VERITAS DGC INC
Form 10-K
October 04, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

(Mark One)

x	**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	For the fiscal year ended July 31, 2006
	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 if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes x No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes o No x

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 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 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.

Large accelerated filer x Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes o No x

The aggregate market value of the registrant s voting stock held by non-affiliates of the registrant was $1,589 million as of January 31, 2006.

The number of shares of the Company s common stock, $.01 par value, outstanding at August 31, 2006 was 36,058,583.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s definitive proxy statement to be filed in connection with the registrant s 2006 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 or 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

Merger Agreement

On September 4, 2006, we entered into a merger agreement with Compagnie Générale de Géophysique, a société anonyme organized under the laws of the Republic of France (CGG), whereby CGG agreed to acquire Veritas in a part cash, part stock transaction. The transaction is currently expected to close around the end of calendar year 2006. See further discussion on the proposed merger in Note 15, Subsequent Events, of Notes to Consolidated Financial Statements.

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 approximately 200,000 line kilometers of 2D data and 210,000 square kilometers of 3D data. Our marine data library includes surveys in the Gulf of Mexico, the North Sea, 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 revenue by contract type and geographic area based on the location of the product or service provided:

Revenue by Contract Type	Years Ended July 31, 2006 (In thousands)	2005	2004
Contract work	$ 470,132	$ 389,046	$ 289,404
Licensing of multi-client data	352,056	244,980	275,065
Total	$ 822,188	$ 634,026	$ 564,469

Revenue by Geographic Area	Years Ended July 31, 2006 (In thousands)	2005	2004
United States	$ 343,299	$ 287,993	$ 245,144
Canada	141,667	92,639	88,283
Latin America	67,401	17,178	57,210
Europe	93,589	71,852	79,182
Middle East/Africa	60,771	62,515	32,513
Asia Pacific	115,461	101,849	62,137
Total	$ 822,188	$ 634,026	$ 564,469

In fiscal 2006, 2005 and 2004, 58%, 55% and 57%, respectively, of our revenue was attributable to non-U.S. operations and export sales. (See Note 13 of Notes to Consolidated Financial Statements for additional geographic and segment information.)

Principal Operating Assets

We acquire, process, interpret and sell 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, 2006, our land survey equipment had a combined recording capacity of approximately 52,000 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 use recording units to synchronize the shooting and capture of 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 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 operated as of July 31, 2006.

Vessel	Year Entered Service	Length	Beam	Charter Expiration	
Pacific Sword	1999	189 feet	40 feet	October 2006	(1)
Seisquest	2001	300 feet	60 feet	May 2007	(1)
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 Voyager	2006	220 feet	52 feet	July 2011	(1)
Veritas Searcher	1982	217 feet	44 feet	Owned	(1)

(1) See the following discussions related to various changes in the status of the charters and the vessels subsequent to July 31, 2006.

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The Veritas Searcher was sold in August 2006. During July 2006, we chartered the Veritas Voyager to replace the Veritas Searcher. As of July 31, 2006, the Veritas Searcher was classified in the balance sheet as an asset held for sale.

Each vessel is equipped with geophysical recording instrumentation, digital geophysical streamer cable, cable location and geophysical data location systems, multiple navigation systems, and 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 Voyager are equipped with solid streamers that offer numerous advantages over fluid-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 fluid-filled streamers.

In March 2006, we entered into an agreement with a third party ship owner to charter a vessel currently known as the Veritas Vision, which is currently being converted for seismic operations. The term of the charter is for a period of eight years fixed, with options of up to 10 more years. When delivered in the first calendar quarter of 2007, the Veritas Vision will be the seventh seismic vessel in our fleet.

In September 2006, we entered into an agreement to charter a seismic vessel, currently known as the Viking Poseidon, which is currently expected to be in service commencing in the second calendar quarter of 2007. This vessel will serve as a replacement for the Seisquest vessel, which is under a charter that expires in May of 2007.

Subsequent to July 31, 2006, we renewed our charter agreement to extend the charter expiration related to the Pacific Sword from October 2006 to October 2009.

Data Processing and Interpretation

We operate several 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 first data processing center opened in 1966, and we now have centers in all of our geographic locations.

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 available to 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. During fiscal 2006, 2005 and 2004, research and development expenditures were $22.9 million, $18.9 million and $15.5 million, respectively.

During fiscal 2006, 2005, and 2004, capital expenditures for equipment were $67.9 million, $62.4 million and $30.5 million, respectively. We expect to increase substantially our investment in capital equipment during fiscal 2007 to approximately $200 to $240 million. Our 2007 capital budget includes amounts for replacement and upgrading of our existing equipment and amounts for equipping a new vessel that is expected to be in place during the first calendar quarter of 2007.

During fiscal 2006, 2005 and 2004, our cash multi-client investment, net of capitalized depreciation, was $165.6 million, $148.4 million and $126.3 million, respectively. For fiscal 2007, we are planning to substantially increase our cash investment in multi-client data to approximately $250 to $300 million.

