SEC at the SEC s Public Reference Room at 100 F Street, N.E., Room 1580, Washington, DC 20549. You may obtain information regarding the Public Reference Room by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains an internet website at www.sec.gov that contains reports, proxy and information statements, and other information regarding issuers that file with the SEC.

We provide electronic access to our periodic and current reports on our internet website, www.veritasdgc.com. These reports are available on our website as soon as reasonably practicable after we electronically file such materials with the SEC. You may also contact our investor relations department at 832-351-8821 for paper copies of these reports free of charge.

ITEM 2. Properties

Our headquarters is located in Houston, Texas in a 218,151 square foot office and warehouse complex, which is leased. The complex houses data processing operations, as well as executive, accounting, research and development and operating personnel. This lease expires in the beginning of fiscal 2016. We lease additional space, aggregating approximately 631,966 square feet, which is used by our operations around the world, including the locations identified under Item 1. Business Principal Operating Assets Data Processing and Interpretation. These leases expire at various times through fiscal 2015. We also own and charter seismic acquisition vessels as listed under Item 1. Business Principal Operating Assets Marine Acquisition.

ITEM 3. Legal Proceedings

On occasion, we are named as a defendant in litigation relating to our normal business operations. Although we are insured against various business risks to the extent we believe prudent, there is no assurance that the nature and amount of such insurance will be adequate in every case. As of August 31, 2005, we are not a party to any legal proceeding that we believe to be material.

ITEM 4. Submission of Matters to a Vote of Security Holders

On June 22, 2005, at the annual Meeting of Stockholders, the stockholders voted, as follows, to elect eight directors of Veritas DGC Inc. and ratify PricewaterhouseCoopers LLP as the company s independent accountants.

The results of the election of the directors by the holders of the Shares were as follows:

Name	Votes For	Votes Withheld
Loren K. Carroll	29,775,236	721,589
Clayton P. Comier	29,448,433	1,048,392
James R. Gibbs	29,565,510	931,315
Stephen J. Ludlow	29,364,421	1,132,404
Thierry Pilenko	29,321,307	1,175,518
Jan Rask	29,747,696	749,129
David F. Work	29,773,296	723,529
Terence K. Young	29,027,319	1,469,506

The results of the vote by the holders of Shares on the proposal to ratify the selection of PricewaterhouseCoopers LLP as the company s independent accountants were as follows:

Votes for: 29,583,838 Votes against: 907,079 Abstentions: 5,908

PART II

ITEM 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Price of and Dividends on the Registrants Common Equity and Related Stockholder Matters

Our common stock is listed on the New York Stock Exchange under the symbol VTS. Our common stock is also listed on the Toronto Stock Exchange under the symbol VTS. Our exchangeable shares are listed on the Toronto Stock Exchange under the symbols VER and VER.a. The following table sets forth the high and low sales prices for our common stock as reported by the New York Stock Exchange for the fiscal periods shown.

	Fiscal Period	High	Low
2005	4th Quarter	$ 31.00	$ 23.70
	3rd Quarter	32.18	24.91
	2nd Quarter	25.54	19.72
	1st Quarter	25.00	19.61
2004	4th Quarter	$ 25.01	$ 17.62
	3rd Quarter	23.55	12.05
	2nd Quarter	13.80	8.49
	1st Quarter	9.41	7.58

On August 31, 2005, there were approximately 288 record holders of common stock.

Two shares of our special voting stock are authorized and outstanding, each existing as a series of our common stock. The shares were issued in 1996 and 1999 in connection with business combinations. These special voting shares possess a number of votes equal to the number of Veritas Energy Services Inc., a wholly owned subsidiary, Exchangeable Shares and Veritas Energy Services Inc. Class A Exchangeable Shares, Series 1 outstanding at any time. These exchangeable shares were issued to provide beneficial Canadian tax treatment for the Canadian shareholders of the Canadian corporations participating in the combination transactions. The exchangeable shares may be exchanged on a one-for-one basis for our common stock and when coupled with the voting rights afforded by the special voting shares are virtually identical to our common stock. Any reference to our shares in this annual report refers to all shares, including the exchangeable shares, unless the reference expressly excludes the exchangeable shares.

We have not paid any dividends on our common stock during the two most recent fiscal years and have no current plans to pay any dividends. The payment of any future dividends on our common stock would depend upon our financial condition and upon a determination by our Board of Directors that the payment of dividends would be desirable. In addition, our current Credit Facility prohibits the payment of cash dividends.

On June 1, 2005, a former employee purchased 7,650 shares of our common stock for an aggregate exercise price of $78,284 pursuant to the exercise of outstanding options that had been granted under our stock option plans. The issuance of the shares was deemed exempt from the registration requirements of the Securities Act of 1933 by reason of the exemption provided by section 4(2) of such statute for private sales of securities. In connection with his purchase, the former employee represented that he was acquiring the shares for investment and not with a view to a distribution thereof. The certificates representing the shares purchased contain a legend to the effect that sale of the shares was not registered under the Securities Act of 1933 and the shares may not be transferred except pursuant to an effective registration under the Securities Act of 1933 or pursuant to an exemption from such registration requirements. The sale did not involve any underwriters.

Securities Authorized for Issuance Under Equity Compensation Plans

Information related to our equity compensation plans as of July 31, 2005 may be found under Securities Authorized for Issuance Under Equity Compensation Plans in Item 12.

Issuer Purchases of Equity Securities by the Issuer and Affiliated Purchasers

The following table summarizes issuer purchases of equity securities during the fourth quarter of fiscal 2005:

Period	Total Number of Shares Purchased(1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (2)	Maximum Number (or Approximate Value) of Shares that were Purchased Under Plans or Programs (2)
May 1-31, 2005		$		
June 1-30, 2005				
July 1-31, 2005	176	27.75		
Total	176	$ 27.75		

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(1) During the quarter ended July 31, 2005, we repurchased an aggregate of 176 shares other than as a part of a publicly announced plan or program. We repurchased these securities in connection with our stock compensation plans, which allow participants to use shares to satisfy tax liabilities arising from the vesting of restricted stock. The number above does not include unvested shares forfeited back to us for no consideration pursuant to the terms of our stock compensation plans.

(2) As of July 31, 2005, there were no publicly announced plans or programs to repurchase stock.

