Allis Chalmers Energy Inc.
Form 10-Q
November 06, 2007

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

(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2007

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 1-2199

ALLIS-CHALMERS ENERGY INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**39-0126090**
(State or other jurisdiction of incorporation or organization)	(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

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 þ No 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 larger accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date. At October 31, 2007 there were 35,049,245 shares of common stock, par value $0.01 per share, outstanding.

ALLIS-CHALMERS ENERGY INC.
FORM 10-Q
For the Quarterly Period Ended September 30, 2007
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Form of Performance Award Agreement
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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ALLIS-CHALMERS ENERGY INC.
CONSOLIDATED CONDENSED BALANCE SHEETS
(in thousands, except for share and per share amounts)

	September 30, 2007 (unaudited)	December 31, 2006
Assets		
Cash and cash equivalents	$ 63,091	$ 39,745
Trade receivables, net	132,561	95,766
Inventories	31,832	28,615
Prepaid expenses and other	10,519	16,636
Total current assets	238,003	180,762
Property and equipment, net	601,434	554,258
Goodwill	130,326	125,835
Other intangible assets, net	30,929	32,840
Debt issuance costs, net	14,528	9,633
Other assets	5,054	4,998
Total assets	$ 1,020,274	$ 908,326
Liabilities and Stockholders Equity		
Current maturities of long-term debt	$ 7,579	$ 6,999
Trade accounts payable	27,118	25,666
Accrued salaries, benefits and payroll taxes	13,576	10,888
Accrued interest	6,774	11,867
Accrued expenses	27,132	16,951
Total current liabilities	82,179	72,371
Long-term debt, net of current maturities	508,858	561,446
Deferred income taxes	23,095	19,953
Other long-term liabilities	555	623
Total liabilities	614,687	654,393
Commitments and contingencies		
Stockholders Equity		
Preferred stock, $0.01 par value (25,000,000 shares authorized, no shares issued)		
	348	282

Common stock, $0.01 par value (100,000,000 shares authorized; 34,812,666 issued and outstanding at September 30, 2007 and 28,233,411 issued and outstanding at December 31, 2006)				
Capital in excess of par value		323,140		216,208
Retained earnings		82,099		37,443
Total stockholders equity		405,587		253,933
Total liabilities and stockholders equity	$	1,020,274	$	908,326

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

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ALLIS-CHALMERS ENERGY INC.
CONSOLIDATED CONDENSED INCOME STATEMENTS
(in thousands, except per share amounts)
(unaudited)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2007	**2006**	**2007**	**2006**
Revenues	$ 147,881	$ 86,772	$ 427,143	$ 196,066
Cost of revenues				
Direct costs	89,120	52,531	249,943	113,408
Depreciation	13,168	5,448	37,232	12,606
Total cost of revenues	102,288	57,979	287,175	126,014
Gross margin	45,593	28,793	139,968	70,052
General and administrative	13,456	9,058	41,729	24,540
Gain on capillary asset sale			(8,868)	
Amortization	989	399	3,015	1,212
Income from operations	31,148	19,336	104,092	44,300
Other income (expense):				
Interest expense	(11,805)	(5,330)	(37,671)	(13,342)
Interest income	851	388	2,718	515
Other	32	(26)	308	(6)
Total other income (expense)	(10,922)	(4,968)	(34,645)	(12,833)
Income before income taxes	20,226	14,368	69,447	31,467
Provision for taxes	(7,239)	(3,116)	(24,791)	(6,197)
Net income	$ 12,987	$ 11,252	$ 44,656	$ 25,270
Net income per common share:				
Basic	$ 0.37	$ 0.52	$ 1.32	$ 1.33
Diluted	$ 0.37	$ 0.50	$ 1.29	$ 1.25

Weighted average shares outstanding:				
Basic	34,784	21,644	33,934	18,944
Diluted	35,286	22,453	34,512	20,155

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

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ALLIS-CHALMERS ENERGY INC.
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	For the Nine Months Ended September 30, 2007	2006
Cash Flows from Operating Activities:		
Net income	$ 44,656	$ 25,270
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	40,247	13,818
Amortization and write-off of deferred financing fees	2,686	742
Imputed interest		355
Stock-based compensation expense	2,132	2,638
Allowance for bad debts	441	353
Deferred income taxes	3,142	494
(Gain) on sale of property and equipment	(1,085)	(728)
Gain on capillary asset sale	(8,868)	
Changes in operating assets and liabilities, net of acquisitions:		
(Increase) in trade receivable	(36,801)	(17,161)
(Increase) in inventories	(4,998)	(2,161)
Decrease in other current assets	10,551	1,322
Decrease in other assets	173	530
Increase (decrease) in accounts payable	1,326	(1,609)
(Decrease) increase in accrued interest	(5,093)	4,661
Increase in accrued expenses	9,957	2,516
Increase in accrued salaries, benefits and payroll taxes	2,412	3,110
(Decrease) in other long-term liabilities	(68)	(813)
Net Cash Provided By Operating Activities	60,810	33,337
Cash Flows from Investing Activities:		
Acquisition of businesses, net of cash received	(12,860)	(203,189)
Purchase of investment interests	(498)	
Proceeds from sale of capillary assets	16,250	
Proceeds from sale of property and equipment	5,988	3,516
Purchase of property and equipment	(86,087)	(25,811)
Net Cash Used In Investing Activities	(77,207)	(225,484)
Cash Flows from Financing Activities:		
Proceeds from issuance of stock, net	100,055	46,484
Proceeds from exercises of options and warrants	3,252	5,406
Proceeds from long-term debt	250,000	257,820
Proceeds from line of credit		5,000
Repayments on long-term debt	(307,542)	(51,712)

Repayments on related party debt		(3,031)
Repayments on line of credit		(11,400)
Tax benefits on stock plans	1,559	
Debt issuance costs	(7,581)	(8,029)
Net Cash Provided By Financing Activities	39,743	240,538
Net change in cash and cash equivalents	23,346	48,391
Cash and cash equivalents at beginning of year	39,745	1,920
Cash and cash equivalents at end of period	$ 63,091	$ 50,311

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

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ALLIS-CHALMERS ENERGY INC.

NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

NOTE 1 NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Allis-Chalmers Energy Inc. and its subsidiaries (Allis-Chalmers , we , our or us) is a multi-faceted oilfield service company that provides services and equipment to oil and natural gas exploration and production companies, throughout the United States including Texas, Louisiana, New Mexico, Colorado, Oklahoma, Mississippi, Wyoming, Arkansas, West Virginia, offshore in the Gulf of Mexico, and internationally, primarily in Argentina and Mexico. We operate in six sectors of the oil and natural gas service industry: Rental Services; International Drilling; Directional Drilling; Tubular Services; Underbalanced Drilling; and Production Services.

