

Edgar Filing: ALLIS CHALMERS CORP - Form 10-Q

ALLIS CHALMERS CORP  
Form 10-Q  
August 16, 2004

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 20549  
FORM 10-Q  
(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2004 OR

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 1-2199

ALLIS-CHALMERS CORPORATION  
-----

(Exact name of registrant as specified in its charter)

DELAWARE  
-----

(State or other jurisdiction of  
incorporation or organization)

39-0126090  
-----

(I.R.S. Employer  
Identification No.)

5075 WESTHEIMER, SUITE 890, HOUSTON, TEXAS 77056  
-----

(Address of principal executive offices) (Zip code)

(713) 369-0550  
-----

Registrant's telephone number, including area code

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT: NONE

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:  
COMMON STOCK, PAR VALUE \$0.01 PER SHARE

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  No

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

At August 12, 2004, there were 9,783,681 shares of common stock outstanding.

ALLIS-CHALMERS CORPORATION

FORM 10-Q

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FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2004

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ALLIS-CHALMERS CORPORATION  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(in thousands, except per share)

Three Months Ended		Six Months E
June 30,		June 30
2004	2003	2004
-----	-----	-----
(in thousands, except per share)		

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Revenues	\$ 11,422	\$ 7,340	\$ 21,083
Cost of sales	8,340	5,410	15,729
	-----	-----	-----
Gross Profit	3,082	1,930	5,354
General and administrative expense	1,853	1,020	2,956
	-----	-----	-----
Income/ (loss) from operations	1,229	910	2,398
Other Income (expense)			
Interest income	--	--	--
Interest expense	(499)	(843)	(1,068)
Other	18	(186)	205
Minority interest	(161)	(124)	(256)
	-----	-----	-----
Net income/(loss) before income taxes	587	(243)	1,279
	-----	-----	-----
Provision for income taxes	117	92	220
	-----	-----	-----
Net income/ (loss)	470	(335)	1,059
	-----	-----	-----
Preferred stock dividend	(36)	(87)	(124)
	-----	-----	-----
Net income/ (loss) attributed to common shares	\$ 434	\$ (422)	\$ 935
	=====	=====	=====
Net income/ (loss) per common share basic	\$ 0.07	\$ (0.11)	\$ 0.18
	=====	=====	=====
Net income/ (loss) per common share diluted	\$ 0.04	\$ (0.11)	\$ 0.11
	=====	=====	=====
Weighted average number of common shares outstanding			
Basic	6,253	3,927	5,077
	=====	=====	=====
Diluted	10,237	3,927	8,394
	=====	=====	=====

This interim statement is unaudited.

The accompanying Notes are an integral part of the Financial Statements.

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	June 30, 2004	December 2003
	-----	-----
ASSETS		
Cash and cash equivalents	\$ 485	\$ 1
Trade receivables, net	10,305	8
Lease receivable, current	180	
Deferred offering costs	2,650	
Prepays and other current assets	1,137	
	-----	-----
Total current assets	14,757	11
Property and equipment, net	27,234	26
Goodwill	7,661	7
Other intangible assets, net	2,054	2
Debt issuance costs, net	612	
Lease receivable	664	
Other assets	79	
	-----	-----
Total assets	\$ 53,061	\$ 48
	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current maturities of long-term debt	\$ 4,848	\$ 5
Trade accounts payable	3,391	3
Accrued salaries, benefits and payroll taxes	677	
Accrued interest	212	
Accrued expenses	1,332	1
Accounts payable, related parties	541	
	-----	-----
Total current liabilities	11,001	11
Accrued postretirement benefit obligations	520	
Long-term debt, net of current maturities	26,163	27
Other long-term liabilities	129	
Redeemable warrants	1,500	1
Redeemable convertible preferred stock	-	4
	-----	-----
Total liabilities	39,313	45
Commitments and Contingencies (Note 9 and Note 19)		
Minority interests	2,782	2
COMMON SHAREHOLDERS' EQUITY		
Common stock, \$.01 par value (20,000,000 shares authorized; 6,264,758 and 3,926,668 issued and outstanding, respectively)	63	
Capital in excess of par value	18,593	9
Accumulated (deficit)	(7,690)	(8
	-----	-----
Total shareholders' equity	10,966	1
	-----	-----
Total liabilities and shareholders' equity	\$ 53,061	\$ 48
	=====	=====

This interim statement is unaudited.

The accompanying Notes are an integral part of the Financial Statements.

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ALLIS-CHALMERS CORPORATION  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(in thousands)

	Six Months Ended June 30,	
	2004	2003
	-----	-----
Cash flows from operating activities:		
Net income (loss)	\$ 1,059	\$ (28)
Adjustments to reconcile net (loss) to net cash provided by operating activities:		
Depreciation and amortization expense	1,389	1,38
Fair value of warrant issued to consultant	14	-
(Gain) loss on sale of fixed assets	--	18
Amortization of discount on debt	109	36
Minority interest in income of subsidiary	256	31
Changes in working capital:		
Decrease (increase) in accounts receivable	(1,482)	(1,59)
Decrease (increase) in other current assets	(250)	(61)
Decrease (increase) in other assets	84	3
Decrease (increase) in lease deposit	--	52
(Decrease) increase in accounts payable	258	1,38
(Decrease) increase in accrued interest	60	46
(Decrease) increase in accrued expenses	(429)	(39)
(Decrease) increase in other long-term liabilities	(141)	-
(Decrease) increase in accrued employee benefits and payroll taxes	(185)	(8)
	-----	-----
Net cash provided by operating activities	742	1,67
Cash flows from investing activities:		
Proceeds from sale of fixed assets	--	70
Purchase of equipment	(1,879)	(82)
	-----	-----
Net cash provided (used) by investing activities	(1,879)	(12)
Cash flows from financing activities:		
Proceeds from issuance of common stock, net	1,865	-
Repayments of long-term debt	(1,331)	(1,66)
Debt issuance costs	(211)	-
	-----	-----
Net cash provided (used) by financing activities	323	(1,66)
	-----	-----
Net increase (decrease) in cash and cash equivalents	(814)	(11)
Cash and cash equivalents at beginning of year	1,299	14
	-----	-----
Cash and cash equivalents at end of period	\$ 485	\$ 3
	=====	=====
Supplemental information - interest paid	\$ 1,068	\$ 1,48
	=====	=====

This interim statement is unaudited.

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The accompanying Notes are an integral part of the Financial Statements.

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### NOTES TO FINANCIAL STATEMENTS

#### NOTE 1 - NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

This interim financial data should be read in conjunction with the consolidated financial statements and related notes, management's discussion and analysis and other information included in Allis-Chalmers Corporation's ("Allis-Chalmers" or the "Company") Annual Report on Form 10-K for the year ended December 31, 2003 (the "Form 10-K").

All normal and recurring adjustments considered necessary for a fair presentation of the results of operations have been included in the unaudited financial statements. In addition, all non-recurring adjustments necessary to prevent the financial statements from being misleading have been included in the unaudited financial statements. The results of operations for any interim period are not necessarily indicative of the Company's operating results for a full year.