ITEM 6. Selected Consolidated Financial Data

	Years Ended July 31,									
	2005(1)		2004(2)		2003(3)		2002(4)		2001	
	(In thousands, except per share amounts)									
Statement of Operations Data:										
Revenues	$	634,026	$	564,469	$	501,821	$	452,183	$	476,640
Operating income		62,241		27,770		(12,112)		(833)		46,562
Net income (loss)		83,001		5,221		(59,097)		(24,051)		21,440
Net income (loss) per common share basic		2.45		.16		(1.77)		(.74)		.70
Net income (loss) per common share diluted		2.37		.15		(1.77)		(.74)		.68
Balance Sheet Data:										
Total assets	$	966,598	$	776,246	$	790,945	$	781,403	$	796,389
Long-term debt (including current maturities)		155,000		155,000		194,225		140,000		135,000

(1) Fiscal 2005 included a gain on involuntary conversion of assets of $9.9 million and a $6.8 million income tax benefit from the release of deferred tax valuation allowances of $36.9 million.

(2) Fiscal 2004 included charges of $22.1 million related to a change in multi-client accounting and $7.4 million related to debt refinancing. The change in multi-client accounting may affect the comparability between periods and is more fully described in Note 1 of Notes to Consolidated Financial Statements.

(3) Fiscal 2003 included charges of $39.3 million for goodwill impairment, $4.9 million for impairment of a multi-client survey, $7.6 million loss related to the sale of our $(RC)^2$ software operations and $21.0 million related to deferred tax asset valuation allowances.

(4) Fiscal 2002 included charges of $55.3 million for impairment of multi-client surveys, $14.6 million for costs of a terminated merger and $6.5 million valuation allowance for Argentine deferred tax assets.

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

Overview

Fiscal 2005 proved to be another year of improvement in the seismic industry, as it continues to move out of the weak 1999 - 2003 timeframe to what appears to be a robust future. We first noted a change in our marketplace during the first quarter of fiscal 2005, when we began to see exploration and production companies actively competing with each other for access to seismic acquisition assets in certain markets, driving prices upward. Indeed, the growth of demand in the global marine seismic acquisition market was an industry highlight of fiscal 2005, and the area where we generated most of our growth.

Over the last few years, the seismic industry has been able to provide increased fidelity of subsurface depiction in difficult areas to image, such as below the massive salt formations in the Gulf of Mexico, by using advanced acquisition techniques, processing technologies and more powerful computers. Recently, exploration and production companies have begun to show increased interest in these new techniques to further illuminate the subsurface. While seismic has traditionally been used primarily as an exploration tool, we are seeing increasing interest in new seismic imaging techniques, such as multi- or wide-azimuth marine acquisition, which offer better definition of complex structures, advancing the use of seismic for reservoir delineation. We have been, and continue to be, the leader in the area of improved imaging through our cutting edge processing technologies, including proprietary pre-stack depth migration (PSDM) and wave-equation migration methods. Additionally, many of the surveys in our data library have been acquired or enhanced using these advanced techniques. In the data acquisition area, we were an early adopter of multi-component acquisition on land and, in fiscal 2005, were the first company to acquire a large-scale wide-azimuth survey offshore.

The recent increased interest in these enhanced acquisition and processing techniques is further driven by the oil industry s inability to replace reserves at or above their rate of use. Since the beginning of calendar 1985, on average, global oil produced has significantly exceeded the annual volume of reserves discovered. Accordingly, estimates of global excess oil capacity have been dropping while demand has been increasing. The most obvious result of these trends is the increasing global oil price, which has repeatedly set new records in recent months.

To increase their reserve replacement rate, we believe most of our customers will respond to the challenge by increasing their exploration budgets over the next two to three years. While much of their total exploration budgets may go toward drilling, they will first need drillable prospects. The most successful tool for economically finding these prospects is 3-D seismic. The applicability of seismic has been expanded greatly over the past decade. Where standard 3-D seismic has not been sufficient, our advanced techniques have been used on certain geologic problems with spectacular results, as exemplified by the delineation and discovery of the large sub-salt reservoirs in the deepwater Gulf of Mexico.

While the increases in petroleum consumption may change from year to year, overall consumption seems to be on a continuous climb upward. Similarly, new, economic oil reserves seem to be increasingly difficult to find, especially in areas of low political risk. With this supply and demand situation, we are reasonably confident that exploration spending will continue to rise, but more importantly, we expect that more of that spending will be directed toward areas of geophysical difficulty, requiring the high-end seismic services that we provide.

In this improving business environment, our strategy to maximize performance has been to:

continue the long-term commitment to building multi-client data libraries in areas such as the Gulf of Mexico, the North Sea and onshore Canada and the United States;

invest in data processing and research resources to maintain leadership in subsurface imaging through continuous innovation;

- target innovative and higher margin marine acquisition contracts in selected regions; and

- focus our land acquisition resources on the North American and Oman markets and be selective with contracts in Latin America.

We expect to continue this balanced contract and multi-client strategy through fiscal 2006.

Due to our selling and operational efforts and the more robust seismic market, we have seen our backlog increase $155 million from $147 million at July 31, 2004 to $302 million at July 31, 2005. We expect to complete most of the work in backlog over the next twelve months. We believe that our traditional pattern of revenue generation will occur again during fiscal 2006, with revenues in our second and third fiscal quarters being higher than in our first and fourth quarters. This pattern is driven by end of calendar year spending, which results in higher library revenue in our second fiscal quarter and higher land acquisition activity during our second and third fiscal quarters, corresponding with the winter seismic season in Alaska and Canada.

During the first quarter of fiscal 2005, we reorganized our company into three geographic regions: North and South America (NASA), Europe, Africa, Middle East and the Commonwealth of Independent States (EAME), and Asia Pacific (APAC) and our financial statements and presentation of segment data for prior periods have been realigned to conform to this revised organization structure. The managers of these regions are responsible for all facets of sales and operations and are the primary point of contact with our customer within each region. Centrally managed processing, acquisition, and reservoir professionals support these managers from locations around the globe. We feel this new organization structure allows our front-line managers to focus exclusively on their customers while allowing our company to develop and deploy technology consistently across our markets. We have put processes in place that will allow for the free movement of our seismic equipment across the three regions so that we may maximize our return on investment.

Results of Operations

Fiscal 2005 Compared with Fiscal 2004

Revenues. Revenues increased by 12% from $564.5 million in fiscal 2004 to $634.0 million in fiscal 2005. This increase was driven by increased contract work, primarily marine, in all regions and increased sales of multi-client data licenses in EAME partially offset by decreased sales of multi-client data licenses primarily in the NASA region, which includes the Gulf of Mexico, the United States, Brazil and Canada. During fiscal 2005, NASA significantly decreased its land acquisition operations in South America. NASA s increase in contract marine work was primarily in the Gulf of Mexico where the Veritas Vantage and two additional third party vessels acquired a wide azimuth survey during fiscal 2005. APAC s revenue increase was also generated by marine contract work, as we operated the Veritas Viking II, the Pacific Sword and Veritas Searcher in Australia, India, Myanmar and New Zealand during the period. EAME generated most of its increased revenue through sales of multi-client data licenses for offshore Africa and the North Sea.