We derive operating revenues from rates per day and rates per job that we charge for the labor and equipment required to provide a service and rates per day for equipment and tools that we rent to our customers. The price we charge for our services depends upon several factors, including the level of oil and natural gas drilling activity and the competitive environment in the particular geographic regions in which we operate. Contracts are awarded based on price, quality of service and equipment and general reputation and experience of our personnel. The principal operating costs are direct and indirect labor and benefits, repairs and maintenance of our equipment, insurance, equipment rentals, fuel, depreciation and general and administrative expenses.

On October 25, 2006 our Board of Directors approved the transfer of the listing of our common stock from the American Stock Exchange (AMEX) to the New York Stock Exchange (NYSE). Our common stock continued to trade on the AMEX under the symbol ALY until the transfer was completed on March 22, 2007, at which time we began trading on the NYSE under the symbol ALY .

Basis of Presentation

Our unaudited consolidated condensed financial statements included herein have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission, or SEC. Accordingly, certain information and disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. We believe that the presentations and disclosures herein are adequate to make the information not misleading. The unaudited consolidated condensed financial statements reflect all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of the interim periods. These unaudited consolidated condensed financial statements should be read in conjunction with our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2006. The results of operations for the interim periods are not necessarily indicative of the results of operations to be expected for the full year.

Certain reclassifications have been made to the prior year s consolidated condensed financial statements to conform with the current period presentation.

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 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 perceived with certainty. Accordingly, our 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 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 our operating environment changes.

ALLIS-CHALMERS ENERGY INC.

NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

NOTE 1 NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48). FIN 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*. It prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. We adopted the provisions of FIN 48 effective January 1, 2007 and such adoption did not have a material effect on our financial statements.

Our policy is that we recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. As of the date of adoption of FIN 48, we did not have any accrued interest or penalties associated with any unrecognized tax benefits. For United States federal tax purposes, our tax returns for the tax years 2001 through 2006 remain open for examination by the tax authorities. Our foreign tax returns remain open for examination for the tax years 2001 through 2006. Generally, for state tax purposes, our 2002 through 2006 tax years remain open for examination by the tax authorities under a four year statute of limitations, however, certain states may keep their statute open for six to ten years.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157), which is intended to increase consistency and comparability in fair value measurements by defining fair value, establishing a framework for measuring fair value and expanding disclosures about fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We are currently evaluating the provisions of SFAS 157 and have not yet determined the impact, if any, on our financial statements.

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159), which permits entities to elect to measure many financial instruments and certain other items at fair value. Upon adoption of SFAS 159, an entity may elect the fair value option for eligible items that exist at the adoption date. Subsequent to the initial adoption, the election of the fair value option should only be made at the initial recognition of the asset or liability or upon a re-measurement event that gives rise to the new-basis of accounting. All subsequent changes in fair value for that instrument are reported in earnings. SFAS No. 159 does not affect any existing accounting literature that requires certain assets and liabilities to be recorded at fair value nor does it eliminate disclosure requirements included in other accounting standards. SFAS 159 is effective as of the beginning of each reporting entity s first fiscal year that begins after November 15, 2007. We are currently evaluating the provisions of SFAS 159 and have not yet determined the impact, if any, on our financial statements.

NOTE 2 ACQUISITIONS

In June 2007, we acquired Coker Directional, Inc., or Coker, for a purchase price of approximately $3.5 million in cash and a promissory note for $350,000. Coker operated in the Gulf Coast and Central Texas regions and will be included in our Directional Drilling segment.

In July 2007, we acquired Diggar Tools, LLC, or Diggar, for a purchase price of approximately $9.6 million in cash and a promissory note for $750,000. Diggar operated in the Rocky Mountains and owned 115 downhole motors and will be included in our Directional Drilling segment.

NOTE 3 SALE OF CAPILLARY ASSETS

On June 29, 2007, we sold our capillary tubing units and related equipment for approximately $16.3 million. We reported a gain of approximately $8.9 million. The assets sold represented a small portion of our Production Services segment. Our Production Services segment will continue to provide a variety of production-related rental tools, equipment and services.

ALLIS-CHALMERS ENERGY INC.

NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

NOTE 4 STOCK-BASED COMPENSATION

We adopted SFAS No. 123R, *Share-Based Payment*, effective January 1, 2006. This statement requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their grant-date fair values. Compensation cost for awards granted prior to, but not vested, as of January 1, 2006 would be based on the grant date attributes originally used to value those awards for pro forma purposes under SFAS No. 123. We adopted SFAS No. 123R using the modified prospective transition method, utilizing the Black-Scholes option pricing model for the calculation of the fair value of our employee stock options. Under the modified prospective method, we record compensation cost related to unvested stock awards as of December 31, 2005 by recognizing the unamortized grant date fair value of these awards over the remaining vesting periods of those awards with no change in historical reported earnings. We estimated forfeiture rates for the first nine months of 2007 and 2006 based on our historical experience

The Black-Scholes model incorporates assumptions to value stock-based awards. The risk-free rate of interest is the related U.S. Treasury yield curve for periods within the expected term of the option at the time of grant. The dividend yield on our common stock is assumed to be zero as we have historically not paid dividends and have no current plans to do so in the future. The expected volatility is based on historical volatility of our common stock.

Our net income for the three months ended September 30, 2007 and 2006 includes approximately $1.0 million and $860,000, respectively of compensation costs related to share-based payments. Our net income for the nine months ended September 30, 2007 and 2006 includes approximately $2.1 million and $2.6 million, respectively of compensation costs related to share-based payments. As of September 30, 2007 there is $2.8 million of unrecognized compensation expense related to non-vested stock option grants. We expect to recognize approximately $364,000 over the remainder of 2007, approximately $939,000, $918,000 and $532,000 to be recognized during the years ended 2008, 2009 and 2010, respectively.

A summary of our stock option activity and related information as of and for the nine months ended September 30, 2007 is as follows:

	Shares Under Option	Weighted Average Exercise Price	Weighted Average Contractual Life (Years)	Aggregate Intrinsic Value (millions)
Balance at beginning of period	1,350,365	$ 6.88		
Granted	220,000	21.83		
Canceled	(9,000)	6.89		
Exercised	(552,102)	5.89		
Outstanding at end of period	1,009,263	10.68	8.19	$ 8.34
Exercisable at end of period	626,931	$ 6.69	7.60	$ 7.68

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between the closing price of our common stock on the last trading day of the third quarter of 2007 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on September 30, 2007. The total intrinsic value of options exercised during the three and nine months ended September 30, 2007 was $362,000 and $6.5 million, respectively. The total cash received from

option exercises during the three and nine months ended September 30, 2007 was $114,000 and $3.2 million, respectively.

The following summarizes the assumptions used for the Black-Scholes model:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2007	**2006**	**2007**	**2006**
Expected dividend yield				
Expected price volatility	66.17%	72.28%	66.21%	72.28%
Risk free interest rate	4.82%	5.07%	4.81%	5.07%
Expected life of options	5 years	7 years	5 years	7 years
Weighted average fair value of options granted at market value	$12.90	$10.58	$12.86	$10.58

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ALLIS-CHALMERS ENERGY INC.
NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

NOTE 4 STOCK-BASED COMPENSATION (Continued)

For options granted since June 2007, we decreased the expected option life to 5 years from 7 years to reflect recent option exercise experience.