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, safety record 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 division of Schlumberger), CGG 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. On September 5, 2006, we announced that we entered into a merger agreement with CGG whereby CGG will acquire Veritas in a part cash, part stock transaction. See further discussion on the proposed merger in Note 15, Subsequent Events, of Notes to Consolidated Financial Statements.

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 and 2006, 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, 2006, our backlog of commitments for future revenue was $456.4 million, compared with $301.8 million at July 31, 2005. We expect that approximately 90% of our July 31, 2006 backlog will be completed during 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 international oil and gas companies, national oil companies and independent oil and gas companies. In fiscal 2006, no customer accounted for 10% or more of our total revenue. A single, large multi-national oil company represented 12% of our revenue in fiscal 2005. In fiscal 2004, no customer accounted for 10% or more of our total revenue.

Employees

During fiscal 2006, we employed an average of approximately 2,800 people on a full-time basis. Our number of employees varies greatly due to activity changes in our land acquisition business and during fiscal 2006 ranged from a low of approximately 2,400 to a high of approximately 4,300. This variation typically occurs on a seasonal basis, with higher employee counts and higher revenue 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 1A. Risk Factors

Our recently announced merger agreement with CGG may cause uncertainties among our customers.

Some customers may be hesitant to contract for our services in light of uncertainties about our ability to perform due to our recently announced plan to merge with CGG or may prefer not to do business with us following the completion of the merger. If we are unable to reassure our customers to continue utilizing our services, our financial results may be adversely affected.

In the event our recently announced plan to merge with CGG is not consummated, our ability to carry on our business at current levels may be affected.

Closing of our current agreement to merge with CGG is contingent upon a number of items, including, among other things, approval of the merger by an affirmative vote of a majority of our shareholders and approval of the issuance of CGG shares in the merger by the affirmative vote of two-thirds of CGG s shareholders, as well as the receipt of necessary regulatory approvals from several agencies in several countries. There can be no assurance that all such approvals will be obtained, and, in the event any approval required under the merger agreement as a condition to closing is not obtained, the merger may not be consummated. If the merger is not consummated, we may have difficulty retaining and recruiting employees in vital areas and we may have difficulty retaining current customers or attracting new customers.

In the event our recently announced plan to merge with CGG is not consummated, the price of our stock may be affected.

Our closing stock price was $57.27 on July 31, 2006 and closed at $70.07 on September 5, 2006, after announcement of the merger. The increase in the stock price is primarily due to the premium to be paid related to the merger. In the event our previously announced merger with CGG is not consummated, the price of our common shares may be adversely affected because

the stockholders will not receive the premium contemplated by the merger agreement.

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 had 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 revenue is 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 and possible uncertainties caused by our recently announced plan to merge with CGG. 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 revenue are derived from foreign activities. During the fiscal years ended July 31, 2006 and 2005, approximately 57% and 53% of our revenue, respectively, was attributable to activities outside the United States. During the fiscal years ended July 31, 2006 and 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 that fiscal year:

Country of origin	July 31, 2006 (In millions)	2005
Australia	$ 71.8	$ 38.7
Brazil	42.2	6.4
Cameroon	10.3	0.5
Canada	140.0	90.7
India	10.1	12.1
Indonesia	11.4	1.8
Malaysia	6.4	19.2
Nigeria	0.6	12.0
Norway	29.3	21.5
Oman	14.8	22.3
Peru	17.0	4.3
South Africa	0.8	6.9
Trinidad and Tobago	14.9	
United Kingdom	47.7	43.1

Foreign revenue is 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 2006 we generated $5.4 million of revenue from Libyan customers (Libya was identified by the U.S. government as a state sponsor of terrorism until September 2004), $0.7 million of revenue from Iranian customers and $7 thousand 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 may be 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. In September 2006, we amended our shareholder rights plan to provide that no rights will be issued to our current shareholders in connection with our previously announced plan to merge with CGG.

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.

We have the ability to issue additional equity securities, which would lead to dilution of our issued and outstanding common stock.

The issuance of additional equity securities or securities convertible into equity securities would result in dilution of then existing stockholders equity interests in us. Our board of directors has the authority to issue, without vote or action of stockholders, up to 1,000,000 shares of preferred stock in one or more series, and has the ability to fix the rights, preferences, privileges and restrictions of any such series. Any such series of preferred stock could contain dividend rights, conversion rights, voting rights, terms of redemption, redemption prices, liquidation preferences or other rights superior to the rights of holders of our common stock. Our board of directors has no present intention of issuing any such preferred stock, but reserves the right to do so in the future. In addition, we are authorized to issue, without stockholder approval, up to 78,500,000 shares of common stock, of which approximately 35,871,367 shares were outstanding as of July 31, 2006.

ITEM 1B. Unresolved Staff Comments

Not applicable.

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 660,000 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 September 30, 2006, we were not a party to any legal proceeding that we believed to be material.

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

None.

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. The following table sets forth the high and low daily closing sales prices for our common stock as reported by the New York Stock Exchange for the fiscal periods shown.