Revenues from our operating segments were as follows:

	Years Ended July 31,		Change	
	2005	2004(1)	$	%
	(In millions)			
NASA	$ 404.8	$ 385.9	$ 18.9	5%
EAME	131.0	118.5	12.5	11%
APAC	98.2	60.1	38.1	63%
Total Revenues	$ 634.0	$ 564.5	$ 69.5	12%

(1) 2004 segment information has been changed to reflect our current organization (See Note 12 of Notes to Consolidated Financial Statements)

Revenues consisted of the following:

	Years Ended July 31,		Change	
	2005	2004	$	%
	(In millions)			
Multi-client:				
Land	$ 54.7	$ 66.0	$ (11.3)	(17)%
Marine	190.3	209.1	(18.8)	(9)%
Subtotal	245.0	275.1	(30.1)	(11)%
Contract:				
Land	161.6	154.0	7.6	5%
Marine	227.4	135.4	92.0	68%
Subtotal	389.0	289.4	99.6	34%
Total Revenues	$ 634.0	$ 564.5	$ 69.5	12%

Operating income (loss). Operating income increased by $36.4 million from $27.8 million in fiscal 2004 to $64.2 million in fiscal 2005. During the first quarter of fiscal 2004, we changed our multi-client amortization accounting policy to include a minimum amortization from the date of survey completion, instead of only during the last 24 months of the survey s book life. As a result of this change, we recorded a charge of $22.1 million in cost of services in the first quarter of fiscal 2004. The remaining $14.3 million increase in operating income from fiscal 2004 is the result of increased margins (revenues less cost of services) of $24.1 million partially offset by increased research and development costs and general and administrative costs. Our margin increase was primarily due to our revenue increase and a decrease in cost of services as a percent of revenue of approximately 2%. Increased productivity, favorable mix of jobs and higher pricing contributed to the margin increase.

Research and development costs have increased by $3.4 million from fiscal 2004 primarily due to our focus on advanced acquisition and processing and general increases in research spending. General and administrative expense increased by $6.4 million due to the expenses associated with the restatement of our historical financial statements and those associated with our increased efforts in the areas of disclosure controls and procedures and internal control over our financial reporting. Research and development expense and general and administrative expense both grew due to increased incentive compensation related to our improved financial performance.

Interest expense. Interest expense decreased from $18.9 million in fiscal 2004 to $4.0 million in fiscal 2005. This decrease is due primarily to the issuance of our Convertible Senior Notes in the third quarter of fiscal 2004 and the repayment of our term notes with the proceeds. This refinancing resulted in a significantly lower interest rate. Our Convertible Senior Notes accrue interest at a rate of three month LIBOR less 0.75%, which equated to a weighted average interest rate of 1.72% for fiscal 2005 and is much lower than the various tranches of debt in place in fiscal 2004. In addition, approximately $7.4 million of debt issuance costs were expensed in fiscal 2004 in connection with the retirement of the term notes.

*Involuntary conversion of asset*s. In January 2005, our seismic vessel Veritas Viking experienced an engine failure while acquiring data in the Gulf of Mexico and lost substantial amounts of overboard seismic equipment. As this seismic equipment was insured at its replacement cost, we recognized a $9.9 million gain related to this insurance settlement.

Other (income) expense, net. In fiscal 2005, other income increased to $6.1 million from $0.0 million in fiscal 2004. This increase is primarily due to increased interest income of $3.7 million earned on our cash balances augmented by a small foreign currency exchange gain in fiscal 2005.

Income taxes. We reversed $36.9 million of valuation allowances on certain of our deferred tax assets during the fourth quarter of fiscal 2005, resulting in a net tax benefit of $6.8 million for fiscal 2005. The deferred tax assets were originally reserved at the end of fiscal 2003 primarily due to our historical losses in several tax jurisdictions. As of the fourth quarter of fiscal 2005, we had recognized profits in those jurisdictions and had a positive operational outlook. The combination of these two factors was sufficient to cause the reversal of the reserves. This decrease in provision was offset, in part, by the increased current tax provision resulting from substantially higher income in fiscal 2005. Excluding the release of valuation allowances, our effective tax rate would have been approximately 40%. (See Note 5 of Notes to Consolidated Financial Statements for further information on income taxes.)

Fiscal 2004 Compared with Fiscal 2003

Revenues. Revenues increased 12%, from $501.8 million in fiscal 2003 to $564.5 million in fiscal 2004. Increased multi-client revenues were responsible for most of the growth, with all three regions showing substantial increases. Contract revenues increased by 2%. In the NASA region, land contract acquisition work increased in North America but was offset by declines in South America. In response to the South American decline, we are reducing our presence in that region and redeploying our assets and key personnel into other markets. Marine contract acquisition revenues increased overall, but we experienced a significant regional shift as we moved the Veritas Viking II from NASA to APAC.

Revenues from our current operating segments were as follows:

	Years Ended July 31,			
			Change	
	2004(1)	2003(1)	$	%
	(In millions)			
NASA	$ 385.9	$ 376.7	$ 9.2	2%
EAME	118.5	91.3	27.2	30%
APAC	60.1	33.8	26.3	78%
Total Revenues	$ 564.5	$ 501.8	$ 62.7	12%

(1) Segment information has been changed to reflect our current organization (See Note 12 of Notes to Consolidated Financial Statements)

Revenues consisted of the following:

	Years Ended July 31,			
			Change	
	2004	2003	$	%
	(In millions)			
Multi-client:				
Land	$ 66.0	$ 56.6	$ 9.4	17%
Marine	209.1	161.3	47.8	30%
Subtotal	275.1	217.9	57.2	26%
Contract:				
Land	154.0	157.2	(3.2)	(2)%
Marine	135.4	126.7	8.7	7%
Subtotal	289.4	283.9	5.5	2%
Total Revenues	$ 564.5	$ 501.8	$ 62.7	12%

Operating income (loss). Operating income increased by $39.9 million, from a loss of $12.1 million in fiscal 2003 to operating income of $27.8 million in fiscal 2004. Fiscal 2003 included charges of $51.8 million related to asset impairments and reserves while fiscal 2004 included a $22.1 million charge related to a change in accounting for our multi-client library. The difference in the amount of these charges had the effect of increasing our operating income by $29.7 million. The remaining $10.2 million increase in operating income is the result of increased multi-client margins of $10.4 million, increased contract margins of $1.9 million and reduced general and administrative costs of $1.8 million, partially offset by $3.9 million of additional research and development spending.

In fiscal 2003, contract margin included a $2.9 million charge to establish a reserve against an account receivable from one of our customers. This receivable was settled in the first quarter of fiscal 2004 resulting in a gain of $0.6 million.