#### ORGANIZATION OF BUSINESS

OilQuip Rentals, Inc., an oil and gas rental company ("OilQuip"), was incorporated on February 4, 2000 to find and acquire acquisition targets to operate as subsidiaries.

On February 6, 2001, OilQuip, through its subsidiary, Mountain Compressed Air Inc. ("Mountain Air"), a Texas corporation, acquired certain assets of Mountain Air Drilling Service Co., Inc. ("MADSCO"), whose business consisted of providing equipment and trained personnel in the four corner areas of the southwestern United States. Mountain Air primarily provides compressed air equipment and related products and services and trained operators to companies in the business of drilling for natural gas.

On May 9, 2001, OilQuip merged into a subsidiary of Allis-Chalmers. In the merger, all of OilQuip's outstanding common stock was converted into 2,000,000 shares of Allis-Chalmers' common stock.

For legal purposes, we acquired OilQuip, the parent company of Mountain Air. However, for accounting purposes, OilQuip was treated as the acquiring company in a reverse acquisition of Allis-Chalmers. Our financial statements prior to the merger reflect the operations of OilQuip. As a result of the merger, the fixed assets, goodwill and other intangibles of Allis-Chalmers were increased by \$2,691,000.

On February 6, 2002, we acquired 81% of the outstanding stock of Jens' Oilfield Service, Inc. ("Jens'"), which supplies highly specialized equipment and operations to install casing and production tubing required to drill and complete oil and gas wells. The Company also purchased substantially all the outstanding common stock and preferred stock of Strata Directional Technology, Inc. ("Strata"), which provides high-end directional and horizontal drilling services for specific targeted reservoirs that cannot be reached vertically.

In July 2003, through our subsidiary Mountain Air, we entered into a limited liability company operating agreement with a division of M-I L.L.C. ("M-I"), a

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joint venture between Smith International and Schlumberger N.V. (Schlumberger Limited), to form a Texas limited liability company named AirComp LLC ("AirComp"). Mountain Air contributed assets with a net book value of approximately \$6.3 million and M-I contributed assets with a net book value of approximately \$6.8 million to AirComp L.L.C.. In addition, the AirComp issued a subordinated note to M-I in the amount of \$4.8 million. The Company owns 55% and M-I owns 45% of AirComp. Because the Company controls AirComp, the Company has accounted for the joint venture as a business combination.

On June 10, 2004, the Company effected a reverse stock split in order to increase the share price of the Common Stock. As a result of the reverse stock split, every five shares of the Company's common stock were combined into one share of common stock. The reverse stock split reduced the number of shares of outstanding common stock from 31,393,789 to approximately 6,265,000 and reduced the number of stockholders of the Company from approximately 6,070 to approximately 2,140.

### USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Future events and their effects cannot be predicted with certainty. Accordingly, the Company's accounting estimates require the exercise of judgment. While management believes that the estimates and assumptions used in the preparation of the consolidated financial statements are appropriate, actual results could differ from those estimates. Estimates are used for, but are not limited to, determining the following: allowance for doubtful accounts, recoverability of long-lived assets and intangibles, useful lives used in depreciation and amortization, income taxes and related valuation allowances. The accounting estimates used in the preparation of the consolidated financial statements may change as new events occur, as more experience is acquired, as additional information is obtained and as the Company's operating environment changes.

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### PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of Allis-Chalmers and its subsidiaries Mountain Air, Jens', and Strata and its joint venture, AirComp. All significant inter-company transactions have been eliminated.

### REVENUE RECOGNITION

The Company's revenue recognition policy is significant because revenue is a key component of reported results of operations. In addition, revenue recognition determines the timing of certain expenses, such as commissions. The Company follows specific and detailed guidelines in measuring revenue. Revenues are recognized by the Company and its subsidiaries as services are rendered, provided that pricing is fixed or determinable and collection is reasonably assured. The Securities and Exchange Commission's ("SEC") Staff Accounting Bulletin ("SAB") No. 104, REVENUE RECOGNITION IN FINANCIAL STATEMENTS ("SAB No. 104"), provides guidance on the SEC staff's views on application of generally accepted accounting principles to selected revenue recognition issues. The Company's revenue recognition policy is in accordance with generally accepted

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accounting principles and SAB No. 104.

### RECLASSIFICATIONS AND RESTATEMENT OF FORM 10-Q

Certain prior period balances have been reclassified to conform to current year presentation.

The accompanying 2003 financial statements have been restated from the previously filed interim financial statements included in Form 10-Q for the first, second and third quarters of 2003. As discussed in Note 7 in the financial statements included in the Form 10-K, an adjustment was recorded in the fourth quarter of 2003 to reflect a change in estimate of the recoverability of foreign taxes paid in 2003. The effect of the significant fourth quarter adjustment on the individual quarterly financial statements is as follows:

	Three Months Ended June 30, 2003	Six Months Ended June 30, 2003
	-----	-----
Net income (loss) attributed to common shareholders		
Previously reported	\$ (330)	\$ (513)
Adjustment	(92)	(250)
Restated	(422)	(763)
Net income (loss) per share, basic and diluted		
Previously reported	\$ (0.08)	\$ (0.13)
Adjustment	(0.03)	(0.06)
Restated	(0.11)	(0.19)

### SEGMENTS OF AN ENTERPRISE AND RELATED INFORMATION

The Company discloses the results of its segments in accordance with SFAS No. 131, DISCLOSURES ABOUT SEGMENTS OF AN ENTERPRISE AND RELATED INFORMATION ("SFAS No. 131"). The Company designates the internal organization that is used by management for allocating resources and assessing performance as the source of the Company's reportable segments. SFAS No. 131 also requires disclosures about products and services, geographic areas and major customers. At June 30, 2004 and 2003, the Company operated in three segments organized by service line: casing services, directional drilling services and compressed air drilling services.

### NOTE 2 - ACQUISITIONS

In July 2003, through our subsidiary Mountain Air, we entered into a limited liability company operating agreement with a division of M-I, a joint venture between Smith International and Schlumberger N.V. (Schlumberger Limited), to form a Texas limited liability company named AirComp. The formation of AirComp has created the second largest provider of compressed air and related products and services for the drilling, workover, completion, and transmission segments of the oil, gas and geothermal industries.

Mountain Air contributed assets with a net book value of approximately \$6.3 million and M-I contributed assets with a net book value of approximately \$6.8 million to AirComp L.L.C. In addition, the Company issued a subordinated note to



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M-I in the amount of \$4.8 million. The Company owns 55% and M-I owns 45% of AirComp. Because the Company controls AirComp, the Company has accounted for the joint venture as a business combination.

The following unaudited pro forma consolidated summary financial information illustrates the effects of the formation of AirComp on the Company's results of operations as of June 30, 2003, based on the historical statements of operations, as if the transaction had occurred as of the beginning of the period presented.