	Fiscal Period	High	Low
2006	4th Quarter	$ 57.27	$ 43.81
	3rd Quarter	51.58	39.18
	2nd Quarter	45.09	29.48
	1st Quarter	37.59	29.84
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

On August 31, 2006, there were approximately 168 record holders of common stock.

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 limits the amount 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 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, 2006 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 2006:

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, 2006				
June 1-30, 2006	220	46.60		
July 1-31, 2006	176	51.58		
Total	396	$ 48.81		

(1) During the quarter ended July 31, 2006, we repurchased an aggregate of 396 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, 2006, there were no publicly announced plans or programs to repurchase stock.

ITEM 6. Selected Consolidated Financial Data

	Years Ended July 31, 2006(1)	2005(2)	2004(3)	2003(4)	2002(5)
	(In thousands, except per share amounts)				
Statement of Operations Data:					
Revenue	$ 822,188	$ 634,026	$ 564,469	$ 501,821	$ 452,183
Operating income	132,879	64,241	27,770	(12,112)	(833)
Net income (loss)	82,231	83,001	5,221	(59,097)	(24,051)
Net income (loss) per common share basic	2.33	2.45	.16	(1.77)	(.74)
Net income (loss) per common share diluted	2.08	2.37	.15	(1.77)	(.74)
Balance Sheet Data:					
Total assets	$ 1,158,030	$ 966,598	$ 776,246	$ 790,945	$ 781,403
Long-term debt (including current maturities)	155,000	155,000	155,000	194,225	140,000

(1) Fiscal 2006 included a gain on involuntary conversion of assets of $2.0 million.

(2) Fiscal 2005 included a gain on involuntary conversion of assets of $9.9 million and a release of deferred tax valuation allowances of $36.9 million.

(3) 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.

(4) 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.

(5) 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.

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

Overview

Fiscal 2006 proved to be another year of strengthening conditions 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 second half of calendar 2004, 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 continued through fiscal 2006 and is an area of strong growth for us.

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, imaging 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 imaging technologies. 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 remained at relatively high levels.

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 few 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 3D seismic. The applicability of seismic has been expanded greatly over the past decade. Where standard 3D 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; and
- target innovative and higher margin marine and land acquisition contracts in selected regions.

We expect to continue our balanced contract and multi-client strategy through fiscal 2007.

Due to our sales and operational efforts and the more robust seismic market, we have seen our backlog increase $154 million from $302 million at July 31, 2005 to $456 million at July 31, 2006. We expect that approximately 90% of our July 31, 2006 backlog will be completed during the next twelve months. We believe that our traditional pattern of revenue generation will occur again during fiscal 2007, with revenue 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.

We have organized the company into four reportable segments: North and South America (NASA); Europe, Africa, Middle East and Commonwealth of Independent States (EAME); Asia Pacific (APAC); and Veritas Hampson-Russell (VHR). In NASA, EAME and APAC, 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. NASA, EAME and APAC offer a common suite of these products and services to their customers, although each product or service may be adapted to meet the needs of the local markets. VHR licenses geophysical software and provides geophysical reservoir consulting services. The results of VHR s operations were previously included in those of the NASA region; however, beginning in fiscal 2006, senior management began to review the results of VHR separately. This segmentation of our company is representative of the manner in which it is viewed and managed by our senior managers and our Board of Directors.

Results of Operations

Fiscal 2006 Compared with Fiscal 2005

Revenue. Revenue for the year was up 30% from $634.0 million in fiscal 2005 to $822.2 million in fiscal 2006. The increases for the year came from all product lines and across all geographic segments.

Increased multi client revenue was driven by strong marine library sales in the Gulf of Mexico and in Brazil. Multi client land library sales were more than double from a year ago primarily due to sales in US and Canada.

Contract revenue in fiscal 2006 grew $81.1 million or 21% from the prior fiscal year. Increased revenue came from both land and marine work. Market conditions continue to improve and strengthen our business worldwide and we saw much of the growth in this fiscal year from land acquisition work in Canada and Alaska as well as increased imaging revenue across all geographic operating regions. Marine acquisition revenue remained strong in all geographic regions.

During fiscal 2006, NASA revenue increased by $152.8 million. This increase is primarily due to marine and land multi-client library sales in Canada, Gulf of Mexico and Brazil. NASA also increased its land acquisition work primarily in Canada and Alaska. EAME generated most of its increased revenue through its marine acquisition work. The increased revenue in the APAC segment came primarily from its marine acquisition work.