Research and development expense in fiscal 2004 increased by $3.9 million from fiscal 2003. A substantial amount of the increase was due to work on multi-component (pressure and shear wave) acquisition and processing. We spent the majority of our research budget on developing advanced processing techniques.

General and administrative expense in fiscal 2004 decreased by $1.8 million from fiscal 2003. The decrease was due primarily to lower severance cost in fiscal 2004, partially offset by expenses associated with requirements of the Sarbanes-Oxley Act and related rules.

The fiscal 2004 charge of $22.1 million, as described above, is included in cost of services on the Consolidated Statements of Operations and Comprehensive Income (Loss) and relates to a change in accounting for our multi-client library. This charge represents the adjustment necessary to reduce each of our surveys as of August 1, 2003, the first day of fiscal 2004, to a balance no greater than that which would have been recorded had we been using the new method. While the sales forecast method remains our primary means of expensing multi-client surveys, we have now established a minimum cumulative amortization for each survey based upon straight-line amortization over five years. The monthly expense recognized for each survey is the greater of the amount derived by the sales forecast method or the amount of minimum amortization. This is a change from the prior method that provided for a minimum amortization only during the last two years of the survey s book life.

The fiscal 2003 charge of $51.8 million includes an impairment of multi-client surveys of $4.9 million, impairment and severance expense related to the sale of $(RC)^2$, our reservoir characterization software business, of $7.6 million, and an impairment charge for goodwill of $39.3 million, with each charge described more fully below.

We periodically review the carrying value of the multi-client data library to assess whether there has been a permanent impairment of value and record losses when it is determined that estimated sales would not be sufficient to cover the carrying value of the asset. In fiscal 2003, we recognized a $4.9 million pretax impairment charge related to a survey in the Gulf of Mexico that we have been unable to license. This survey was acquired at right angles to an existing survey and customers have not been willing to pay for the moderately increased resolution.

We had not been satisfied with the results of the software operation acquired with the $(RC)^2$ business in February 2001. We were not making the software sales projected in our acquisition plan and were ineffective at bringing any new products to market. In the fourth quarter of fiscal 2003, we decided to sell this operation and entered into a letter of intent with Seismic Micro-Technology, Inc., a company more focused on software development. We took a charge in fiscal year 2003 of $7.6 million related to these operations, of which $5.9 million was applied to reduce the carrying value of the $(RC)^2$ software to its estimated market value of $2.0 million. The remaining $1.7 million primarily related to employee severance and facility costs. The sales agreement allows us to continue using the $(RC)^2$ suite of software in our reservoir consulting business. In addition, we have entered into an agreement that allows us to continue as sales agents of the software. The sale closed in September 2003.

Our reduced earnings in fiscal year 2003, coupled with the instability in our industry, led to a sharp decline in our stock price in fiscal year 2003, leaving our market value below our book value. As a result of our continued weak stock price and the sale of the $(RC)^2$ software business, we performed an evaluation of our existing goodwill balance at the end of fiscal 2003. This analysis indicated our goodwill was impaired and, as a result, we recognized an impairment charge of $39.3 million, an amount equal to our entire goodwill balance.

Income taxes. Our provision for income taxes decreased by $24.5 million from fiscal 2003 to fiscal 2004 due principally to two reasons. First, fiscal 2003 was negatively impacted by unbenefited net operating losses, non-deductibility of our goodwill impairment and increased valuation allowances on our deferred tax assets. Second, fiscal 2004 was positively affected by the reduction of certain tax contingencies and resolution of certain tax matters in early calendar year 2005, due to the extended open period of fiscal 2004 caused by our restatement. (See Note 5 of Notes to Consolidated Financial Statements for further information on income taxes.)

Liquidity and Capital Resources

Sources and Uses

Our internal sources of liquidity are cash, cash equivalents and cash flow from operations. External sources include public and private debt financing, equity sales, equipment financing and our revolving loan facility and trade credit. We believe that our current cash balance and cash flow from operations are adequate to meet our liquidity needs for the next twelve months.

Net cash provided by operating activities increased 36% from $243.0 million in fiscal 2004 to $331.3 million in fiscal 2005 primarily due to improved profitability and improvements in working capital. Net cash used by investing activities increased 36% from $152.4 million in fiscal 2004 to $206.7 million in fiscal 2005. Our cash investment for fiscal 2005 includes capital expenditures to replace and upgrade our existing equipment of approximately $62.4 million and investment in our data library of approximately $148.4 million. We expect to continue to fund these investments from our current cash and cash equivalents on hand and from internally generated funds.

For the past three fiscal years, cash provided by our operating activities has increased while combined expenditures for capital equipment and multi-client surveys have not increased at the same rate. We expect spending to increase modestly in fiscal 2006, but also expect that cash provided by operating activities will again exceed our investment in our operations. For fiscal 2006, we expect capital expenditures of approximately $61 million and cash multi-client library investment of approximately $162 million for a combined investment of approximately $223 million. These amounts are relatively flexible and will be adjusted to meet the needs of the business. In addition to these amounts, we plan to spend approximately $19 million for research and development during fiscal 2006.

While we believe that we have adequate sources of funds to meet our liquidity needs, our ability to meet our obligations depends on our future performance, which is subject to many factors beyond our control. Key internal factors affecting future results include utilization levels of acquisition and processing assets and the level of multi-client data library licensing, all of which are driven by the external factors of spending by exploration and production companies and, ultimately, underlying commodity prices.

Debt Structure

Our long-term debt consists of $155.0 million of Convertible Senior Notes due 2024. In addition, we have a Credit Facility consisting primarily of a revolving loan facility permitting borrowings of up to $55 million and various unsecured lines of credit totaling $8.5 million.

The Convertible Senior Notes are our senior unsecured obligations and are convertible under certain circumstances into a combination of cash and our common stock. In general, upon conversion of a note, the holder of such note will receive cash equal to the principal amount of the note and shares of our common stock for the note s conversion value in excess of such principal amount. We entered into a registration rights agreement in which we agreed to file a registration statement with the Securities and Exchange Commission within 90 days of March 3, 2004 to register resales of the notes and associated shares of common stock. We filed a registration statement on May 28, 2004 in compliance with the registration rights agreement; however, the registration statement was not effective until August 31, 2005. Because our registration statement was not effective on August 31, 2004 as required by the indenture, we incurred liquidated damages in the aggregate amount of $0.8 million in fiscal 2005.

The Convertible Senior Notes bear interest at a per annum rate which is equal to the three-month LIBOR rate, adjusted quarterly, minus a spread of 0.75%. The interest rate of the notes, from September 15, 2005 through December 14, 2005, is 3.12%, based on a LIBOR rate of 3.87%. For fiscal 2005 the weighted average interest rate was approximately 1.72% The notes will mature on March 15, 2024 and may not be redeemed by us prior to March 20, 2009. Holders of the notes may require us to repurchase some, or all, of the notes on March 15, 2009, 2014 and 2019. They could also require repurchase upon a change of control (as defined in the indenture under which the Convertible Senior Notes were issued.)