	THREE MONTHS ENDED JUNE 30, -----	SIX MONTHS ENDED JUNE 30, -----
	(UNAUDITED)	
	(in thousands, except per share)	
	2003 ----	2003 ----
Revenues	\$ 8,181	\$ 16,061
Operating income (loss)	\$ 620	\$ 2,206
Net income (loss)	\$ (612)	\$ (394)
Net income (loss) per common share		
Basic	\$ (0.16)	\$ (0.10)
Diluted	\$ (0.16)	\$ (0.10)

### NOTE 3 - DEBT

Debt is as follows at June 30:

	2004 -----
	(in thousands)
Debt of Mountain Air	
Note payable to Wells Fargo - Equipment leasing	\$ 223
Note payable to Seller of Mountain Air Drilling Service Company	1,555
Debt of Jens'	
Note payable to Wells Fargo -Term Note	3,672
Note payable to Wells Fargo -Real Estate Note	118
Line of Credit with Wells Fargo	248
Subordinated Note payable to Seller of Jens	4,000
Note payable to Seller of Jens' for non-compete agreement	638
Note payable to Texas State Bank - Term Note	354
Debt of Strata	
Vendor financing	1,746
Line of Credit with Wells Fargo	2,782
Debt of Allis-Chalmers	
Notes payable to certain former Directors	394
Note payable to Wells Fargo - Subordinated Debt, net	2,309
Debt of AirComp, LLC	
Line of Credit to Wells Fargo	807
Note payable to Wells Fargo	6,857
Note payable to Wells Fargo	490
Subordinated Note payable to M-I L.L.C	4,818
	-----
Total debt	31,011
Less short-term debt and current maturities	4,848
	-----

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Long-term debt obligations	\$ 26,163 =====
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Substantially all of the Company's assets are pledged as collateral under the credit agreements.

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### NOTE 4 - SHAREHOLDERS' EQUITY

On April 2, 2004, the Company completed the following transactions:

- o In exchange for an investment of \$2,000,000, the Company issued 620,000 shares of common stock for a purchase price equal to \$2.50 per share, and issued warrants to purchase 800,000 shares of common stock at an exercise price of \$2.50 per share, expiring on April 1, 2006, to an investor group (the "Investor Group") consisting of entities affiliated with Donald and Christopher Engel and directors Robert Nederlander and Leonard Toboroff. The aggregate purchase price for the common stock was \$1,550,000, and the aggregate purchase price for the warrants was \$450,000.
- o Energy Spectrum converted its 3,500,000 shares of Series A 10% Cumulative Convertible Preferred Stock, including accrued dividend rights, into 1,718,090 shares of common stock. The conversion of the preferred stock will have an impact on the earnings per share in future periods since the Company will not record any dividends.
- o The Company, the Investor Group, Energy Spectrum, and director Saeed Sheikh, and officers and directors Munawar H. Hidayatallah and Jens H. Mortensen entered into a stockholders agreement pursuant to which the parties have agreed to vote for the election to the board of directors of the Company three persons nominated by Energy Spectrum, two persons nominated by the Investor Group and one person nominated by Messrs. Hidayatallah, Mortensen and Sheikh. In addition, the parties and the Company agreed that in the event the Company has not effected a public offering of its shares prior to September 30, 2005, then, at the request of Energy Spectrum, the Company will retain an investment banking firm to identify candidates for a transaction involving the sale of the Company or its assets.

### NOTE 5 - REVERSE STOCK SPLIT

The Company effected a reverse stock split on June 10, 2004 in order to increase the share price of the common stock. As a result of the reverse stock split, every five shares of the Company's common stock were combined into one share of common stock. The reverse stock split reduced the number of shares of outstanding common stock from 31,393,789 to approximately 6,265,000 and reduced the number of stockholders of the Company from approximately 6,070 to approximately 2,140. The Company currently has an application pending to list the Common Stock on the American Stock Exchange, which has an initial listing requirement that the Common Stock trade for a minimum of \$3.00 per share and certain other qualitative and quantitative listing requirements. There can be no assurance that the Company will be successful in listing the Common Stock on the

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American Stock Exchange.

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NOTE 6 - SEGMENT INFORMATION

The Company has three operating segments including Casing Services (Jens'), Directional Drilling Services (Strata) and Compressed Air Drilling Services (AirComp). All of the segments provide services to the petroleum exploration and production industry. The revenues, operating income (loss), depreciation and amortization, interest, capital expenditures and assets of each of the reporting segments plus the General Corporate function are reported below for the quarters and the six months ended June 30, 2004 and 2003:

	Three Months Ended June 30, 2004	2003	Six Months Ended June 30, 2004	2003
	-----	-----	-----	-----
	(in thousands)			
<b>REVENUES:</b>				
Casing services	\$ 2,446	\$ 2,644	\$ 4,386	\$ 4,386
Directional drilling services	6,422	3,503	11,675	11,675
Compressed air drilling services	2,554	1,193	5,022	5,022
	-----	-----	-----	-----
Total revenues	\$ 11,422	\$ 7,340	\$ 21,083	\$ 21,083
	=====	=====	=====	=====
<b>OPERATING INCOME (LOSS):</b>				
Casing services	\$ 783	\$ 988	\$ 1,225	\$ 1,225
Directional drilling services	727	255	1,389	1,389
Compressed air drilling services	419	71	812	812
General corporate	(700)	(404)	(1,028)	(1,028)
	-----	-----	-----	-----
Total income/(loss) from operations	\$ 1,229	\$ 910	\$ 2,398	\$ 2,398
	=====	=====	=====	=====
<b>DEPRECIATION AND AMORTIZATION EXPENSE:</b>				
Casing services	\$ 355	\$ 275	\$ 717	\$ 717
Directional drilling services	114	39	214	214
Compressed air drilling services	197	180	408	408
General corporate	25	(3)	50	50
	-----	-----	-----	-----
Total depreciation and amortization expense	\$ 691	\$ 491	\$ 1,389	\$ 1,389
	=====	=====	=====	=====
<b>INTEREST EXPENSE:</b>				
Casing services	\$ 155	\$ 230	\$ 320	\$ 320
Directional drilling services	67	77	142	142
Compressed air drilling services	158	331	317	317
General corporate	119	205	289	289
	-----	-----	-----	-----
Total interest expense	\$ 499	\$ 843	\$ 1,068	\$ 1,068
	=====	=====	=====	=====
<b>CAPITAL EXPENDITURES</b>				
Casing services	\$ 46	\$ 201	\$ 425	\$ 425
Directional drilling services	83	61	788	788

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Compressed air drilling services	338	379	664	
General corporate	1	5	2	
	-----	-----	-----	-----
Total capital expenditures	\$ 468	\$ 646	\$ 1,879	\$
	=====	=====	=====	=====
ASSETS:				
Casing services	\$ 17,060	\$ 16,562	\$ 17,060	\$ 1
Directional drilling services	12,795	8,125	12,795	
Compressed air drilling services	18,588	9,038	18,588	
General corporate	4,617	1,322	4,617	
	-----	-----	-----	-----
Total assets	\$ 53,061	\$ 35,047	\$ 53,061	\$ 3
	=====	=====	=====	=====

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NOTE 7 - LEGAL MATTERS

The Company is involved in various legal proceedings arising in the ordinary course of business. The legal proceedings are at different stages. In the opinion of management and their legal counsel, the ultimate gain or loss, if any, to the Company from all such proceedings can not be reasonably estimated at this time.