Restricted stock awards, or RSAs, activity during the nine months ended September 30, 2007 were as follows:

	Number of shares	Weighted Average Grant-Date Fair Value per Share
Nonvested at December 31, 2006	27,000	$ 18.30
Granted	831,200	17.34
Vested	(24,000)	18.30
Forfeited		
Nonvested at September 30, 2007	834,200	$ 17.34

We determine the fair value of RSAs based on the market price of our common stock on the date of grant. Compensation cost for RSAs is primarily recognized on a straight-line basis over the vesting or service period and is net of forfeitures. The total fair value of shares vested during the three and nine months ended September 30, 2007 was $485,000. As of September 30, 2007, there was approximately $13.4 million of total unrecognized compensation cost related to nonvested RSAs. We expect approximately $2.1 million to be recognized over the remainder of 2007, approximately $5.6 million, $4.5 million and $1.2 million to be recognized during the years ended 2008, 2009 and 2010, respectively.

NOTE 5 INCOME PER COMMON SHARE

We compute income per common share in accordance with the provisions of SFAS No. 128, *Earnings Per Share*. SFAS No. 128 requires companies with complex capital structures to present basic and diluted earnings per share. Basic earnings per share are computed on the basis of the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share is similar to basic earnings per share, but presents the dilutive effect on a per share basis of potential common shares (e.g., convertible preferred stock, stock options, etc.) as if they had been converted. Potential dilutive common shares that have an anti-dilutive effect (e.g., those that increase income per share) are excluded from diluted earnings per share.

The components of basic and diluted earnings per share are as follows (in thousands, except per share amounts):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2007	2006	2007	2006
Numerator:				
Net income	$ 12,987	$ 11,252	$ 44,656	$ 25,270
Denominator:				
Basic earnings per share weighted average shares outstanding	34,784	21,644	33,934	18,944
Effect of potentially dilutive common shares:				
	502	809	578	1,211

Warrants and employee and director stock options								
Diluted earnings per share weighted average shares outstanding and assumed conversions		35,286		22,453		34,512		20,155
Net income per share basic	$	0.37	$	0.52	$	1.32	$	1.33
Net income per share diluted	$	0.37	$	0.50	$	1.29	$	1.25

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ALLIS-CHALMERS ENERGY INC.
NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

NOTE 6 GOODWILL AND INTANGIBLE ASSETS

In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, goodwill and indefinite-lived intangible assets are not permitted to be amortized. Goodwill and indefinite-lived intangible assets remain on the balance sheet and are tested for impairment on an annual basis, or when there is reason to suspect that their values may have been diminished or impaired. Goodwill and indefinite-lived intangible assets listed on the balance sheet totaled $130.3 million and $125.8 million at September 30, 2007 and December 31, 2006, respectively. Based on impairment testing performed during 2006 pursuant to the requirements of SFAS No. 142, these assets were not impaired.

Intangible assets with definite lives continue to be amortized over their estimated useful lives. Definite-lived intangible assets that continue to be amortized under SFAS No. 142 relate to our purchase of customer-related and marketing-related intangibles. These intangibles have useful lives ranging from five to ten years. Amortization of intangible assets for the three and nine months ended September 30, 2007 were $989,000 and $3.0 million, respectively, compared to $399,000 and $1.2 million, respectively for the same periods in the prior year. At September 30, 2007, intangible assets totaled $30.9 million, net of $5.3 million of accumulated amortization.

NOTE 7 INVENTORIES

Inventories are comprised of the following (in thousands):

	September 30, 2007	December 31, 2006
Chemicals and drilling fluids	$ 2,822	$ 2,673
Coiled tubing and related inventory	1,827	1,627
Drive pipe	565	716
Finished goods	2,033	1,476
Hammers	1,245	1,016
Raw materials	3,955	2,638
Rental supplies	1,854	1,845
Rig parts and related inventory	10,385	9,762
Shop supplies and related inventory	5,190	4,596
Work in process	1,956	2,266
Total inventory	$ 31,832	$ 28,615

NOTE 8 DEBT

Our long-term debt consists of the following: (in thousands)

	September 30, 2007	December 31, 2006
Senior notes	$ 505,000	$ 255,000
Bridge loan		300,000
Bank term loans	5,484	7,302
Revolving line of credit		
Seller notes	1,850	900
Obligations under non-compete agreements	160	270
Notes payable to former directors	32	32
Equipment and vehicle installment notes	942	3,502

Insurance premium financing		2,927		1,025
Capital lease obligations		42		414
Total debt		516,437		568,445
Less: current maturities		7,579		6,999
Long-term debt obligations	$	508,858	$	561,446

ALLIS-CHALMERS ENERGY INC.
NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

NOTE 8 DEBT (continued)

Senior notes, bank loans and line of credit agreements

On January 18, 2006 and August 14, 2006, we closed on private offerings, to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933, of $160.0 and $95.0 million aggregate principal amount of our senior notes, respectively. The senior notes are due January 15, 2014 and bear interest at 9.0%. The proceeds were used to fund the acquisitions of Specialty Rental Tools, Inc., or Specialty, and DLS Drilling, Logistics & Services Corporation, or DLS, to repay existing debt and for general corporate purposes.

On January 18, 2006, we also executed an amended and restated credit agreement which provided for a $25.0 million revolving line of credit with a maturity of January 2010. Our January 2006 amended and restated credit agreement contained customary events of default and financial covenants and limits our ability to incur additional indebtedness, make capital expenditures, pay dividends or make other distributions, create liens and sell assets. Our obligations under the January 2006 amended and restated credit agreement were secured by substantially all of our assets located in the United States.

On December 18, 2006, we closed on a $300.0 million senior unsecured bridge loan. The bridge loan was due 18 months after closing and bore a weighted average interest rate of 10.6%. The bridge loan, which was repaid on January 29, 2007, was used to fund the acquisition of substantially all of the assets of Oil & Gas Rental Services, Inc., or OGR.

In January 2007, we closed on a private offering, to qualified institutional buyers pursuant to Rule 144A under the Securities Act, of $250.0 million principal amount of 8.5% senior notes due 2017. The proceeds of the senior notes offering, together with a portion of the proceeds of our concurrent common stock offering, were used to repay the debt outstanding under our $300.0 million bridge loan facility which we incurred to finance our acquisition of substantially all the assets of OGR.

On April 26, 2007, we entered into a Second Amended and Restated Credit Agreement, which increased our revolving line of credit to $62.0 million, and has a final maturity date of April 26, 2012. The amended and restated credit agreement contains customary events of default and financial covenants and limits our ability to incur additional indebtedness, make capital expenditures, pay dividends or make other distributions, create liens and sell assets. Our obligations under the amended and restated credit agreement are secured by substantially all of our assets located in the United States.