Under certain circumstances and at the option of the holder, the Convertible Senior Notes are convertible prior to the maturity date into cash and shares of our common stock. Certain of these circumstances may result in classification of the Convertible Senior Notes as current on our balance sheet. These circumstances include:

(1) if the closing sale price of our common stock is over 120% of the conversion price, which is currently $24.03 (with 120% being $28.84) for 20 trading days in the period of 30 consecutive trading days ending on the last trading day of the fiscal quarter preceding the quarter in which the conversion occurs;

(2) if we called the notes for redemption and the redemption has not occurred;

(3) the occurrence of a five consecutive trading day period in which the trading price of the notes was less than 95% of the closing sale price of our common stock on such day multiplied by the number of shares of our common stock issuable upon conversion of the notes; or

(4) the occurrence of specified corporate transactions.

Should any of these circumstances occur, the Convertible Senior Notes would be convertible at the then current stock price times the conversion ratio of 41.6146. This amount would be payable in cash equal to the principal amount of the notes, the par value adjusted for dividends or other equity transactions, with the additional amount payable in shares of our common stock. Currently, the maximum amount payable by us on conversion is $155 million in cash plus approximately 6.5 million shares. For clarity, conversion at a $40 stock price would result in our payment of $155 million in cash and 2.575 million shares of common stock. This settlement method is prescribed in the indenture and is not optional at the discretion of any party. The shares issuable from such conversion are considered in the calculation of diluted earnings per share.

Given the recent market price for shares of our common stock, it is reasonable to assume that our debt may become convertible as soon as the second quarter of fiscal 2006. Should our stock price remain above the current conversion price, we would not expect any notes to be converted; however, we would have to classify the notes as a current liability on our consolidated balance sheet.

On February 14, 2003, we entered into a Credit Facility with Deutsche Bank AG, New York Branch, as Administrative Agent, Deutsche Bank AG, Canada Branch, as Canadian Administrative Agent, and certain other lending institutions. In addition to term loans, which have been retired, the Credit Facility provided a revolving loan facility aggregating $55.0 million, including a facility for swing-line loans of up to $10.0 million and the issuance of letters of credit in an aggregate amount of up to $40.0 million. In August 2005, the limit for the issuance of letters of credit was increased to $48.0 million. Loans made under the revolving loan facility, including swing-line loans, bear interest at a variable rate determined on the date of borrowing that is related to various base rates and margins depending upon our leverage ratio and the location of the borrowing. The revolving loan facility expires in February 2006. The Credit Facility prohibits us from, among other things, paying cash dividends. As of July 31, 2005, there were no borrowings and $8.8 million in letters of credit outstanding under the Credit Facility, leaving $46.2 million available for borrowings.

In addition to the revolving loan facility, we have various unsecured lines of credit with lending institutions that operate in geographic areas not covered by the lending institutions in our Credit Facility, totaling $8.5 million that may be used exclusively for the issuance of letters of credit and bank guarantees. As of July 31, 2005, $1.4 million in letters of credit were outstanding under these lines.

Borrowings under the Credit Facility are secured by assets, including equipment, vehicles, multi-client data library, intellectual property, and stock of certain material subsidiaries, owned by us and certain of our subsidiaries. At July 31, 2005 the carrying value of the secured assets, including intercompany receivables, was $1.2 billion. The Credit Facility and related documents contain a number of covenants, including financial covenants relating to interest coverage, leverage and net worth. These covenants relate to measurements as of quarter ending dates; as of July 31, 2005, we were in compliance with these financial covenants.

During fiscal 2005, we obtained waivers from our lenders under the Credit Facility related to the late filing of our financial statements. The waivers allowed us to deliver our required reports for fiscal 2004 and for the first three quarters of fiscal 2005 later than required under the agreement. All required financial statements for such periods have now been provided to our lenders under the Credit Facility.

The following table presents our contractual obligations as of July 31, 2005 for the specified periods:

Contractual Obligations	**Total**	**Less than 1 year**	**Payments Due 1 3 years (In thousands)**	**3 5 years**	**More Than 5 years**
Long-term debt (1)	$ 155,000	$	$	$	$ 155,000
Estimated interest payments (2)	95,110	4,836	9,672	9,672	70,930
Operating leases	105,422	41,207	30,385	17,399	16,431
Purchase obligations	10,680	10,680			
Potential payments under letters of credit	10,179	9,877	302		
Other long-term liabilities (3)	36,602		73	79	36,450

(1) Under certain circumstances the Convertible Senior Notes are convertible prior to maturity. Certain of these circumstances may result in classification of the Convertible Senior Notes as current on our balance sheet.

(2) The interest rate on our debt is LIBOR less 0.75%. For purposes of this table, we used our current interest rate of 3.12% based on a LIBOR rate of 3.87%. Each 100 basis point increase in LIBOR will increase our annual interest expense by $1.55 million per year.

(3) Includes income tax, deferred revenue, pension and retirement obligations for which the timing of payment is uncertain.

Off -Balance Sheet Arrangements

As of July 31, 2005, we had no off-balance sheet instruments. During fiscal 2005, our limited hedging program consisted of economic hedge instruments intended to fix the U.S. dollar value of foreign currency payments to be made under a certain customer agreements.

Critical Accounting Policies

While all of our accounting policies are important in assuring that we adhere to current accounting standards, certain policies are particularly important due to their impact on our financial statements or the degree of subjectivity inherent in the assumptions required by the policies. These are described in detail below.

Revenue Recognition

Customer contracts for our services vary in terms and conditions. We review the deliverables in each contract and, where applicable, apply the accounting guidance contained in EITF 00-21, Accounting for Revenue Contracts with Multiple Deliverables (EITF 00-21).

For contract services, we recognize revenues on a proportional performance method based upon output measures as work is performed. This method requires that we recognize revenues based upon quantifiable measures of progress, such as kilometers shot or processed. In contracts where our customer pays separately for the mobilization of equipment, EITF 00-21 requires us to recognize such mobilization fees as revenue during the performance of the seismic acquisition, using the same proportional performance method as for the acquisition work.

Revenues from the licensing of multi-client surveys are based upon agreed rates set forth in the contract and are recognized upon physical delivery of, or customer access to, the surveys. During the acquisition and processing phase of a multi-client survey, in most cases we recognize revenues on in process multi-client surveys after obtaining a signed license agreement that gives the customers access to survey results as they occur, based upon a proportional performance method, using quantifiable measures of progress, such as kilometers shot or processed. After completion of a multi-client survey, we recognize revenues upon delivery of, or customer access to, the data to our customer or the customer s designee.