The Company is a defendant in an action (the "Action") brought in April 2004 (No. 04CV308) in the District Court of Mesa County Colorado by the former owner of Mountain Air Drilling Service Company, Inc. nka Pattongill & Murphy, Inc., from whom the Company's Mountain Compressed Air, Inc. ("MCA") acquired assets in 2001. The plaintiff seeks to accelerate payment of a note (the "Note") issued in connection with the acquisition and are seeking \$1,863,000 in damages (representing principal and interest due under the Note), on the basis that MCA has failed to provide financial statements required by the Note. The Company believes the claim is without merit because MCA no longer maintains separate financial statements and the Company provides plaintiff with the Company's publicly available financial statements. The financial statements disclose as a separate segment the operations of AirComp, which conducts business using the assets acquired from plaintiff. In addition, the rights of the holder of the Note are subordinated to certain senior lease obligations, and therefore even if the plaintiff had the right to accelerate the debt under the terms of the Note, the plaintiff is prevented from doing so pursuant to the terms of the subordination agreement until September, 2007, at which time the Note will mature by its terms. Finally, the Company has claims in the amount of \$12,000 for legal fees and other expenses that the plaintiff agreed to pay the Company in connection with the settlement of an earlier lawsuit involving the acquisition of assets from plaintiff.

NOTE 8 - SUBSEQUENT EVENTS

On March 15, 2004, the Company filed an application to list the common stock on the American Stock Exchange. However, approval of listing of the common stock is subject to numerous conditions, and there can be no assurance that the application will be approved.

On July 17, 2004 our Strata and Jens subsidiaries entered into amendments to their respective Wells Fargo Credit, Inc. credit agreements. The amendments

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provide for an increase in the permitted capital expenditures in 2004 by Strata, and also permitted additional indebtedness by Jens. Each of the amendments also included consents to a \$10.0 million to \$15.0 million equity offering by the Company and waived any requirement that the net proceeds be contributed to Strata or Jens and used to prepay outstanding borrowings under the credit facilities.

On August 10, 2004 we completed the private placement of 3,504,667 shares of our common stock at a price of \$3.00 per share. Net proceeds to us, after selling commissions and expenses, are estimated to be \$9.6 million. The private placement was structured as what is known as a "private investment in public equity" or "PIPE" offering, in which we issued shares pursuant to an exemption from the Securities Act of 1933, and have agreed to subsequently register the common stock under the Securities Act of 1933 to allow investors to resell the common stock in public markets.

We will use the net proceeds of the offering to reduce debt, for acquisitions, and for general corporate purposes. While we are in discussions and in the analysis phase with potential acquisition candidates, as of this date, the Company has not entered into definitive agreements with respect to any acquisition candidate.

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS. -

The information in this Item 2 contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of risks and uncertainties, including, but not limited to, those discussed herein, and in other reports filed with the Securities and Exchange Commission, and in particular those discussed under "Risk Factors" in our Annual Report on Form 10-K. You should not place undue reliance on these forward-looking statements, which speak only as of the date of this report. We are under no obligation to revise or update any forward-looking statements.

#### BACKGROUND

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Prior to May 2001, we operated primarily through Houston Dynamic Services, Inc ("HDS"). In May 2001, as part of a strategy to acquire and develop businesses in the natural gas and oil services industry, we consummated a merger (the "OilQuip Merger") in which we acquired 100% of the capital stock of OilQuip Rentals, Inc. ("OilQuip"), which owned 100% of the capital stock of Mountain Air. In December 2001, we disposed of HDS, and in February 2002, we acquired substantially all of the capital stock of Strata and approximately 81% of the capital stock of Jens'. In July 2003, through our subsidiary Mountain Air, we entered into a limited liability company operating agreement with a division of M-I L.L.C., a joint venture between Smith International and Schlumberger N.V. (Schlumberger Limited) to form AirComp LLC. Mountain Air contributed assets with a net book value of approximately \$6.3 million and M-I contributed assets with a net book value of approximately \$6.8 million to AirComp. In addition, the Company issued a subordinated note to M-I in the amount of \$4.8 million. The Company owns 55% and M-I owns 45% of AirComp. We have consolidated AirComp into our financial statements beginning with the quarter ending September 30, 2003.

#### CRITICAL ACCOUNTING POLICIES

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We have identified the policies below as critical to our business operations and the understanding of our results of operations. The impact and any associated risks related to these policies on our business operations is discussed throughout Management's Discussion and Analysis of Financial Condition and Results of Operations where such policies affect our reported and expected financial results. For a detailed discussion on the application of these and other accounting policies, see Note 1 in the Notes to the Consolidated Financial Statements in our Form 10-K. Note that our preparation of this Quarterly Report on Form 10-Q requires us to make estimates and assumptions that affect the reported amount of assets and liabilities, the disclosure of contingent assets and liabilities at the date of our financial statements, and the reported amounts of revenue and expenses during the reporting period. There can be no assurance that actual results will not differ from those estimates.

ALLOWANCE FOR DOUBTFUL ACCOUNTS. In order to estimate the collectibility of amounts due from our customers, we make estimates and judgments regarding the collectibility of our accounts receivables, based upon customer payment history and current credit worthiness, as well as consideration of the overall business climate in which our customers operate. Provisions for doubtful accounts are recorded when it becomes evident that the customers will not be able to make the required payments at either contractual due dates or in the future. Over the past two years, reserves for doubtful accounts, as a percentage of total accounts receivable before reserves, have ranged from 1% to 2%. We believe that our reserve for doubtful accounts is adequate to cover anticipated losses under current conditions; however, there can be no assurance of such fact.

REVENUE RECOGNITION. Our revenue recognition policy is significant because our revenue is a key component of our results of operations. In addition, our revenue recognition policy determines the timing of certain expenses, such as commissions. We follow specific and detailed guidelines in measuring revenue. Revenue results are difficult to predict, and any shortfall in revenue or delay in recognizing revenue could cause our operating results to vary significantly from quarter to quarter and could result in future operating losses. Revenues are recognized by the Company and its subsidiaries as services are rendered, provided that pricing is fixed or determinable and collection is reasonably assured. The Securities and Exchange Commission's ("SEC") Staff Accounting Bulletin No. 104 ("SAB No. 104"), REVENUE RECOGNITION IN FINANCIAL STATEMENTS, provides guidance on the SEC staff's views on application of generally accepted accounting principles to selected revenue recognition issues. Our revenue recognition policy is in accordance with generally accepted accounting principles and SAB No. 104.

IMPAIRMENT OF LONG-LIVED ASSETS. Long-lived assets, which include property, plant and equipment, goodwill and other intangibles, comprise a significant amount of the Company's total assets. The Company makes judgments and estimates as to the value of these assets, including amounts to be capitalized, depreciation and amortization methods and useful lives. Additionally, the book values of these assets are reviewed for impairment on an annual basis or whenever events or changes in circumstances indicate that the carrying amounts may not be recoverable. An impairment loss is recorded in the period in which it is determined that the carrying amount is not recoverable. This requires the Company to make long-term forecasts of its future revenues and costs related to the assets subject to review. These forecasts require assumptions about demand for the Company's products and services, future market conditions and

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technological developments. Changes to these assumptions could require a provision for impairment in a future period.