Revenue from our operating segments was as follows:

	Years Ended July 31,		**Change**	
	2006	**2005**	**$**	**%**
	(In millions)			
NASA	$ 541.4	$ 388.6	$ 152.8	39 %
EAME	148.7	131.0	17.7	14 %
APAC	112.5	98.2	14.3	15 %
VHR	19.6	16.2	3.4	21 %
Total Revenue	$ 822.2	$ 634.0	$ 188.2	30 %

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Revenue consisted of the following:

	Years Ended July 31,		**Change**		
	2006	**2005**	**$**	**%**	
	(In millions)				
Multi-client:					
Land	$ 109.8	$ 54.7	$ 55.1	101	%
Marine	242.3	190.3	52.0	27	%
Subtotal	352.1	245.0	107.1	44	%
Contract:					
Land	203.1	161.6	41.5	26	%
Marine	267.0	227.4	39.6	17	%
Subtotal	470.1	389.0	81.1	21	%
Total Revenue	$ 822.2	$ 634.0	$ 188.2	30	%

Operating income. Operating income of $132.9 million in fiscal 2006 was $68.6 million higher than in fiscal year 2005. This performance was driven by increases in both multi-client revenue and multi-client operating margins. The overall operating margin was also driven by increased revenue and margins in land acquisition work due to increased activity in Canada and Alaska. Operating income was also benefited by the $2.7 million reduction in depreciation expense related to the land acquisition assets that were considered held for sale for the last two months of the fiscal year. No depreciation expense was recorded during these two months for these assets. General and administrative expenses of $43.2 million for the fiscal year 2006 increased $11.3 million from the prior fiscal year primarily due to share-based compensation expense resulting from the adoption of new accounting rules, increased provision for performance-based incentive compensation, severance costs, and non-recurring costs related to the preparation of the potential sale of the land acquisition business.

Interest expense and interest income. Interest expense increased by $3.3 million from the prior fiscal year as a result of increases in LIBOR, which is the interest rate that the $155.0 million convertible debt is based upon. Interest income increased approximately $6.7 million compared to the prior fiscal year due to higher interest rates and a higher cash balance.

*Involuntary conversion of asset*s. The Company recognized a pre-tax insurance gain of $2 million in the first quarter of fiscal 2006 related to insurance settlements for the equipment loss on the Veritas Viking experienced in the second quarter of fiscal year 2005. In fiscal year 2005, the Company recognized a pre-tax gain of $9.9 million related to this insurance settlement.

Income taxes. The Company s effective tax rate for the fiscal year ended July 31, 2006 was 41.0%. This rate includes approximately $2.5 million of additional tax cost associated with a $55 million one-time repatriation from one of our foreign subsidiaries pursuant to the American Jobs Creation Act of 2004. In the fourth quarter of fiscal 2005, the Company reversed $36.9 million of valuation allowances on certain of its deferred tax assets resulting in a net tax benefit of $37.3 million for the quarter and $6.8 million for the full fiscal year.

Fiscal 2005 Compared with Fiscal 2004

Revenue. Revenue 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.

Revenue from our operating segments was as follows:

	Years Ended July 31, 2005 (In millions)	2004	Change $	%
NASA	$ 388.6	$ 370.9	$ 17.7	5 %
EAME	131.0	118.5	12.5	11 %
APAC	98.2	60.1	38.1	63 %
VHR	16.2	15.0	1.2	8 %
Total Revenue	$ 634.0	$ 564.5	$ 69.5	12 %

Revenue consisted of the following:

	Years Ended July 31, 2005 (In millions)	2004	Change $	%
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 Revenue	$ 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 (revenue 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 and interest income. 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. Interest income increased from $1.6 million to $5.3 million due to interest earned on the cash balances.

*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 the insurance settlement.

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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.)

Liquidity and Capital Resources

Sources and Uses

Our internal sources of liquidity are cash on hand and cash flow from operations. External sources include our existing credit facilities, public financing, equity sales, equipment financing, and trade credit. We believe that our current cash balance and cash flow from operations will be adequate to meet our liquidity needs over the next twelve months.

Net cash provided by operating activities was $–––––336.6 million for fiscal 2006, which is consistent with fiscal 2005 of $331.3 million. Net cash used by investing activities of $216.8 million in 2006 was slightly higher than $206.7 million in 2005 due to the increase in multi-client library investment and expenditures for property and equipment partially offset by the receipt of insurance proceeds. Our currently projected cash investments for fiscal 2007 include capital expenditures to replace and upgrade existing equipment of approximately $200 to $240 million and investment in our data library of approximately $250 to $300 million. We expect to fund these investments from our current cash on hand and from internally generated funds.

As of the beginning of the second quarter of fiscal 2006, our convertible senior notes were convertible. See further discussion on the convertibility of the notes below. The notes continued to be convertible as of July 31, 2006. As of July 31, 2006, we had an adequate amount of cash to fund the conversion of the notes which would require a payment of the entire principal amount had all of the notes been converted on that date.

While we believe that we have adequate sources of funds to meet our liquidity needs even if we were required to fund the conversion of the notes, our ability to meet our obligations depends on our future performance, which is subject to many factors beyond our control. Key factors affecting future results include utilization levels of acquisition and processing assets and demand for multi-client library surveys, all of which are driven by our customers exploration spending and, ultimately, the underlying commodity prices.