Provisions exist in certain contracts with our customers that provide for a full refund if certain deadlines are not met or provide for a revenue sharing arrangement with the customer such that the final sales price is not fixed or determinable. For contracts with these provisions, we do not recognize the revenue under the proportional performance method for that contract and, instead, defer revenue recognition until performance is complete or the sales price is fixed or determinable.

Multi-Client Data Library

We collect and process geophysical data for our own account and retain all ownership rights. We license the data to clients on a non-transferable basis. In some circumstances, we have sold on a non-exclusive basis rights to data prior to our collecting and processing such data, i.e., we have made the first of what we anticipate will be multiple discrete sales of licenses to the same data.

We capitalize costs associated with acquiring and processing the data as an investment in our multi-client data library. The capitalized costs of multi-client data are charged to cost of services in the period sales of licenses occur based upon the greater of the percentage of total costs to total estimated sales for the first five years multiplied by actual sales, a process called the sales forecast method, or five-year straight-line amortization from the date of survey completion. The sales forecast method is our primary method of calculating cost of services. We believe this method of amortizing the capitalized costs aligns the amount of amortization to the period in which the economic benefits of the capitalized costs are consumed.

Estimated sales are determined based upon discussions with our clients, our experience and our knowledge of industry trends. Changes in sales estimates may have the effect of changing the percentage relationship of cost of services to revenues. In applying the sales forecast method, an increase in the projected sales of a survey will result in lower cost of services as a percentage of revenue, and higher earnings when revenue associated with that particular survey is recognized, while a decrease in projected sales will have the opposite effect.

Assuming that the overall volume of sales, mix of surveys generating revenue in the period and minimum amortization amounts were held constant in fiscal 2005, an increase of 10% in the sales forecasts of all of our surveys would have decreased our cost of services by less than 2%, or approximately $8 million.

Our ability to accurately forecast sales of our library surveys for several years into the future is affected by unforeseeable changes in commodity prices, exploration success in the area of the survey and the overall investment decisions of our customers. Therefore, we update our sales forecast for surveys with a significant book value on a quarterly basis to ensure that the most current market information is considered.

The total amortization period of 60 months represents the minimum period over which benefits from these surveys are expected to be derived. We have determined the amortization period of 60 months based upon our historical experience that indicates that the majority of our revenues from multi-client surveys are derived during the acquisition and licensing phases and during the 5 years subsequent to survey completion. Any future decrease in the minimum amortization period would have the effect of increasing cost of services and reducing the carrying value of the multi-client data library.

We periodically review the carrying value of the multi-client data library to assess whether there has been a permanent impairment of value and record losses when it is determined that estimated sales would not be sufficient to cover the carrying value of the asset. Any future reductions in sales estimates may result in an impairment charge that increases cost of services and reduces the carrying value of the multi-client data library. For example, in fiscal 2003, we recognized a $4.9 million pretax impairment charge related to a survey in the Gulf of Mexico that we had been unable to license.

Deferred Tax Asset

Deferred taxes result from the effect of transactions that are recognized in different periods for financial and tax reporting purposes. A valuation allowance, by tax jurisdiction, is established when it is more likely than not that at least some portion of the related deferred tax asset will not be realized. This valuation allowance is then adjusted if realization of the related deferred tax asset subsequently becomes more likely than not.

During fiscal 2005, our valuation allowances decreased $55.3 million, $36.9 million of which was due to the reversal of deferred tax valuation allowances, $16.6 million of which was due to the net utilization of fully reserved deferred tax assets and $1.8 million of which was due to expiration of fully reserved deferred tax assets during the period. As of July 31, 2005, we had $17.8 million of valuation allowances related to deferred tax assets in jurisdictions where historical losses indicate realization is doubtful.

Since our quasi-reorganization on July 31, 1991 with respect to Digicon Inc., the tax benefits of net operating loss carryforwards existing at the date of the quasi-reorganization have been recognized through a direct addition to additional paid-in capital, when realization is more likely than not. Additionally, the utilization of the net operating loss carryforwards existing at the date of the quasi-reorganization is subject to certain limitations. During fiscal 2005, we did not recognize any amount related to these benefits.

Software Capitalization and Amortization

Software available for sale is included in other assets on our consolidated balance sheets. Software acquired through the purchase of software companies is capitalized at its estimated fair market value through the allocation of the purchase price. For internally developed software, we capitalize costs associated with the development of the product from the time the product reaches technological feasibility until it is ready for commercial release.

The amortization of capitalized software is the greater of the amount computed using (a) the ratio that current gross revenues for a product bear to the total of current and anticipated future gross revenues for that product or (b) the straight-line method over the remaining estimated economic life of the product including the period being reported on. The period of amortization begins when the software is released to the market. Estimated useful lives of our software products range from three to five years.

Estimated sales are determined based upon discussions with our clients, our experience and our knowledge of industry trends. Changes in sales estimates will have the effect of changing cost of services. An increase in projected sales will result in lower cost of services as a percentage of sales and higher earnings. A decrease in projected sales will result in higher cost of services as a percentage of sales and lower earnings. Any future increases or decreases in our estimates of useful lives will have the effect of decreasing or increasing future cost of services with an inverse effect on earnings.

Recent Accounting Pronouncements

We maintain stock-based compensation plans that are accounted for using the intrinsic value based method allowed by APB Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations. Under that method, compensation expense is recorded in the consolidated financial statements when the quoted market price of the underlying stock at the grant date or other measurement date exceeds the amount an employee must pay to acquire the stock. Our plans do not permit us to grant stock options at a price lower than market, therefore, we do not record any compensation expense related to stock options. In December 2004, the Financial Accounting Standards Board released SFAS No. 123R, a revision to SFAS No. 123, Accounting for Stock-Based Compensation. SFAS 123R, which will become effective for us beginning with our first quarter of fiscal 2006, will require 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. As required by SFAS No. 148, Accounting for Stock-Based Compensation, we disclose the pro forma effect of stock-based compensation expense on net income and earnings per share that would have been recorded had we used the fair value based method. As presented in Note 1 of the Notes to Consolidated Financial Statements, adoption of SFAS No. 123R will likely reduce our reported net income or increase our reported net loss in future periods.

Risk Factors

As a provider of geophysical technologies, our business is substantially dependent on the level of exploration expenditures by oil and gas companies.