GOODWILL AND OTHER INTANGIBLES. The Company has recorded approximately \$7,661,000 of goodwill and \$2,054,000 of other identifiable intangible assets. The Company allocates purchase price to intangible assets when it makes a business combination. The excess of the purchase price after allocation of fair values to tangible assets is allocated to identifiable intangibles and thereafter to goodwill. Purchase price allocations have been made to intangible assets and goodwill in connection with the acquisition of the Mountain Air, Strata and Jens' operating segments, as well as the reverse merger between the Company and OilQuip. Subsequently, the Company has performed its initial impairment tests and annual impairment tests in accordance with Financial Accounting Standards Board No. 141, BUSINESS COMBINATIONS, and Financial Accounting Standards Board No. 142, GOODWILL AND OTHER INTANGIBLE ASSETS. The initial valuations of intangibles related to the Mountain Air, Strata and Jens' operating segments required the use of third-party valuation experts who in turn developed assumptions to value the carrying amount of the individual reporting units. Changes to these assumptions could require a provision for impairment in future periods.

STOCK BASED COMPENSATION. The Company accounts for its stock-based compensation using Accounting Principles Board's Opinion No. 25 ("APB No. 25"). Under APB No. 25, compensation expense is recognized for stock options with an exercise price that is less than the market price on the grant date of the option. For stock options with exercise prices at or above the market value of the stock on the grant date, the Company adopted the disclosure-only provisions of Statement of Financial Accounting Standards No. 123 ACCOUNTING FOR STOCK-BASED COMPENSATION ("SFAS 123"). The Company has adopted the disclosure-only provisions of SFAS 123 for the stock options granted to the employees and directors of the Company. Accordingly, no compensation expense has been recognized for these options. Many equity instrument transactions are valued based on pricing models such as Black-Scholes, which require judgments by management. Values for such transactions can vary widely and are often material to the financial statements.

### RESULTS OF OPERATIONS

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Results of operations for 2004 and 2003 reflect the business operations of Allis-Chalmers and its subsidiaries Jens' Oilfield Service, Inc., which supplies highly specialized equipment and operations to install casing and production tubing required to drill and complete oil and gas wells ("Casing Services"), and Strata Directional Technology, Inc., which provides directional and horizontal drilling services for specific targeted reservoirs that cannot be reached vertically ("Directional Drilling Services"). In July 2003, through our subsidiary Mountain Air, we entered into a limited liability company operating agreement with a division of M-I L.L.C., a joint venture between Smith International and Schlumberger N.V. (Schlumberger Limited) to form AirComp LLC. Mountain Air contributed assets with a net book value of approximately \$6.3 million and M-I contributed assets with a net book value of approximately \$6.8 million to AirComp L.L.C. The Company owns 55% and M-I owns 45% of AirComp. We have consolidated AirComp into our financial statements beginning with the quarter ending September 30, 2003. The business of Mountain Air and AirComp is referred to below as "Compressed Air Drilling Services."

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Our revenues for the second quarter ended June 30, 2004 were \$11,422,000, an increase of 55.6% compared to \$7,340,000 for the second quarter of 2003. The increase in revenues in the quarter was principally due to the inclusion of the revenues of Aircomp, our joint venture with M-I formed in July 2003, and an increase in revenues for our Directional Drilling Services, offset in part by a decrease in revenues in our Casing Services segment. Revenues for the second quarter ended June 30, 2004 for the Casing Services, Directional Drilling Services and Compressed Air Drilling were \$2,446,000, \$6,422,000, and \$2,554,000, respectively, compared to \$2,644,000, \$3,503,000, and \$1,193,000, respectively, for the second quarter of 2003. Revenues for the Casing Services segment decreased \$198,000, or 7.4%, for the second quarter of 2004, compared to the second quarter of 2003, due to an increased competitive environment in South Texas and a decrease in drilling in Mexico by PEMEX due to bad weather. Our revenues from Directional Drilling Services increased \$2,919,000, or 83.3%, for the second quarter of 2004 compared to the year-ago quarter, due to an increase in demand for our services and our increased penetration of the Gulf Coast area. Revenues for the Compressed Air Drilling Services segment increased \$1,361,000, or 114.0% during the second quarter of 2004 compared to the 2003 second quarter, principally due to the formation of Aircomp, our joint venture company with M-I. Through Aircomp, we were able to expand the geographical areas in which we operate to include geothermal drilling in California and natural gas drilling in West Texas.

Gross profit, as a percentage of sales, was 27.0% for the quarter ended June 30, 2004 compared to 26.3% for the quarter ended June 30, 2003. The gross profit percentage increased primarily as a result of increased revenues and pricing in the Directional Drilling Services segment. Because we have made significant investments in equipment and have a constant number of operations personnel, many of our costs of revenues are relatively fixed, and as a result, our gross profit margins are significantly impacted by either increases or decreases in pricing structures and revenues.

General and administrative expense was \$1,853,000 in the second quarter of 2004 compared with \$1,020,000 in the second quarter of 2003. General and administrative expense increased in 2004 compared to 2003 due to the inclusion of AirComp and the hiring of additional sales and administrative personnel at each of the Company's subsidiaries to meet increased demand for our services and due to increased professional fees and other expenses related to the Company's financing activities.

Operating income for the second quarter ended June 30, 2004 totaled \$1,229,000, a 35.1% increase over the comparable period in 2003, reflecting the inclusion of operating income of AirComp and increased revenue for Directional Drilling Services. In the comparable period of 2003, operating income was \$910,000. Operating income (loss) for the quarter ended June 30, 2004 for the Casing Services, Directional Drilling Services, Compressed Air Drilling Services and General Corporate segments were \$783,000, \$727,000, \$419,000 and (\$700,000), respectively. Operating income (loss) for the quarter ended June 30, 2003 for the Casing Services, Directional Drilling Services, Compressed Air Drilling Services and General Corporate segments were \$988,000, \$255,000, \$71,000 and (\$404,000), respectively. Operating income for the Casing Services decreased approximately \$205,000 due to reduced revenues. Operating income for Directional Drilling Services increased approximately \$472,000 due to our increased penetration of the Gulf Coast area. Compressed Air Drilling Services increased approximately \$348,000 due to the expanded geographical areas in which AirComp operates. General Corporate segments decreased approximately (\$296,000) due to increased professional fees and other expenses related to the Company's financing activities.

Our interest expense for the second quarter of 2004, decreased to \$499,000 from



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\$843,000 for the second quarter of 2003 due to the reduction in our debt.

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We had a net income attributed to common shareholders of \$434,000, or \$0.07 per common share, for the quarter ended June 30, 2004 compared with a net loss of (\$422,000), or (\$0.11) per common share, for the quarter end June 30, 2003.