As part of our acquisition of DLS, we assumed various bank loans with floating interest rates based on LIBOR plus a margin and terms ranging from 2 to 5 years. The weighted average interest rates were 6.72% and 7.0% at September 30, 2007 and December 31, 2006, respectively. The bank loans are denominated in U.S. dollars and the outstanding amounts due as of September 30, 2007 and December 31, 2006 were $5.5 million and $7.3 million, respectively.

Notes payable

As part of the acquisition of Mountain Compressed Air Inc., or Mountain Air, in 2001, we issued a note to the sellers of Mountain Air in the original amount of $2.2 million accruing interest at a rate of 5.75% per annum. The note was reduced to $1.5 million as a result of the settlement of a legal action against the sellers in 2003. At September 30, 2007 and December 31, 2006 the outstanding amounts due were $0 and $150,000, respectively.

In connection with the acquisition of Rogers Oil Tool Services, Inc., or Rogers, we issued to the seller a note in the amount of $750,000. The note bears interest at 5.0% and is due April 3, 2009. In connection with the acquisition of Coker we issued to the seller a note in the amount of $350,000. The note bears interest at 8.25% and is due June 29, 2008. In connection with the acquisition of Diggar we issued to the seller a note in the amount of $750,000. The note bears interest at 6.0% and is due July 26, 2008.

In connection with the purchase of Safco-Oil Field Products, Inc., or Safco, we also agreed to pay a total of $150,000 to the sellers in exchange for a non-compete agreement. We are required to make annual payments of $50,000 through September 30, 2007. In connection with the purchase of Capcoil Tubing Services, Inc., or Capcoil, we agreed to pay a total of $500,000 to two management employees in exchange for non-compete agreements. We are required to make

annual payments of $110,000 through May 2008. Total amounts due under these non-compete agreements at September 30, 2007 and December 31, 2006 were $160,000 and $270,000, respectively.

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ALLIS-CHALMERS ENERGY INC.
NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

NOTE 8 DEBT (continued)

In 2000 we compensated directors, including current directors Nederlander and Toboroff, who served on the board of directors from 1989 to March 31, 1999 without compensation, by issuing promissory notes totaling $325,000. The notes bore interest at the rate of 5.0%. At September 30, 2007 and December 31, 2006, the principal and accrued interest on these notes totaled approximately $32,000.

Other debt

We have various equipment and vehicle financing loans with interest rates ranging from 7.85% to 8.7% and terms of 2 to 3 years. As of September 30, 2007 and December 31, 2006, the outstanding balances for equipment and vehicle financing loans were $942,000 and $3.5 million, respectively. In April 2006 and August 2006, we obtained insurance premium financings in the amount of $1.9 million and $896,000 with fixed interest rates of 5.6% and 6.0%, respectively. Under terms of the agreements, amounts outstanding are paid over 10 month and 11 month repayment schedules. In April 2007, we renewed the insurance premium financing in an amount of $3.2 million with a fixed interest rate of 5.9% and a repayment schedule of 11 months. The outstanding balance of these notes was approximately $2.9 million and $1.0 million as of September 30, 2007 and December 31, 2006, respectively. We also have various capital leases with terms that expire in 2008. As of September 30, 2007 and December 31, 2006, amounts outstanding under capital leases were $42,000 and $414,000, respectively.

NOTE 9 STOCKHOLDERS EQUITY

In January 2007 we closed on a public offering of 6.0 million shares of our common stock at a public offering price of $17.65 per share. Net proceeds from the public offering, together with the proceeds of our concurrent senior notes offering, were used to repay the debt outstanding under our $300.0 million bridge loan facility, which we incurred to finance the OGR acquisition and for general corporate purposes.

We also had options and warrants exercised in the first nine months of 2007, which resulted in 579,255 shares of our common stock being issued for approximately $3.2 million. We recognized approximately $2.1 million of compensation expense related to share based payments in the first nine months of 2007 that was recorded as capital in excess of par value (see Note 4). We also recorded approximately $1.6 million of tax benefit related to our stock compensation plans.

NOTE 10 CONDENSED CONSOLIDATING FINANCIAL INFORMATION

Set forth on the following pages are the condensed consolidating financial statements of (i) Allis-Chalmers Energy Inc., (ii) its subsidiaries that are guarantors of the senior notes and revolving credit facility and (iii) the subsidiaries that are not guarantors of the senior notes and revolving credit facility (in thousands, except for share and per share amounts). Prior to the acquisition of DLS, all of our subsidiaries were guarantors of our senior notes and revolving credit facility, the parent company had no independent assets or operations, the guarantees were full and unconditional and joint and several.

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ALLIS-CHALMERS ENERGY INC.
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NOTE 10 CONDENSED CONSOLIDATING FINANCIAL INFORMATION (Continued)
CONDENSED CONSOLIDATING BALANCE SHEETS
September 30, 2007 (unaudited)

	Allis-Chalmers (Parent/ Guarantor)	Subsidiary Guarantors	Subsidiary Non-Guarantors	Consolidating Adjustments	Consolidated Total
Assets					
Cash and cash equivalents	$	$ 61,260	$ 1,831	$	$ 63,091
Trade receivables, net		83,759	48,806	(4)	132,561
Inventory		15,435	16,397		31,832
Intercompany receivables	82,001			(82,001)	
Note receivable from affiliate	7,406			(7,406)	
Prepaid expenses and other	5,417	3,064	2,038		10,519
Total current assets	94,824	163,518	69,072	(89,411)	238,003
Property and equipment, net		460,905	140,529		601,434
Goodwill		128,803	1,523		130,326
Other intangible assets, net	563	30,302	64		30,929
Debt issuance costs, net	14,528				14,528
Note receivable from affiliates	8,895			(8,895)	
Investments in affiliates	805,066			(805,066)	
Other assets	23	4,989	42		5,054
Total Assets	$ 923,899	$ 788,517	$ 211,230	$ (903,372)	$ 1,020,274
Liabilities and Stockholders Equity					
Current maturities of long-term debt	$ 32	$ 5,171	$ 2,376	$	$ 7,579
Trade accounts payable		12,158	14,964	(4)	27,118
Accrued salaries, benefits and payroll taxes		2,559	11,017		13,576
Accrued interest	6,705	15	54		6,774
Accrued expenses	432	15,906	10,794		27,132
Intercompany payables		438,534	1,185	(439,719)	
Note payable to affiliate			7,406	(7,406)	
Total current liabilities	7,169	474,343	47,796	(447,129)	82,179
Long-term debt, net of current maturities	505,750		3,108		508,858
Note payable to affiliate			8,895	(8,895)	
Deferred income taxes	5,110	10,714	7,271		23,095
Other long-term liabilities	283	272			555

Total liabilities	518,312	485,329	67,070	(456,024)	614,687
Commitments and contingencies					
Stockholders Equity					
Common stock	348	3,526	42,963	(46,489)	348
Capital in excess of par value	323,140	167,508	74,969	(242,477)	323,140
Retained earnings	82,099	132,154	26,228	(158,382)	82,099
Total stockholders equity	405,587	303,188	144,160	(447,348)	405,587
Total liabilities and stockholder s equity	$ 923,899	$ 788,517	$ 211,230	$ (903,372)	$ 1,020,274