Exploration expenditures by oil and gas companies are affected by several factors, including actual and forecasted petroleum commodity prices and such companies own short term and strategic plans. These expenditures may also be affected by worldwide economic conditions. Should there be a sustained period of substantially reduced exploration expenditures by oil and gas companies, the demand for geophysical services likely will drop and have an adverse effect on our results of operations and cash flow during the affected period. In recent years, many of our customers have been using a substantial portion of their discretionary cash to pay down debt, buy back their stock, drill low-risk prospects and maximize production from existing fields rather than exploring for new prospects. While we believe this trend has ended, due to recent commodity price increases and current supply and demand forecasts, there can be no guarantee that oil and gas companies will engage in substantial or prolonged exploration programs involving seismic spending. While petroleum commodity prices are currently high from a historical perspective, history has shown these prices to be very volatile.

Weak demand or technological obsolescence could impair the value of our multi-client data library.

We have invested significant amounts in acquiring and processing multi-client data and expect to continue to do so for the foreseeable future. There is no assurance that we will recover all the costs of such surveys. Technological, regulatory or other industry or general economic developments could render all or portions of our multi-client data library obsolete or reduce its value. For example, in fiscal 2003 and fiscal 2002 we incurred $4.9 million and $55.3 million, respectively, in impairment charges related to slow moving surveys in our multi-client library. These surveys were found to be impaired for various reasons, including slow acreage turnover in the case of U.S. land surveys, a border dispute in the case of a Shetland-Faroes survey and excessive acquisition cost in the case of a Gulf of Mexico survey. Additionally, our individual surveys have a book life of five years, so particular surveys may be subject to significant amortization even though sales of licenses associated with that survey are weak or non-existent, thus reducing our profits.

We are dependent on achieving and maintaining technological advances, which creates risks regarding technological obsolescence, requirements for substantial future capital expenditures, the unavailability of necessary technology and the failure of new technologies.

The development of geophysical data acquisition and processing equipment has been characterized by rapid technological advancements in recent years. We expect this trend to continue. We will be required to invest substantial capital in the future to maintain our technology. Furthermore, manufacturers of geophysical equipment may develop new systems that render our equipment, even if recently acquired, obsolete or less desirable, requiring significant additional capital expenditures. Because some of our competitors are themselves leading designers and manufacturers of seismic equipment, we may not have access to their technology. Even if critical new and advanced equipment is available to us, we may not have funds available or be able to obtain necessary financing on acceptable terms to acquire it. Further, any investment we may make in a perceived technological advance may not be effective, economically successful or otherwise accepted in the market.

We face intense competition in our industry, which could adversely affect our results.

Competition among geophysical service providers historically has been, and we expect will continue to be, intense. Competitive factors in recent years have included price, crew experience, equipment availability, technological expertise and reputation for quality, safety and dependability. Some of our competitors operate substantially more data acquisition crews and have significantly greater financial and other resources than we do. These larger and better-financed operators could enjoy an advantage over us in a competitive environment for contract awards and data sales and in the development of new technologies. Other competitors operate with extremely low overhead and compete vigorously on price in certain markets where that is the determining factor in awarding work. These low-cost competitors can have a competitive advantage over us in these markets.

High fixed costs could result in operating losses.

Our business has high fixed costs. As a result, downtime or low productivity due to reduced demand, weather interruptions, equipment failures or other causes can result in significant operating losses. Low utilization rates may hamper our ability to recover the cost of necessary capital investments.

Our revenues are subject to fluctuations that are beyond our control, which could adversely affect our results of operations in any financial period.

Our operating results vary in material respects from quarter to quarter and will most likely continue to do so in the future. Factors that cause variations include the timing of the receipt and commencement of contracts for data acquisition, customers budgetary cycles, the timing of offshore lease sales and the effect of such timing on the demand for geophysical activities, seasonal factors and the timing of sales of licenses to geophysical data in our multi-client data library, which may be significant to us and which are not typically made in a linear or consistent pattern. Combined with our high fixed costs, these revenue fluctuations could produce unexpected adverse results of operations in any fiscal period.

We may be unable to attract and retain key employees, which could adversely affect our business.

Our success depends upon attracting and retaining highly skilled professionals and technical personnel. A number of our employees are highly skilled scientists and highly trained technicians, and our failure to continue to attract and retain such individuals could adversely affect our ability to compete in the geophysical services industry. We may confront significant and potentially adverse competition for key personnel, particularly during periods of increased demand for geophysical services. In addition, our success will depend to a significant extent upon the abilities and efforts of members of our senior management, the loss of whom could adversely affect our business.

We face risks associated with our foreign revenue generating activities.

Substantial portions of our revenues are derived from foreign activities. During the fiscal year ended July 31, 2005, approximately 53% of our revenue, or $337 million, was attributable to activities outside the United States. During the fiscal year ended July 31, 2005, we recognized revenue from customers residing in the following foreign countries that represented more than 1% of our consolidated revenue on a gross basis for the fiscal year:

Country of Origin	Revenue (in millions)
Australia	38.7
Brazil	6.4
Canada	90.7
India	12.1
Malaysia	19.2
Nigeria	12.0
Norway	21.5
Oman	22.3
South Africa	6.9
United Kingdom	43.1

Foreign revenues are subject to certain risks, including those related to rates of currency exchange, border disputes, war, terrorism, civil disturbances, embargo, and government activities such as radical changes in tax regulations or investment laws. We are exposed to these risks in all of our foreign operations to some degree, and our exposure could be material to our financial condition and results of operations where the political and legal environment is less stable and we generate significant revenue or have large local investments, such as in Brazil, Nigeria, and Oman.

Revenue generating activities in certain foreign countries may require prior United States government approval in the form of an export license and otherwise be subject to tariffs and import/export restrictions. These laws change over time and may result in limitations on our ability to compete globally. In addition, non-U.S. persons employed by our separately incorporated foreign subsidiaries conduct business in foreign jurisdictions, some of which have been subject to U.S. trade embargoes and have been identified by the U.S. government as state sponsors of terrorism or are subject to sanctions by the U.S. Office of Foreign Assets Control. For example, during fiscal 2005 we generated $1.7 million of revenue from Libyan customers (Libya was identified by the U.S. government as a state sponsor of terrorism until September 2004), $1.1 million of revenue from Iranian customers and $10,000 of revenue from a Syrian customer. We have typically generated revenue in these countries through the performance of data processing, reservoir consulting services and the sale of software licenses and software maintenance. The governments of Iran and Syria have been identified by the U.S. government as state sponsors of terrorism and are subject to sanctions by the U.S. Office of Foreign Assets Control and either directly or indirectly control the activities of our customers within their borders. Our relations with customers in these countries are current and on going. We have procedures in place to conduct these operations in compliance with applicable U.S. laws. However, failure to comply with U.S. laws on foreign operations could result in material fines and penalties, damage to our reputation, and a reduction in the value of our shares of common stock. In addition, our activities in these countries could reduce demand for our stock among certain investors.