### PRO FORMA RESULTS

The following unaudited pro forma consolidated summary financial information illustrates the effects of the formation of AirComp on the Company's results of operations, based on the historical statements of operations, as if the transaction had occurred as of the beginning of the periods presented. Pro forma results of operations set forth below includes results of operations for the quarter ended June 30, 2004 and 2003.

Pro forma revenues for the second quarter of 2004 totaled \$11,423,000, compared to pro forma revenues in the second quarter of 2003 of \$8,181,000, an increase of approximately 40%. The increase in 2004 compared to 2003 was primarily due to higher revenues resulting from the overall upturn in the petroleum industry. Pro forma sales for the second quarter of 2004 for AirComp totaled \$2,554,000, compared to pro forma sales in the second quarter of 2003 of \$2,034,000. The pro forma sales in 2004 for AirComp increased \$520,000 due to increased drilling activity in West Texas and a slight increase in activity in the San Juan basin over the same period in 2003.

Pro forma gross profit, as a percentage of sales, was 27.5% for the quarter ended June 30, 2004 compared with a pro forma gross profit of 20.0 % for the quarter ended June 30, 2003. The gross profit percentage increased as a result of increased revenues and service pricing in the Directional Drilling Services segments. Because we have made significant investments in equipment and have a constant number of operations personnel, many of our costs of revenues are relatively fixed, and as a result, our gross profit margins are significantly impacted by either increases or decreases in pricing structures and revenues.

Pro forma general and administrative expense was \$1,853,000 in 2004 compared with \$1,020,000 in 2003. The pro forma general and administrative expense increased in 2004 compared to 2003 due to the additional administrative costs associated with AirComp and the hiring of additional sales force and administrative personnel at each of the Company's subsidiaries to meet increased demand for our services and due to increased professional fees and other expenses related to the Company's financing activities.

The Company had pro forma operating income for the second quarter of 2004 of \$1,229,000, an increase of 98.2% as compared to pro forma operating income of \$620,000 in the second quarter of 2003. The increase in pro forma operating income for 2004 was primarily due to higher revenues resulting from the overall upturn in the petroleum industry.

The Company had a pro forma net income of \$434,000, or \$0.07 per common share, for the quarter ended June 30, 2004 compared with a pro forma net loss of (\$612,000), or (\$0.16) per common share, for the quarter ended June 30 2003.

### SIX MONTHS ENDED JUNE 30, 2004 COMPARED TO JUNE 30, 2003:

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Our revenues for the six months ended June 30, 2004 were \$21,083,000, an

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increase of 47.0% compared to \$14,339,000 for the second quarter of 2003. The increase in revenues for the six months ended June 30, 2004 was principally due to the inclusion of the revenues of Aircomp, our joint venture with M-I formed in July 2003, and an increase in revenues for our Directional Drilling Services, offset in part by a decrease in revenues in our Casing Services segment. Revenues for the six months ended June 30, 2004 for the Casing Services, Directional Drilling Services and Compressed Air Drilling were \$4,386,000, \$11,675,000, and \$5,022,000, respectively, compared to \$ 5,153,000, \$6,983,000, and \$2,203,000, respectively, for the six months ended June 30, 2003. Revenues for the Casing Services segment decreased \$767,000, or 14.9%, for the first six months of 2004, compared to the first six months of 2003, due to an increased competitive environment in South Texas and a decrease in drilling in Mexico by PEMEX due to bad weather. Our revenues from Directional Drilling Services increased \$4,692,000, or 67.2%, for the six months of 2004 compared to the year-ago period, due to an increase in demand for our services and our increased penetration of the Gulf Coast area. Revenues for the Compressed Air Drilling Services segment increased \$2,819,000, or 128.0% during the six months of 2004 compared to the six months of 2003, principally due to the formation of Aircomp, our joint venture company with M-I. Through Aircomp, we were able to expand the geographical areas in which we operate to include geothermal drilling in California and natural gas drilling in West Texas.

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Gross profit, as a percentage of sales, was 25.4% for the six months ended June 30, 2004 compared with 27.4% for the six months ended June 30, 2003. The gross profit percentage decreased as a result of relatively fixed direct costs and decreased service pricing in the Casing Services and Compressed Air Drilling Services segments offset by increased revenues and pricing in the Directional Drilling segment. Because we have made significant investments in equipment and have a constant number of operations personnel, many of our costs of revenues are relatively fixed, and as a result, our gross profit margins are significantly impacted by either increases or decreases in pricing structures or revenues.

General and administrative expense was \$2,956,000 in 2004 compared with \$2,001,000 in 2003. General and administrative expense increased in 2004 compared to 2003 due to the additional administrative costs associated with AirComp and the hiring of additional sales force and administrative personnel at each of the Company's subsidiaries to meet increased demand for our services and due to increased professional fees and other expenses related to the Company's financing activities.

Operating income for the six months ended June 30, 2004 totaled \$2,398,000, a 24.1% increase over the comparable period in 2003, reflecting the inclusion of operating income of AirComp and the increased revenues from Directional Drilling Services, offset in part by a decrease in revenues in our Casing Services segment. In the comparable period of 2003, operating income was \$1,933,000. Operating income (loss) for the six months ended June 30, 2004 for the Casing Services, Directional Drilling Services, Compressed Air Drilling Services and General Corporate segments were \$1,225,000, \$1,389,000, \$812,000 and (\$1,028,000), respectively. Operating income (loss) for the six months ended June 30, 2003 for the Casing Services, Directional Drilling Services, Compressed Air Drilling Services and General Corporate segments were \$2,227,000, \$511,000, (\$36,000) and (\$769,000), respectively. Operating income for the Casing Services decreased approximately \$1,009,000 due reduced revenues. Operating income for Directional Drilling Services increased approximately \$878,000 due to an increase in demand for our services and increased penetration of the Gulf Coast

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area. Compressed Air Drilling Services increased approximately \$848,000 due the expanded geographical areas in which AirComp operates. General Corporate segments decreased approximately (\$259,000) due to increased professional fees and other expenses related to the Company's financing activities.

Our interest expense decreased to \$1,068,000 for the six months of 2004, compared to \$1,480,000 for the six months of the prior year due to the reduction of our debt.

We had a net income attributed to common shareholders of \$935,000, or \$0.18 per common share, for the six months ended June 30, 2004 compared with a net loss of (\$763,000), or (\$0.19) per common share, for the six months end June 30, 2003.

### PRO FORMA RESULTS

The following unaudited pro forma consolidated summary financial information illustrates the effects of the formation of AirComp on the Company's results of operations, based on the historical statements of operations, as if the transaction had occurred as of the beginning of the periods presented. Pro forma results of operations set forth below includes results of operations for the six months ended June 30, 2004 and 2003.

Pro forma revenues for the six months of 2004 totaled \$21,083,000, compared to pro forma sales in the six months of 2003 of \$16,061,000, an increase of approximately 31%. The increase in 2004 compared to 2003 was primarily due to higher revenues resulting from the overall upturn in the petroleum industry. Pro forma sales for the second six months of 2004 for AirComp totaled \$3,925,000, compared to pro forma sales in the second six months of 2003 of \$2,203,000. The pro forma sales in 2004 for AirComp increased \$1,722,000 due to increased drilling activity in West Texas and a slight increase in activity in the San Juan basin over the same period in 2003.