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ALLIS-CHALMERS ENERGY INC.
NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
NOTE 10 CONDENSED CONSOLIDATING FINANCIAL INFORMATION (Continued)
CONDENSED CONSOLIDATING BALANCE SHEETS
December 31, 2006

	Allis-Chalmers (Parent/ Guarantor)	Subsidiary Guarantors	Subsidiary Non-Guarantors	Consolidating Adjustments	Consolidated Total
Assets					
Cash and cash equivalents	$	$ 37,769	$ 1,976	$	$ 39,745
Trade receivables, net		62,089	33,971	(294)	95,766
Inventory		13,194	15,421		28,615
Intercompany receivables	67,909			(67,909)	
Note receivable from affiliate	5,502			(5,502)	
Prepaid expenses and other	5,703	10,200	733		16,636
Total current assets	79,114	123,252	52,101	(73,705)	180,762
Property and equipment, net		422,297	131,961		554,258
Goodwill		124,331	1,504		125,835
Other intangible assets, net	598	32,153	89		32,840
Debt issuance costs, net	9,633				9,633
Note receivable from affiliates	12,339			(12,339)	
Investments in affiliates	722,202			(722,202)	
Other assets	257	4,719	22		4,998
Total assets	$ 824,143	$ 706,752	$ 185,677	$ (808,246)	$ 908,326
Liabilities and Stockholders Equity					
Current maturities of long-term debt	$ 32	$ 3,809	$ 3,158	$	$ 6,999
Trade accounts payable	31	13,510	12,125		25,666
Accrued salaries, benefits and payroll taxes		2,993	7,895		10,888
Accrued interest	11,755		112		11,867
Accrued expenses	135	9,247	7,863	(294)	16,951
Intercompany payables		425,610	17	(425,627)	
Note payable to affiliate			5,502	(5,502)	
Total current liabilities	11,953	455,169	36,672	(431,423)	72,371
Long-term debt, net of current maturities	555,750	770	4,926		561,446
Note payable to affiliate			12,339	(12,339)	
Deferred income tax liability	2,203	10,714	7,036		19,953
Other long-term liabilities	304	319			623

Total liabilities	570,210	466,972	60,973	(443,762)	654,393
Commitments and contingencies					
Stockholders Equity					
Common stock	282	3,526	42,963	(46,489)	282
Capital in excess of par value	216,208	167,508	74,969	(242,477)	216,208
Retained earnings	37,443	68,746	6,772	(75,518)	37,443
Total stockholders equity	253,933	239,780	124,704	(364,484)	253,933
Total liabilities and stock holders equity	$ 824,143	$ 706,752	$ 185,677	$ (808,246)	$ 908,326

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NOTE 10 CONDENSED CONSOLIDATING FINANCIAL INFORMATION (Continued)
CONDENSED CONSOLIDATING INCOME STATEMENTS
For the Nine Months Ended September 30, 2007 (unaudited)

	Allis-Chalmers (Parent/ Guarantor)	Subsidiary Guarantors	Subsidiary Non-Guarantors	Consolidating Adjustments	Consolidated Total
Revenues	$	$ 266,883	$ 160,295	$ (35)	$ 427,143
Cost of revenues					
Direct costs		134,492	115,486	(35)	249,943
Depreciation		28,929	8,303		37,232
Total cost of revenues		163,421	123,789	(35)	287,175
Gross margin		103,462	36,506		139,968
General and administrative	1,856	33,486	6,387		41,729
Gain on capillary asset sale		(8,868)			(8,868)
Amortization	35	2,955	25		3,015
Income from operations	(1,891)	75,889	30,094		104,092
Other income (expense):					
Equity earnings in affiliates, net of tax	82,864			(82,864)	
Interest, net	(36,356)	2,364	(961)		(34,953)
Other	39	224	45		308
Total other income (expense)	46,547	2,588	(916)	(82,864)	(34,645)
Net income before income taxes	44,656	78,477	29,178	(82,864)	69,447
Provision for income taxes		(15,069)	(9,722)		(24,791)
Net income	$ 44,656	$ 63,408	$ 19,456	$ (82,864)	$ 44,656

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ALLIS-CHALMERS ENERGY INC.
NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
NOTE 10 CONDENSED CONSOLIDATING FINANCIAL INFORMATION (Continued)
CONDENSED CONSOLIDATING INCOME STATEMENTS
For the Three Months Ended September 30, 2007 (unaudited)

	Allis-Chalmers (Parent/ Guarantor)	Subsidiary Guarantors	Subsidiary Non-Guarantors	Consolidating Adjustments	Consolidated Total
Revenues	$	$ 89,343	$ 58,546	$ (8)	$ 147,881
Cost of revenues					
Direct costs		45,943	43,185	(8)	89,120
Depreciation		10,296	2,872		13,168
Total cost of revenues		56,239	46,057	(8)	102,288
Gross margin		33,104	12,489		45,593
General and administrative	839	10,398	2,219		13,456
Amortization	12	969	8		989
Income from operations	(851)	21,737	10,262		31,148
Other income (expense):					
Equity earnings in affiliates, net of tax	25,235			(25,235)	
Interest, net	(11,411)	736	(279)		(10,954)
Other	14	109	(91)		32
Total other income (expense)	13,838	845	(370)	(25,235)	(10,922)
Net income before income taxes	12,987	22,582	9,892	(25,235)	20,226
Provision for income taxes		(4,057)	(3,182)		(7,239)
Net income	$ 12,987	$ 18,525	$ 6,710	$ (25,235)	$ 12,987

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NOTE 10 CONDENSED CONSOLIDATING FINANCIAL INFORMATION (Continued)
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For the Nine Months Ended September 30, 2006 (unaudited)

	Allis-Chalmers (Parent/ Guarantor)	Subsidiary Guarantors	Subsidiary Non-Guarantors	Consolidating Adjustments	Consolidated Total
Revenues	$	$ 172,213	$ 23,853	$	$ 196,066
Cost of revenues					
Direct costs		96,084	17,324		113,408
Depreciation		11,107	1,499		12,606
Total cost of revenues		107,191	18,823		126,014
Gross margin		65,022	5,030		70,052
General and administrative	2,032	21,621	887		24,540
Amortization	35	1,174	3		1,212
Income from operations	(2,067)	42,227	4,140		44,300
Other income (expense):					
Equity earnings in affiliates, net of tax	39,644			(39,644)	
Interest, net	(12,343)	(261)	(223)		(12,827)
Other	36	(25)	(17)		(6)
Total other income (expense)	27,337	(286)	(240)	(39,644)	(12,833)
Net income before income taxes	25,270	41,941	3,900	(39,644)	31,467
Provision for income taxes		(4,957)	(1,240)		(6,197)
Net income	$ 25,270	$ 36,984	$ 2,660	$ (39,644)	$ 25,270