In March 2006, we entered into an agreement with a third party ship owner to charter a vessel currently known as the Veritas Vision, which is currently being converted for seismic operations. The term of the charter is for a period of eight years fixed, with options of up to 10 more years. When delivered in the first calendar quarter of 2007, the Veritas Vision will be the seventh seismic vessel in our fleet. In addition to the charter, we expect to invest approximately $62 million to equip the vessel for seismic operations. Of this expected total, approximately $5 million was spent during the fiscal year ended July 31, 2006 and the remainder is expected to be spent during the fiscal year ending July 31, 2007.

In September 2006, we entered into an agreement to charter a seismic vessel, currently known as the Viking Poseidon, which is currently expected to be in service commencing in the second calendar quarter of 2007. This vessel will serve as a replacement for the Seisquest vessel, which is under a charter that expires in May of 2007.

We have also entered into a commitment to purchase approximately $26 million of recording equipment to upgrade a vessel in our existing fleet. Substantially all of this amount will be spent during the fiscal year ending July 31, 2007.

Debt Structure

As of July 31, 2006, our notes payable consisted of $155.0 million of Convertible Senior Notes due 2024. These notes are classified as a current liability as of July 31, 2006 because the conversion feature discussed below results in the notes being convertible at the option of the holders.

The Convertible Senior Notes bear interest at a per annum rate which equals the three-month LIBOR rate, adjusted quarterly, minus a spread of 0.75%. The interest rate of the notes, from June 15, 2006 through September 14, 2006, was 4.58%, based on a LIBOR rate of 5.33%. For fiscal 2006, the weighted average interest rate on the notes was 3.66%. 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. 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 conversion ratio; 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, and 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. This settlement method is prescribed in the indenture and is not at the discretion of any party. The shares issuable from such conversion are considered in the calculation of diluted earnings per share.

As of the beginning of the second fiscal quarter of 2006, the Convertible Senior Notes were convertible as the stock price remained greater than 120% of the Conversion Price for at least 20 trading days in the period of 30 consecutive trading days ending on October 31, 2005. The notes continued to be convertible as of July 31, 2006. Because of the convertibility, the notes have been classified as a current liability on our consolidated balance sheet as of July 31, 2006. The determination of the convertibility of the notes occurs quarterly. Depending upon the common stock price in the future, the notes may not be convertible in future quarters and therefore would not be classified as current on our consolidated balance sheet. Assuming a stock price of $57.27 (which was the closing stock price on July 31, 2006), conversion of all the notes would result in our payment of $155 million in cash and 3.7 million shares of common stock.

In connection with our issuance of the Convertible Senior Notes, we entered into a registration rights agreement pursuant to which we agreed to register the resale of the notes and underlying common stock by the holders thereof. Under the terms of that registration rights agreement, we were required to file a shelf registration statement for the notes and underlying common stock within an agreed amount of time and thereafter to keep it current or useable for two-year period ending in March 2006. If we failed to file or keep the shelf registration statement related to this debt effective or usable in accordance with the registration rights agreement, then, subject to certain exceptions, we were required to pay liquidated damages to all holders of notes and all holders of our common stock issued upon conversion of the notes. The liquidated damages to be paid were equal to an annual rate of 0.50% of the principal amount. In November 2005, the shelf registration statement became no longer effective and, accordingly, we began accruing and paying liquidated damages at approximately $2,100 per day. We are not required to register the resale of the notes and underlying common stock after March 10, 2006 and therefore, our liability for the payment of liquidated damages ended on that date. For the fiscal year end 2006, we have recorded and paid approximately $310,000 of expense related to these liquidated damages.

In addition to the notes, we also have a five-year $85 million revolving loan agreement with a syndicate of banks. We entered into this facility in February 2006. The facility provides for revolving loans and the issuance of letters of credit to Veritas DGC Inc. and certain of its subsidiaries of up to $45 million in the United States, $15 million in Canada, $15 million in Singapore and $10 million in the United Kingdom. As of July 31, 2006, there were no borrowings and $3.8 million of outstanding letters of

credit, leaving $81.2 million available under the revolving loan facility. This new credit facility replaced our previous credit facility that consisted primarily of a revolving loan facility.

The facility is secured by pledges of accounts receivable and the U.S. land data library, which, when added together, have a carrying amount of approximately $242 million as of July 31, 2006. The facility is also secured by certain intercompany notes and stock in certain Veritas subsidiaries. Veritas and certain of its subsidiaries have also issued loan guarantees with respect to certain borrowings. Interest rates on borrowings under the facility are selected by the borrower at the time of any advance and the rates so selected may be either at LIBOR plus 1.00% or the Base Rate (defined as the lesser of the applicable prime rate or the federal funds rate). These rates may be adjusted upward depending upon our leverage ratio (calculated as a ratio of funded debt versus EBITDA for the previous four quarters) to a maximum of LIBOR plus 1.50% or the base rate plus 0.50%. The loan agreement and related documents contain customary financial covenants and default provisions, including a limit on the amount of cash dividends. These covenants contain certain financial measurements as of quarter ending dates, and, as of our last fiscal quarter ended July 31, 2006, we were in compliance with these covenants.