Pro forma gross profit, as a percentage of sales, was 25.4% for the six months ended June 30, 2004 compared with a pro forma gross margin of 31.0% for the six months ended June 30, 2003. The gross margin ratio decreased as a result of relatively fixed direct costs and decreased revenues and service pricing in the Casing Services and Compressed Air Drilling Services segments, offset in part by increased revenues and service pricing in the Directional Drilling segment. Because we have made significant investments in equipment and have a constant number of operations personnel, many of our costs of revenues are relatively fixed, and as a result, our gross profit margins are significantly impacted by either increases or decreases in revenues.

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Pro forma general and administrative expense was \$2,956,000 in 2004 compared with \$2,001,000 in 2003. The pro forma general and administrative expense increased in 2004 due to the overhead costs associated with AirComp and the hiring of additional sales force and administrative personnel at each of the Company's subsidiaries to meet increased demand in the market.

The Company had pro forma operating income for the first six months of 2004 of \$2,398,000, an increase of 8% as compared to pro forma operating income of \$2,206,000 in the first six months of 2003. The increase in pro forma operating income for 2004 was primarily due to higher revenues resulting from the overall upturn in the petroleum industry.

The Company incurred a pro forma net income of \$935,000, or \$0.18 per common

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share, for the six months ended June 30, 2004 compared with a pro forma net loss of (\$394,000), or (\$0.10) per common share, for the six months ended June 30 2003.

### SCHEDULE OF CONTRACTUAL OBLIGATIONS

The following table summarizes the Company's obligations and commitments to make future payments under its notes payable, operating leases, employment contracts and consulting agreements for the periods specified as of June 30, 2004.

CONTRACTUAL OBLIGATIONS -----	PAYMENTS DUE BY PERIOD			
	TOTAL -----	1 YEAR -----	2-3 YEARS -----	4-5 YEAR -----
Notes payable	\$ 31,011,000	\$ 7,608,000	\$ 13,051,000	\$ 10,352,000
Interest Payments on notes payable	2,016,000	495,000	848,000	673,000
Operating Lease	756,000	318,000	323,000	115,000
Employment Contracts	2,818,000	1,006,000	1,812,000	
	-----	-----	-----	-----
Total Contractual Cash Obligations	\$ 36,601,000	\$ 9,427,000	\$ 16,034,000	\$ 11,140,000
	=====	=====	=====	=====

### FINANCIAL CONDITION AND LIQUIDITY -----

Cash and cash equivalents totaled \$485,000 at June 30, 2004 compared to \$1,299,000 at December 31, 2003. The decrease in cash and cash equivalents was due to \$1,879,000 in purchases of equipment, \$1,331,000 of repayment of long-term debt, and \$211,000 of debt issuances costs offset in part by \$742,000 in net cash provided by operating activities and \$1,865,000 of net proceeds from the issuance of common stock.

Net trade receivables at June 30, 2004 were \$10,305,000 compared to \$8,823,000 at December 31, 2003, due to increased sales at Strata and AirComp.

Net property, plant and equipment were \$27,234,000 at June 30, 2004 compared to \$26,339,000 at December 31, 2003. The increase in net property, plant and equipment was due to the addition of approximately \$788,000 of downhole motors and other assets used in the operations at Strata, the addition of casing equipment of approximately \$425,000 at Jens', and capital repairs to the existing equipment of approximately \$664,000 at AirComp. Capital expenditures for the six months of 2004 were \$1,879,000 compared to capital expenditures for 2003 of \$821,000. Capital expenditures for the balance of 2004 are projected to be approximately \$3,100,000. We expect these expenditures will be funded from operating cash flows and lines of credit already in place available for capital projects.

Trade accounts payable at June 30, 2004 were \$3,391,000 as compared to \$3,133,000 at December 31, 2003. The increase was primarily due to increased operational expenses.

At June 30, 2004, other current liabilities, excluding the current portion of long-term debt and trade accounts payable, were \$2,762,000 consisting of

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interest in the amount of \$212,000, accrued salary and benefits in the amount of \$677,000, income taxes payable of \$45,000, accrued restructuring costs of \$98,000, related party payables of \$541,000, accrued operating expenses of \$1,153,000, and legal and professional expenses in the amount of \$36,000. Included in accrued restructuring costs was compensation in the amount of \$98,000 due to former employees of the Company. At December 31, 2003, other current liabilities, excluding the current portion of long-term debt and trade accounts payable, were \$3,291,000 consisting of interest in the amount of \$152,000, accrued salary and benefits in the amount of \$591,000, income taxes payable of \$45,000, accrued restructuring costs of \$296,000, related party payables of \$787,000, accrued operating expenses of \$1,358,000, and legal and professional expenses in the amount of \$62,000. Included in accrued restructuring costs was compensation in the amount of \$166,000 due to former employees of the Company. All of these balance sheet accounts decreased significantly from December 31, 2003 balances due to increased cash flow from operations.

Long-term debt including current maturities was \$31,011,000 at June 30, 2004 as compared to \$32,233,000 at December 31, 2003. The decrease in long-term debt resulted from scheduled principal repayments as well as a prepayment on Strata's vendor financed note of approximately \$637,000.

### CAPITAL REQUIREMENTS

Our long-term capital needs are to repay and/or refinance our existing debt, provide funds for existing operations, and to secure funds for acquisitions in the oil and gas equipment rental and services industry. In order to pay our debts as they become due, including the amounts due to the bank lenders described above, we will require additional financing, which may include the issuance of equity or debt securities, as well as secured and unsecured loans. See "Recent Developments" below for a discussion of capital transactions completed subsequent to June 30, 2004. In March 2004, we entered into an agreement with Morgan Joseph & Co. Inc. to assist us in restructuring our outstanding debt and to pursue an offering of its common stock. However, there can be no assurance that the Company will be successful in such efforts. Any new issuance of equity securities may further dilute existing shareholders.

### RECENT DEVELOPMENTS

The Company effected a reverse stock split on June 10, 2004 in order to increase the share price of the common stock. As a result of the reverse stock split, every five shares of the Company's common stock were combined into one share of common stock. The reverse stock split reduced the number of shares of outstanding common stock from 31,393,789 to approximately 6,265,000 and reduced the number of stockholders of the Company from approximately 6,070 to approximately 2,140. The Company currently has an application pending to list the Common Stock on the American Stock Exchange, which has an initial listing requirement that the Common Stock trade for a minimum of \$3.00 per share and certain other qualitative and quantitative listing requirements. There can be no assurance that the Company will be successful in listing the Common Stock on the American Stock Exchange.

On July 17, 2004 our Strata and Jens subsidiaries entered into amendments to their respective Wells Fargo Credit, Inc. credit agreements. The amendments provide for an increase in the permitted capital expenditures in 2004 by Strata, and also permitted additional indebtedness by Jens. Each of the amendments also included consents to a \$10.0 million to \$15.0 million equity offering by us and waived any requirement that the net proceeds be contributed to Strata or Jens and used to prepay outstanding borrowings under the credit facilities.