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NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
NOTE 10 CONDENSED CONSOLIDATING FINANCIAL INFORMATION (Continued)
CONDENSED CONSOLIDATING INCOME STATEMENTS
For the Three Months Ended September 30, 2006 (unaudited)

	Allis-Chalmers (Parent/ Guarantor)	Subsidiary Guarantors	Subsidiary Non- Guarantors	Consolidating Adjustments	Consolidated Total
Revenues	$	$ 62,919	$ 23,853	$	$ 86,772
Cost of revenues					
Direct costs		35,207	17,324		52,531
Depreciation		3,949	1,499		5,448
Total cost of revenues		39,156	18,823		57,979
Gross margin		23,763	5,030		28,793
General and administrative	637	7,534	887		9,058
Amortization	11	385	3		399
Income from operations	(648)	15,844	4,140		19,336
Other income (expense):					
Equity earnings in affiliates, net of tax	16,872			(16,872)	
Interest, net	(4,983)	264	(223)		(4,942)
Other	11	(20)	(17)		(26)
Total other income (expense)	11,900	244	(240)	(16,872)	(4,968)
Net income before income taxes	11,252	16,088	3,900	(16,872)	14,368
Provision for income taxes		(1,876)	(1,240)		(3,116)
Net income	$ 11,252	$ 14,212	$ 2,660	$ (16,872)	$ 11,252

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NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
NOTE 10 CONDENSED CONSOLIDATING FINANCIAL INFORMATION (Continued)
CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOW
For the Nine Months Ended September 30, 2007 (unaudited)

	Allis-Chalmers (Parent/ Guarantor)	Subsidiary Guarantors	Other Subsidiaries (Non-Guarantors)	Consolidating Adjustments	Consolidated Total
Cash Flows from Operating Activities:					
Net income	$ 44,656	$ 63,408	$ 19,456	$ (82,864)	$ 44,656
Adjustments to reconcile net income to net cash provided by (used in) operating activities:					
Depreciation and amortization	35	31,884	8,328		40,247
Amortization and write-off of deferred financing fees	2,686				2,686
Stock-based compensation expense	2,132				2,132
Allowance for bad debts		441			441
Equity earnings in affiliates	(82,864)			82,864	
Deferred income taxes	2,907		235		3,142
(Gain) on sale of equipment		(1,011)	(74)		(1,085)
(Gain) on capillary asset sale		(8,868)			(8,868)
Changes in operating assets and liabilities, net of acquisitions:					
(Increase) in trade receivables		(21,966)	(14,835)		(36,801)
(Increase) in inventories		(4,022)	(976)		(4,998)
(Increase) decrease in other current assets	286	11,570	(1,305)		10,551
(Increase) decrease in other assets	234	(22)	(39)		173
(Decrease) increase in accounts payable	(31)	(1,482)	2,839		1,326
(Decrease) increase in accrued interest	(5,050)	15	(58)		(5,093)
Increase in accrued expenses	297	6,729	2,931		9,957
(Decrease) increase in accrued salaries, benefits and payroll taxes		(710)	3,122		2,412
(Decrease) in other long- term liabilities	(21)	(47)			(68)
Net Cash Provided By (Used In) Operating Activities	(34,733)	75,919	19,624		60,810
Cash Flows from Investing Activities:					
Notes receivable from affiliates	1,540			(1,540)	
Acquisition of businesses, net of cash received		(12,860)			(12,860)
Purchase of investment interests		(498)			(498)
Proceeds from sale of capillary assets		16,250			16,250
Proceeds from sale of property and equipment		5,910	78		5,988
Purchase of property and equipment		(69,212)	(16,875)		(86,087)
Net Cash Provided By (Used in) Investing Activities	1,540	(60,410)	(16,797)	(1,540)	(77,207)

Cash Flows from Financing Activities:					
Proceeds from long-term debt	250,000				250,000
Payments on long-term debt	(300,000)	(4,942)	(2,600)		(307,542)

ALLIS-CHALMERS ENERGY INC.
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NOTE 10 CONDENSED CONSOLIDATING FINANCIAL INFORMATION (Continued)
CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOW

	Allis-Chalmers (Parent/ Guarantor)	Subsidiary Guarantors	Other Subsidiaries (Non-Guarantors)	Consolidating Adjustments	Consolidated Total
Cash Flows from Financing Activities: (continued)					
Accounts receivable from affiliates	(14,092)			14,092	
Accounts payable to affiliates		12,924	1,168	(14,092)	
Note payable to affiliate			(1,540)	1,540	
Proceeds from issuance of common stock	100,055				100,055
Proceeds from exercises of options and warrants	3,252				3,252
Tax benefits on stock plans	1,559				1,559
Debt issuance costs	(7,581)				(7,581)
Net Cash Provided By (Used In) Financing Activities	33,193	7,982	(2,972)	1,540	39,743
Net change in cash and cash equivalents		23,491	(145)		23,346
Cash and cash equivalents at beginning of year		37,769	1,976		39,745
Cash and cash equivalents at end of period	$	$ 61,260	$ 1,831	$	$ 63,091

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NOTE 10 CONDENSED CONSOLIDATING FINANCIAL INFORMATION (Continued)
CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOW
September 30, 2006 (unaudited)

	Allis-Chalmers (Parent/ Guarantor)	Subsidiary Guarantors	Other Subsidiaries (Non-Guarantors)	Consolidating Adjustments	Consolidated Total
Cash Flows from Operating Activities:					
Net income	$ 25,270	$ 36,984	$ 2,660	$ (39,644)	$ 25,270
Adjustments to reconcile net income to net cash provided by (used in) operating activities:					
Depreciation and amortization	35	12,281	1,502		13,818
Amortization of deferred financing fees	742				742
Imputed interest		355			355
Stock-based compensation expense	1,655	983			2,638
Allowance for bad debts		353			353
Equity earnings in affiliates	(39,644)			39,644	
Deferred taxes	281	213			494
(Gain) loss on sale of equipment		(729)	1		(728)
Changes in operating assets and liabilities, net of acquisitions:					
(Increase) decrease in trade receivables		(17,883)	722		(17,161)
(Increase) decrease in inventory		(2,325)	164		(2,161)
Decrease in other current assets	396	660	266		1,322
Decrease (increase) in other assets	548	82	(100)		530
(Decrease) in accounts payable	(82)	(1,159)	(368)		(1,609)
Increase (decrease) in accrued interest	4,703	(42)			4,661
(Decrease) increase in accrued expenses	(387)	3,560	(657)		2,516
(Decrease) increase in accrued salaries, benefits and payroll taxes	(1,957)	2,988	2,079		3,110
Increase in other long- term liabilities	(31)	(782)			(813)
Net Cash Provided By (Used In) Operating Activities	(8,471)	35,539	6,269		33,337
Cash Flows from Investing Activities:					