Finally, some of our operational activities result in accounts receivable or accounts payable that are denominated in foreign currencies and, therefore, subject to fluctuations in foreign currency exchange rates. There can be no assurance that we will not experience difficulties in connection with future foreign revenue generation and, in particular, adverse effects from foreign currency fluctuations.

We operate under hazardous conditions that subject us to risk of damage to property or personal injuries and may interrupt our business.

Our seismic data acquisition activities involve operating under extreme weather and other hazardous conditions. These operations are subject to risks of loss to property and injury to personnel from fires, accidental explosions, ice floes, and high seas. These types of events could result in an interruption of our business or significant liability. We may not obtain insurance against all risks or for certain equipment located from time to time in certain areas of the world.

The trading price of our securities could be subject to significant fluctuations.

The trading prices of our securities fluctuate. Factors such as fluctuations in our financial performance, and that of our competitors, as well as general market conditions could have a significant impact on the future trading prices of our securities. The trading prices also may be affected by weakness in oil prices, changes in interest rates and other factors beyond our control. Any one or combination of these factors may cause a decline in the trading price of our securities.

We may be unable to repurchase our Convertible Senior Notes as required upon a change in control or on the specified dates at the option of the holder or to pay the required cash upon conversion of the notes.

Upon a change in control, as defined in the indenture governing our Convertible Senior Notes, and on March 15, 2009, 2014 and 2019, the holders of the notes have the right to require us to repurchase the notes for cash. In addition, upon conversion of the notes, the holders will have the right to receive a cash payment. If we do not have sufficient funds to pay the repurchase price for all of the notes tendered upon a change in control, the cash due upon repurchases of the notes on March 15, 2009, 2014 or 2019 or the cash due upon conversion, an event of default under the indenture governing the notes would occur as a result of such failure. In addition, cash payments in respect of notes tendered for repurchase or conversion are subject to limits and might be prohibited, or create an event of default, under our Credit Facility as well as other agreements relating to borrowings that we may enter into from time to time. Our failure to make cash payments in respect of the Convertible Senior Notes could result in an event of default under our Credit Facility. There can be no guarantee that our available sources of cash will be sufficient to allow us to make the required cash payments.

Our business is subject to governmental regulation, which may adversely affect our future operations or the accounting thereof.

Our operations are subject to a variety of federal, provincial, state, foreign and local laws and regulations, including environmental laws. We invest financial and managerial resources to comply with these laws and related permit requirements. Failure to timely obtain the required permits may result in crew downtime and operating losses. Because laws and regulations change frequently, we cannot predict the impact of government regulations on our future operations. The adoption of laws and regulations that have the effect of curtailing exploration by oil and gas companies could also adversely affect our operations by reducing the demand for our geophysical services.

We follow the generally accepted accounting principles of the United States (GAAP) as promulgated and/or enforced by the Financial Accounting Standards Board, the Securities and Exchange Commission and other organizations. GAAP is subject to change, with such changes occurring at a rapid rate in recent years. Changes in GAAP can affect the reporting of our future results.

Certain provisions of our charter, Delaware law and our shareholder rights plan may make it difficult for a third party to acquire us, even in situations that may be viewed as desirable by our stockholders.

The General Corporation Law of the State of Delaware contains provisions that may delay or prevent an attempt by a third party to acquire control of our company. Our certificate of incorporation and bylaws contain provisions that authorize the issuance of preferred stock, and establish advance notice requirements for director nominations and actions to be taken at stockholder meetings. These provisions could also discourage or impede a tender offer, proxy contest or other similar transaction involving control of us, even if viewed favorably by stockholders. In addition, we have adopted a stockholder rights plan that would likely discourage a hostile attempt to acquire control of us.

The amounts we amortize from our data library each period may fluctuate significantly, and these fluctuations can have a significant effect on our reported results of operations.

How we account for our multi-client data library has a significant effect on our reported results of operations. We amortize the cost of our multi-client library based primarily upon our estimates of future sales of licenses to data, known as the sales forecast method. Although we also employ a minimum amortization for each survey in our data library based on straight-line amortization over five years, this amortization is secondary to that derived from the sales forecast method. The estimates used in the sales forecast method are inherently imprecise and may vary from period to period depending upon market developments and our expectations. We update our estimates on a quarterly basis and change our amortization rates accordingly. Substantial changes in amortization rates can have a significant effect on our reported results of operations.

ITEM 7A. Quantitative and Qualitative Disclosures Regarding Market Risk

As of July 31, 2005, we had $155.0 million Convertible Senior Notes bearing interest at LIBOR less 0.75% with a fair value of $221.9 million, based upon the bid price of 143.19 on July 29, 2005. These notes are not hedged and represent our total exposure to interest rate risk. Each 100 basis point increase in the LIBOR rate will increase our interest expense by $1.6 million per year.

ITEM 8. Consolidated Financial Statements and Supplementary Data

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Management s Responsibilities for Financial Statements

To the Stockholders of Veritas DGC Inc.:

The accompanying consolidated financial statements of Veritas DGC Inc. and its subsidiaries are the responsibility of management and have been prepared in conformity with accounting principles generally accepted in the United States of America. They necessarily include some amounts that are based on best judgments and estimates. The financial information displayed in other sections of this report is consistent with these financial statements.

The Board of Directors pursues its oversight role in the area of financial reporting and internal control over financial reporting through its Audit Committee. This committee, composed solely of independent directors, regularly meets (jointly and separately) with the independent registered public accounting firm, management and internal auditors to monitor the proper discharge by each of their responsibilities relative to internal control over financial reporting and the consolidated financial statements.

Thierry Pilenko	Mark E. Baldwin
Chairman of the Board and	*Executive Vice President,*
Chief Executive Officer	*Chief Financial Officer and*
	Treasurer

Management s Report on Internal Control over Financial Reporting

To the Stockholders of Veritas DGC Inc.:

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a 15(f) under the Securities and Exchange Act of 1934). An evaluation of the design and effectiveness of our internal control over financial reporting, based on the framework in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission, was conducted under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer. Based on the results of this evaluation, we concluded that our internal control over financial reporting was effective as of July 31, 2005.

Our assessment of the effectiveness of our internal control over financial reporting as of July 31, 2005 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their audit report, which is included herein.

Thierry Pilenko *Chairman of the Board and* *Chief Executive Officer*	Mark E. Baldwin *Executive Vice President,* *Chief Financial Officer and* *Treasurer*

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of Veritas DGC Inc.:

We have completed an integrated audit of Veritas DGC Inc. s 2005 consolidated financial statements and of its internal control over financial reporting as of July 31, 2005 and audits of its 2004 and 2003 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated financial statements and financial statement schedule

In our opinion, the financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Veritas DGC Inc. and its subsidiaries at July 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended July 31, 2005 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financia