On August 10, 2004 we completed the private placement of 3,504,677 shares of our common stock at a price of \$3.00 per share. Net proceeds to us, after selling

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commissions and expenses, are estimated to be \$9.6 million. The private placement was structured as what is known as a "private investment in public equity" or "PIPE" offering, in which we issued shares pursuant to an exemption from the Securities Act of 1933, and have agreed to subsequently register the common stock under the Securities Act of 1933 to allow investors to resell the common stock in public markets.

We will use the net proceeds of the offering to reduce debt, for acquisitions, and for general corporate purposes. While we are in discussions and in the analysis phase with potential acquisition candidates, as of this date, the Company has not entered into definitive agreements with respect to any acquisition.

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### ITEM 4. CONTROLS AND PROCEDURES.

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES. Our chief executive officer and our chief accounting officer have evaluated the effectiveness of the Company's "disclosure controls and procedures" (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this Report (the "Evaluation Date"), and have concluded that, as of the Evaluation Date, our disclosure controls and procedures are effective in enabling us to record, process, summarize, and report information required to be included in our SEC filings within the required time period. Since the Evaluation Date, there have not been any significant changes in our internal controls, or in other factors that could significantly affect these controls subsequent to the Evaluation Date.

It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system will be met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events.

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## PART II

### ITEM 1. LEGAL PROCEEDINGS.

The Company is a defendant in an action (the "Action") brought in April 2004 (No. 04CV308) in the District Court of Mesa County Colorado by the former owner of Mountain Air Drilling Service Company, Inc. nka Pattongill & Murphy, Inc., from whom the Company's Mountain Compressed Air, Inc. ("MCA") acquired assets in 2001. The plaintiff seeks to accelerate payment of a note (the "Note") issued in connection with the acquisition and are seeking \$1,863,000 in damages (representing principal and interest due under the Note), on the basis that MCA has failed to provide financial statements required by the Note. The Company believes the claim is without merit because MCA no longer maintains separate financial statements and the Company provides plaintiff with the Company's publicly available financial statements. The financial statements disclose as a

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separate segment the operations of AirComp, which conducts business using the assets acquired from plaintiff. In addition, the rights of the holder of the Note are subordinated to certain senior lease obligations, and therefore even if the plaintiff had the right to accelerate the debt under the terms of the Note, the plaintiff is prevented from doing so pursuant to the terms of the subordination agreement until September, 2007, at which time the Note will mature by its terms. Finally, the Company has claims in the amount of \$12,000 for legal fees and other expenses that the plaintiff agreed to pay the Company in connection with the settlement of an earlier lawsuit involving the acquisition of assets from plaintiff.

### ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS.

On April 2, 2004, the Company completed the following transactions:

- o In exchange for an investment of \$2.0 million, the Company issued 620,000 shares of common stock for a purchase price equal to \$2.50 per share, and issued warrants to purchase 800,000 shares of common stock at an exercise price of \$2.50 per share, expiring on April 1, 2006, to an investor group (the "Investor Group") consisting of entities affiliated with Donald and Christopher Engel and directors Robert Nederlander and Leonard Toboroff. The aggregate purchase price for the common stock was \$1,550,000, and the aggregate purchase price for the warrants was \$450,000. The transaction did not involve a public offering and was exempt from registration under the Securities Act of 1933 pursuant to Regulation D of the Securities and Exchange Commission.
- o Energy Spectrum converted its 3,500,000 shares of Series A 10% Cumulative Convertible Preferred Stock, including accrued dividend rights, into 1,718,090 shares of common stock. The conversion of the preferred stock will have an impact on the earnings per share in future periods since the Company will not record any dividends. The transaction did not involve a public offering and was exempt from registration under the Securities Act of 1933 pursuant to Regulation D of the Securities and Exchange Commission.
- o The Company, the Investor Group, Energy Spectrum, and director Saeed Sheikh, and officers and directors Munawar H. Hidayatallah and Jens H. Mortensen entered into a stockholders agreement pursuant to which the parties have agreed to vote for the election to the board of directors of the Company three persons nominated by Energy Spectrum, two persons nominated by the Investor Group and one person nominated by Messrs. Hidayatallah, Mortensen and Sheikh. In addition, the parties and the Company agreed that in the event the Company has not effected a public offering of its shares prior to September 30, 2005, then, at the request of Energy Spectrum, the Company will retain an investment banking firm to identify candidates for a transaction involving the sale of the Company or its assets.

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### ITEM 6. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

#### (a) List of Documents Filed

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The Index to Financial Statements is included on page 2 of this report. Financial statements Schedules not included in this report have been omitted because they are not applicable or the required information is included in the Financial Statements or Notes thereto. The exhibits listed on the Exhibit Index located at Page 19 of this Quarterly Report are filed as part of this Form 10-Q.

#### (b) Reports on Form 8-K

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Reports on Form 8-K were filed on June 3, 2004 and on June 24, 2004.

### SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on August 16, 2004.

ALLIS-CHALMERS CORPORATION

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(Registrant)

/S/ MUNAWAR H. HIDAYATALLAH

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Munawar H. Hidayatallah  
Chief Executive Officer and Chairman

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### EXHIBIT INDEX

- 3.1 Amended and Restated Certificate of Incorporation of Allis-Chalmers Corporation.
- 3.4 Certificate of Amendment of Certificate of Incorporation filed with the Delaware Secretary of State on June 9, 2004.
- 4.1 Specimen Stock Certificate of Common Stock of Allis-Chalmers Corporation.
- 10.45 Fourth Amendment to Credit Agreement dated as of January 30, 2004, by and between Strata Directional Technologies, Inc., and Wells Fargo Credit Inc.
- 10.46 Second Amendment to Credit Agreement dated as of April 2, 2004, between AirComp, LLC and Wells Fargo Bank, NA.



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- 10.47 \*Employment Agreement dated as of April 1, 2004 between Registrant and Munawar H. Hidayatallah.
- 10.48 \*Employment Agreement dated as of April 1, 2004 between Registrant and David Wilde
- 10.49 Stock and Warrant Purchase Agreement dated April 2, 2004 by and among Registrant and Donald Engel, Christopher Engel and Leonard Toboroff.
- 10.50 Form of Warrant issued to Investors pursuant to Stock and Warrant Purchase Agreement dated April 2, 2004 by and among Registrant and Donald Engel, Christopher Engel and Leonard Toboroff.
- 10.51 Preferred Stock Conversion Agreement dated April 2, 2004 by and between Registrant and Energy Spectrum Partners LP
- 10.52 Amendment to Credit Agreement by and between Registrant and Wells Fargo Energy Capital dated April 2, 2004.
- 10.53 Fifth Amendment to Credit Agreement dated as of April 6, 2004, by and between Strata Directional Technology, Inc., and Wells Fargo Credit Inc.
- 10.54 Third Amendment to Credit Agreement dated as of April 6, 2004, by and between Jens Oilfield Service, Inc. and Wells Fargo Credit Inc.
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Accounting Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of the Chief Executive Officer and Chief Accounting Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

\* Compensation Plan or Arrangement