Acquisition of businesses, net of cash	(191,940)	(11,667)	418		(203,189)
Notes receivable from affiliates	1,005			(1,005)	
Proceeds from sale of equipment		3,516			3,516
Purchase of property and equipment		(22,721)	(3,090)		(25,811)
Net Cash Used In Investing Activities	(190,935)	(30,872)	(2,672)	(1,005)	(225,484)
Cash Flows from Financing Activities:					
Proceeds from exercises of options/warrants	5,406				5,406
Proceeds from issuance of common stock	46,484				46,484
Accounts receivable from affiliates	(51,691)			51,691	

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ALLIS-CHALMERS ENERGY INC.
NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
NOTE 10 CONDENSED CONSOLIDATING FINANCIAL INFORMATION (Continued)
CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOW
September 30, 2006 (unaudited)

	Allis-Chalmers (Parent/ Guarantor)	Subsidiary Guarantors	Other Subsidiaries (Non-Guarantors)	Consolidating Adjustments	Consolidated Total
Cash Flows from Financing Activities: (continued)					
Accounts payable to affiliates		51,691		(51,691)	
Note payable to affiliate			(1,005)	1,005	
Proceeds from long-term debt	256,064	1,756			257,820
Proceeds from line of credit	5,000				5,000
Repayments on long-term debt	(43,478)	(7,274)	(960)		(51,712)
Repayments on related party debt		(3,031)			(3,031)
Repayments on line of credit	(11,400)				(11,400)
Debt issuance costs	(8,029)				(8,029)
Net Cash Provided By (Used In) Financing Activities	198,356	43,142	(1,965)	1,005	240,538
Net change in cash and cash equivalents	(1,050)	47,809	1,632		48,391
Cash and cash equivalents at beginning of year	1,050	870			1,920
Cash and cash equivalents at end of period	$	$ 48,679	$ 1,632	$	$ 50,311

NOTE 11 SUPPLEMENTAL CASH FLOW INFORMATION

	For the Nine Months Ended September 30, 2007	2006
	(in thousands)	
Cash paid for interest and income taxes:		
Interest	$40,493	$ 7,584
Income taxes	8,639	6,171
Non cash activities:		
Insurance premium financed	4,434	2,871
Common stock issued for acquisition of business		39,795
Notes payable issued for acquisition of businesses	1,100	750
Non-compete payable in the future		250

ALLIS-CHALMERS ENERGY INC.
NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

NOTE 12 SEGMENT INFORMATION

At September 30, 2007, we had six operating segments: Rental Services, International Drilling, Directional Drilling, Tubular Services, Underbalanced Drilling and Production Services. All of the segments provide services to the energy industry. The revenues, operating income (loss), depreciation and amortization, capital expenditures and identifiable assets of each of the reporting segments, plus the corporate function, are reported below (in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2007	2006	2007	2006
Revenues				
Rental Services	$ 28,903	$ 13,203	$ 92,863	$ 36,331
International Drilling	58,546	23,853	160,295	23,853
Directional Drilling	27,556	19,996	69,352	55,161
Tubular Services	12,582	13,762	41,029	37,790
Underbalanced Drilling	12,927	12,000	36,448	32,048
Production Services	7,367	3,958	27,156	10,883
	$ 147,881	$ 86,772	$ 427,143	$ 196,066
Operating Income (Loss):				
Rental Services	$ 12,519	$ 6,575	$ 41,212	$ 18,881
International Drilling	10,262	4,139	30,094	4,139
Directional Drilling	5,963	5,125	14,252	12,097
Tubular Services	2,313	3,734	8,673	9,899
Underbalanced Drilling	3,104	3,176	9,240	8,617
Production Services	402	119	11,904	737
General corporate	(3,415)	(3,532)	(11,283)	(10,070)
	$ 31,148	$ 19,336	$ 104,092	$ 44,300
Depreciation and Amortization:				
Rental Services	$ 6,841	$ 1,735	$ 19,592	$ 5,121
International Drilling	2,880	1,502	8,328	1,502
Directional Drilling	837	406	1,849	1,054
Tubular Services	1,298	968	3,734	2,736
Underbalanced Drilling	942	821	2,604	2,236
Production Services	1,224	329	3,779	921
General corporate	135	86	361	248
	$ 14,157	$ 5,847	$ 40,247	$ 13,818

Capital Expenditures:				
Rental Services	$ 12,174	$ 1,715	$ 31,056	$ 2,816
International Drilling	11,005	3,090	16,875	3,090
Directional Drilling	800	384	6,741	3,789
Tubular Services	2,103	2,300	6,861	7,800
Underbalanced Drilling	8,725	3,286	15,250	6,302
Production Services	3,987	686	8,617	1,732
General corporate	112	104	687	282
	$ 38,906	$ 11,565	$ 86,087	$ 25,811

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ALLIS-CHALMERS ENERGY INC.
NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
NOTE 12 SEGMENT INFORMATION (Continued)

	As of September 30, 2007	As of December 31, 2006
Goodwill:		
Rental Services	$ 106,382	$ 106,132
International Drilling	1,523	1,504
Directional Drilling	8,689	4,168
Tubular Services	6,103	6,464
Underbalanced Drilling	3,950	3,950
Production Services	3,679	3,617
General corporate		
	$ 130,326	$ 125,835
Identifiable Assets:		
Rental Services	$ 462,178	$ 453,802
International Drilling	211,230	185,677
Directional Drilling	58,254	28,585
Tubular Services	77,859	74,372
Underbalanced Drilling	69,833	54,288
Production Services	56,934	57,954
General corporate	83,986	53,648
	$ 1,020,274	$ 908,326
Long Lived Assets:		
United States	$ 628,232	$ 574,302
International	154,039	153,262
	$ 782,271	$ 727,564

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2007	2006	2007	2006
Revenues:				
United States	$ 85,160	$ 61,142	$ 255,626	$ 166,600
International	62,721	25,630	171,517	29,466

	$ 147,881	$ 86,772	$ 427,143	$ 196,066

NOTE 13 LEGAL MATTERS

We are named from time to time in legal proceedings related to our activities prior to our bankruptcy in 1988. However, we believe that we were discharged from liability for all such claims in the bankruptcy and believe the likelihood of a material loss relating to any such legal proceeding is remote.

We are also involved in various other legal proceedings in the ordinary course of business. The legal proceedings are at different stages; however, we believe that the likelihood of material loss relating to any such legal proceeding is remote.

NOTE 14 SUBSEQUENT EVENTS

On October 23, 2007, we purchased all of the issued and outstanding stock of Rebel Rentals, Inc., or Rebel Rentals, for an aggregate purchase price of $6.75 million. The acquisition of Rebel Rentals adds additional equipment and support to our casing and tubing operations in our Tubular Services segment.