We also 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, 2006, $1.0 million in letters of credit were outstanding under these lines.

The following table presents our contractual obligations as of July 31, 2006 for the specified periods:

	Payments Due				
Contractual Obligations	**Total (In thousands)**	**Less than 1 year**	**1 3 years**	**3 5 years**	**More Than 5 years**
Long-term debt (1)	$ 155,000	$	$	$	$ 155,000
Estimated interest payments (2)	125,418	7,099	14,198	14,198	89,923
Operating leases	222,755	49,099	64,944	49,680	59,032
Capital leases	1,767	1,502	265		
Purchase obligations	86,564	86,564			
Potential payments under letters of credit	4,816	4,579	237		
Other long-term liabilities (3)	34,561	85	1,434	21	33,021
Total	630,881	148,928	81,078	63,899	336,976

(1) The debt of $155 million has been classified as a current liability since October 31, 2005 because the stock price has remained above the level that triggers the convertibility features of the debt.

(2) The interest rate on our debt is LIBOR less 0.75%. For purposes of this table, we used our current interest rate of 4.58% based on a LIBOR rate of 5.33%. 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, 2006, we had no off-balance sheet instruments.

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).

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For contract services, we recognize revenue on a proportional performance method based upon output measures as work is performed. This method requires that we recognize revenue 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.

Revenue from the licensing of multi-client surveys is 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 revenue 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 revenue 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 revenue. 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, the mix of surveys generating revenue in the period, and minimum amortization amounts were held constant in fiscal 2006, 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 $12 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 revenue 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 future 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.

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. The amount of a valuation allowance is later reduced if realization of the related deferred tax asset subsequently becomes more likely than not. As of July 31, 2006, we had $19.3 million of valuation allowances related to deferred tax assets in jurisdictions where historical losses or certain limitations on their use indicate realization is doubtful.

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 revenue for a product bear to the total of current and anticipated future gross revenue 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.

Share Based Compensation

As of August 1, 2005, we adopted the Financial Accounting Standard Board Statement No. 123(R) (SFAS 123R) to account for share based compensation. SFAS 123R 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. We elected to use the modified prospective method for adoption, which requires compensation expense to be recorded for all unvested stock options and other equity-based compensation beginning in the first quarter of adoption. For all unvested options outstanding as of August 1, 2005, the previously measured but unrecognized compensation expense, based on the fair value at the original grant date, we began recognizing in the statement of operations over the remaining vesting period. For equity-based compensation granted subsequent to August 1, 2005, compensation expense, based on the fair value on the date of grant, we began recognizing in the statement of operations over the vesting period. Determining the fair value of stock based awards at the grant date requires judgment, including estimating the expected term of stock options, the expected volatility of our stock and the amount of stock options to be forfeited. If actual results differ significantly from these estimates, share based compensation expense and the results of operations could be materially impacted. As of July 31, 2006, there was approximately $7.3 million of total unrecognized compensation cost related to nonvested share-based compensation arrangements. That cost is expected to be recognized on a straight line basis over the weighted average remaining period which is approximately 2 years.

Pension Plan

We maintain a contributory defined benefit pension plan (the Pension Plan) for eligible participating employees in the United Kingdom. Monthly contributions by employees are equal to 7.0% of their salaries increased from 5.5% effective December 1, 2005. We provide an additional contribution in an actuarially determined amount necessary to fund future benefits to be provided under the Pension Plan. Benefits provided are based upon 1/60 of the employee s final pensionable salary (as defined in the Pension Plan) for each complete year of service up to 2/3 of the employee s final pensionable salary and increase annually in line with inflation subject to a maximum of 5% per annum. The Pension Plan also provides for 50% of such actual or expected benefits to be paid to a surviving spouse upon the death of a participant. Pension Plan assets consist mainly of investments in marketable securities that are held and managed by an independent trustee.

The Pension Plan is impacted by certain actuarial assumptions, including the discount rate, the expected rate of return on plan assets and expected salary increases. These rates are evaluated by outside actuaries and senior management on an annual basis and adjusted only as appropriate to reflect changes in market rates and outlook. In accordance with U.S. GAAP, the net amount by which actual results differ from our assumptions is deferred. If this net deferred amount exceeds 10% of the greater of plan assets or liabilities, a portion of the deferred amount is included in expense for the following year. The cost or benefit of plan changes, such as increasing or decreasing benefits for prior employee service (prior service cost), is deferred and included in expense on a straight-line basis over the average remaining service period of the employees expected to receive benefits.

The expected long-term rate of return on plan assets reflects the average rate of earnings expected on the funds invested or to be invested to provide for the benefits included in the projected benefit obligation. We have used a rate we believe is appropriate for long-term investment in an equity-based portfolio. For fiscal 2006, the average return on assets assumption was 6.5% compared to a historical actual rate of return of 6.5% over the past 10 years. A 0.25% decrease in the expected return on plan assets would increase our net periodic pension cost by approximately $0.1 million.

The discount rate is determined by using the return available from an index of AA-rated corporate non-callable bonds of appropriate duration and currency. For fiscal 2006, the discount rate used was 5.0%. A 0.25% decrease in the discount rate would increase our net periodic pension cost by approximately $0.3 million.

For fiscal 2007, we plan to contribute approximately $1.4 million to the pension scheme and we expect to continue to fund the pension scheme at an appropriate level over the remaining life of the scheme.

In fiscal 2006, we recorded net pension expense of $2.8 million compared to $1.2 million in fiscal 2005 and $1.0 million in fiscal 2004.

Recent Accounting Pronouncements

In December 2004, the FASB issued FASB Staff Position No. 109-1, Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004, which provides guidance on the recently enacted American Jobs Creation Act of 2004 (the Act). The Act provides a U.S. tax deduction for income from qualified domestic production activities beginning in our fiscal year ended July 31, 2006. FSP 109-1 provides for the treatment of the deduction as a special deduction as described in SFAS No. 109. Accordingly, we will record the amount of any special deductions in the years they are taken. The impact of this deduction did not have a material impact on our fiscal year 2006 financial statements.

In December 2004, the FASB issued FASB Staff Position No. 109-2, Accounting and Disclosure Guidance for the Foreign Repatriation Provision within the American Jobs Creation Act of 2004, which provides guidance under SFAS No. 109 with respect to recording the potential impact of the repatriation provisions of the Act on a company s income tax expense and deferred tax liability. FSP 109-2 states that a company is allowed time beyond the financial reporting period of enactment to evaluate the effect of the Act on its plan for reinvestment or repatriation of foreign earnings for purposes of applying SFAS No. 109. During July 2006, the Company elected to repatriate $55 million from one of its foreign subsidiaries to realize the benefits of this provision of the Act. We plan to use the net proceeds for qualifying U.S. expenditures. The impact of the repatriation was approximately $2.5 million increase to the fiscal 2006 tax provision.

In December 2004, the FASB issued SFAS No. 153, Exchanges of Nonmonetary Assets an amendment of APB Opinion No. 29, to address the measurement of exchanges of nonmonetary assets. SFAS No. 153 eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. 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. This statement was adopted by the company beginning August 1, 2005. The adoption of this statement had no impact on the company s financial statements.

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections a replacement of APB Opinion No. 20 and FASB Statement No. 3. SFAS No. 154 requires retrospective application to prior periods financial statements for changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS 154 also requires that a change in depreciation, amortization, or depletion method for long-lived, non-financial assets be accounted for as a change in accounting estimate effected by a change in accounting principle. SFAS 154 is

As of August 1, 2005, we adopted the Financial Accounting Standard Board Statement No. 123(R) (SFAS 123R) to

As of August 1, 2005, we adopted the Financial Accounting Standard Board Statement No. 123(R) (SFAS 123R) to effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The implementation of SFAS No. 154 is not expected to have a material impact on the company s financial statements.

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 150. SFAS No. 155 (a) permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, (b) clarifies that certain instruments are not subject to the requirements of SFAS 133, (c) establishes a requirement to evaluate interests in securitized financial assets to identify interests that may contain an embedded derivative requiring bifurcation, (d) clarifies what may be an embedded derivative for certain concentrations of credit risk and (e) amends SFAS 140 to eliminate certain prohibitions related to derivatives on a qualifying special-purpose entity. SFAS 155 is effective for us for the fiscal year beginning August 1, 2007. The implementation of SFAS No. 155 is not expected to have a material impact on the company s financial statements.

In July 2006, the FASB issued FASB Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109. FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. FIN No. 48 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. The new standard also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods and disclosure. The provisions of FIN No. 48 are effective for fiscal years beginning after December 15, 2006. We are currently evaluating the provisions of FIN No. 48 to determine the impact on our consolidated financial statements.

In September 2006, the FASB issued FASB Staff Position No. AUG AIR-1, Accounting for Planned Major Maintenance Activities. This guidance prohibits the use of the accrue-in-advance method of accounting for planned major activities because an obligation has not occurred and therefore a liability should not be recognized. The provisions of this guidance will be effective for us for the fiscal year beginning August 1, 2007. We are currently evaluating the provisions of this guidance to determine the impact on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R). SFAS No. 158 requires an employer to: (a) Recognize in its statement of financial position an asset for a plan s overfunded status or a liability for a plan s underfunded status; (b) Measure a plan s assets and its obligations that determine its funded status as of the end of the employer s fiscal year (with limited exceptions); (c) Recognize changes in the funded status of a defined benefit postretirement plan in the year in which the changes occur. Those changes will be reported in comprehensive income of a business entity and in changes in net assets of a not-for-profit organization. The requirement to recognize the funded status of a benefit plan and the disclosure requirements are effective for us for the fiscal year ending on July 31, 2007. The requirement to measure plan assets and benefit obligations as of the date of our fiscal year-end balance sheet is effective for us for the fiscal year ending July 31, 2009. We are currently evaluating the provisions of this guidance to determine the impact on our consolidated financial statements.

ITEM 7A. Quantitative and Qualitative Disclosures Regarding Market Risk

As of July 31, 2006, we had $155.0 million Convertible Senior Notes bearing interest at LIBOR less 0.75% with a fair value of $383 million, based upon the bid price of 247.25 on July 31, 2006. 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. We operate in a number of international areas and are involved in transactions denominated in currencies other than U.S. dollars, which exposes us to foreign exchange rate risk. We review these risks on a case-by-case basis. We have not entered into any hedges related to this foreign exchange rate risk in fiscal 2006.

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 Chief Executive Officer	*Executive Vice President, 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, 2006.

Our assessment of the effectiveness of our internal control over financial reporting as of July 31, 2006 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their audit report, which is included herein.

Thierry Pilenko	Mark E. Baldwin
Chairman of the Board and Chief Executive Officer	*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 integrated audits of Veritas DGC Inc. s 2006 and 2005 consolidated financial statements and of its internal control over financial reporting as of July 31, 2006, and an audit of its 2004 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 consolidated 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, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended July 31, 2006 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1 to the consolidated financial statements, the Company changed its accounting for amortization of multi-client data library on August 1, 2003. As discussed in Note 1 to the consolidated financial statements, the Company changed the manner in which it accounts for share based compensation in fiscal 2006.

Internal control over financial reporting

Also, in our opinion, management s assessment, included in the accompanying Management s Report on Internal Control over Financial Reporting, appearing under Item 9A, that the Company maintained effective internal control over financial reporting as of July 31, 2006 based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of July 31, 2006, based on criteria established in *Internal Control - Integrated Framework* issued by the COSO. The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management s assessment and on the effectiveness of the Company s internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Houston, Texas

October 4, 2006

VERITAS DGC INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

(In thousands, except per share amounts)

	For the Years Ended July 31, 2006	2005	2004
Revenue	$ 822,188	$ 634,026	$ 564,469
Cost of services	623,159	519,008	495,709
Research and development	22,910	18,882	15,536
General and administrative	43,240	31,895	25,454
Operating income	132,879	64,241	27,770
Interest expense	7,319	3,996	18,851
Interest income	(11,989)	(5,262)	(1,602)
Gain on involuntary conversion of assets	(2,000)	(9,861)	
Other (income) expense, net	123	(875)	1,585
Income before provision (benefit) for income taxes	139,426	76,243	8,936
Provision (benefit) for income taxes	57,195	(6,758)	3,715
Net income	$ 82,231	$ 83,001	$ 5,221
Net income per share:			
Basic:			
Weighted average common shares	35,260	33,843	33,572
Income per common share	$ 2.33	$ 2.45	$ .16
Diluted:			
Weighted average common shares	39,623	35,054	34,260
Income per common share	$ 2.08	$ 2.37	$ .15
Comprehensive income			
Net income	$ 82,231	$ 83,001	$ 5,221
Other comprehensive income (loss) (net of tax, $0 in all periods except as specified):			
Foreign currency translation adjustments	7,538	6,914	3,835
Unrealized gain (loss) on investments-available for sale		(159)	(588)
Reclassification of unrealized gain on investments recognized in income	(197)		
Unrealized gain on hedge transactions			145
Minimum pension liability adjustment (net of tax benefit of $409, $3,074 and $0 in 2006, 2005 and 2004, respectively)	(956)	(7,171)	338
Total other comprehensive income (loss)	6,385	(416)	3,730
Comprehensive income	$ 88,616	$ 82,585	$ 8,951

See Notes to Consolidated Financial Statements

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VERITAS DGC INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

(Dollars in thousands, except par value)

	July 31, 2006	2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 401,955	$ 249,393
Restricted cash investments	302	237
Accounts receivable (net of allowance for doubtful accounts: $1,895 in 2006 and $1,322 in 2005)	215,244	165,989
Materials and supplies inventory	6,366	5,381
Prepayments and other	18,917	18,900
Deferred tax asset	8,225	12,486
Current assets held for sale	5,148	
Total current assets	656,157	452,386
Property and equipment:		
Land	2,855	7,005
Geophysical equipment	200,297	329,436
Data processing equipment	79,590	75,337
Geophysical vessel		8,331
Leasehold improvements and other	76,941	74,981
Total	359,683	495,090
Less accumulated depreciation	249,079	367,173
Property and equipment, net	110,604	127,917
Multi-client data library	296,603	316,793
Deferred tax asset, net	41,511	45,963
Other assets	22,699	23,539
Noncurrent assets held for sale	30,456	
Total	$ 1,158,030	$ 966,598
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Notes payable	$ 155,000	$
Accounts payable, trade	107,863	75,810
Accrued and deferred income taxes	29,224	9,402
Deferred revenue	29,280	42,043
Other accrued liabilities	70,313	65,193
Current liabilities held for sale	21,245	
Total current liabilities	412,925	192,448
Non-current liabilities:		
Long-term debt		155,000
Other non-current liabilities	34,561	36,602
Total non-current liabilities	34,561	191,602