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ALLIS-CHALMERS ENERGY INC.
NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

NOTE 14 SUBSEQUENT EVENTS (continued)

On November 1, 2007, we purchased substantially all the assets of Diamondback Oilfield Services, Inc., or Diamondback, for a purchase price of $22.0 million. This acquisition expands the operations of Allis-Chalmers Directional Drilling segment further into the Texas Panhandle and Oklahoma. The acquisition of Diamondback adds additional personnel and equipment, including approximately 18 directional drillers, 30 downhole motors, five measurement-while-drilling tools, and eight wireline steering vehicles

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

The following discussion and analysis should be read in conjunction with our consolidated financial statements and the notes thereto included elsewhere in this report. This report contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from the results discussed in such forward-looking statements. Factors that might cause such differences include, but are not limited to, the general condition of the oil and natural gas drilling industry, demand for our oil and natural gas service and rental products, and competition. For more information on forward-looking statements please refer to the section entitled Forward-Looking Statements on page 30.

Overview of Our Business

We are a multi-faceted oilfield services company that provides services and equipment to oil and natural gas exploration and production companies, throughout domestically primarily in Texas, Louisiana, New Mexico, Colorado, Oklahoma, Mississippi, Wyoming, Arkansas, West Virginia, offshore in the Gulf of Mexico and internationally primarily in Argentina and Mexico. We currently operate in six sectors of the oil and natural gas service industry: Rental Services; International Drilling; Directional Drilling; Tubular Services; Underbalanced Drilling; and Production Services.

We derive operating revenues from rates per day and rates per job that we charge for the labor and equipment required to provide a service and rates per day for equipment and tools that we rent to our customers. The price we charge for our services depends upon several factors, including the level of oil and natural gas drilling activity and the competitive environment in the particular geographic regions in which we operate. Contracts are awarded based on price, quality of service and equipment, and the general reputation and experience of our personnel. The demand for drilling services has historically been volatile and is affected by the capital expenditures of oil and natural gas exploration and development companies, which can fluctuate based upon the prices of oil and natural gas, or the expectation for the prices of oil and natural gas.

The number of working drilling rigs, typically referred to as the rig count, is an important indicator of activity levels in the oil and natural gas industry. The rig count in the United States increased from 862 as of December 31, 2002 to 1,760 on October 26, 2007 according to the Baker Hughes rig count. Furthermore, directional and horizontal rig counts increased from 283 as of December 31, 2002 to 767 on October 26, 2007, which accounted for 32.8% and 43.6% of the total U.S. rig count, respectively. However, the U.S. Gulf of Mexico rig count has decreased to 51 as of October 26, 2007 from 87 one year ago.

Our cost of revenues represents all direct and indirect costs associated with the operation and maintenance of our equipment. The principal elements of these costs are direct and indirect labor and benefits, repairs and maintenance of our equipment, insurance, equipment rentals, fuel and depreciation. Operating expenses do not fluctuate in direct proportion to changes in revenues because, among other factors, we have a fixed base of inventory of equipment and facilities to support our operations, and in periods of low drilling activity we may also seek to preserve labor continuity to market our services and maintain our equipment.

Cyclical Nature of Equipment Rental and Services Industry

The oilfield services industry is highly cyclical. The most critical factor in assessing the outlook for the industry is the worldwide supply and demand for oil and the domestic supply and demand for natural gas. The peaks and valleys of demand are further apart than those of many other cyclical industries. This is primarily a result of the industry being driven by commodity demand and corresponding price increases. As demand increases, producers raise their prices. The price escalation enables producers to increase their capital expenditures. The increased capital expenditures ultimately result in greater revenues and profits for services and equipment companies. The increased capital expenditures also ultimately result in greater production which historically has resulted in increased supplies and reduced prices.

Demand for our services has been strong for approximately the past three years beginning in 2004, due to high oil and natural gas prices and increased demand and declining production costs for natural gas as compared to other energy sources. Management believes the current market fundamentals are indicative of a favorable long-term trend of activity in our markets. However, these factors could be more than offset by other developments affecting the

worldwide supply and demand for oil and natural gas products. The price for natural gas in the U.S. can have a significant impact on the capital expenditures of our customers operating in the U.S. domestic market. Natural gas prices can be affected by such factors as the U.S. economy, new production or pipeline capacity and weather.

Results of Operations

In April 2006, we acquired all of the outstanding stock of Rogers Oil Tool Services, Inc., or Rogers. We report the operations of Rogers in our Tubular Services segment. In August 2006, we acquired all of the outstanding stock of DLS Drilling, Logistics & Services Corporation, or DLS, and in December 2006, we acquired all of the outstanding stock of Tanus Argentina S.A., or Tanus. We report the operations of DLS and Tanus in our International Drilling segment. In October 2006, we acquired all of the outstanding stock of Petro-Rentals, Incorporated, or Petro Rentals. We report the operations of Petro Rentals in our Production Services segment. In December 2006, we acquired substantially all of the assets of Oil & Gas Rental Services, Inc., or OGR. We report the operations of OGR in our Rental Services segment. In June of 2007, we acquired all of the outstanding stock of Coker Directional, Inc., or Coker. In July of 2007, we acquired all of the outstanding stock of Diggar Tools, LLC, or Diggar. We report the operations of Coker and Diggar in our Directional Drilling segment. We consolidated the results of these acquisitions from the day they were acquired.

The foregoing acquisitions affect the comparability from period to period of our historical results, and our historical results may not be indicative of our future results.

Comparison of Three Months Ended September 30, 2007 and 2006

Our revenues for the three months ended September 30, 2007 were $147.9 million, an increase of 70.4% compared to $86.8 million for the three months ended September 30, 2006. Revenues increased in all of our business segments, except for Tubular Services, due to acquisitions completed in 2006, the investment in new capital equipment, improved pricing and the opening of new operating locations. The most significant increase in revenues was due to the acquisition of DLS on August 14, 2006 which expanded our operations to a sixth operating segment, International Drilling. Revenues also increased significantly at our Rental Services segment due to the OGR asset acquisition on December 18, 2006. Our Directional Drilling segment revenues increased in the 2007 period compared to the 2006 period due to improved pricing for directional drilling, the purchase of additional downhole motors and measurement-while-drilling, or MWD, tools and the addition of directional drilling personnel. Revenues for our Production Services segment increased due to the acquisition of Petro Rentals on October 17, 2006 and the addition of two coil tubing units in the fourth quarter of 2006 and one additional unit in the first quarter of 2007. Revenues increased at our Underbalanced Drilling segment due to the purchase of additional equipment, principally new compressor packages.

Our gross margin for the quarter ended September 30, 2007 increased 58.3% to $45.6 million, or 30.8% of revenues, compared to $28.8 million, or 33.2%, of revenues for the three months ended September 30, 2006. The increase in gross margin is due to the increase in revenues in five of our business segments. The increase in gross margin was due primarily to the acquisition of the OGR assets on December 18, 2006 and the acquisition of DLS on August 14, 2006. Also, contributing to our gross margin was the purchase of additional MWD tools and downhole motors, the addition of directional drilling personnel, the acquisition of Petro Rentals, and the addition of two coil tubing units in the fourth quarter of 2006 and one additional unit in the first quarter of 2007. The decrease in gross margin as a percentage of revenues is primarily due to the lower gross margin percentage that DLS achieves in the International Drilling segment partly offset by the acquisition of the OGR assets in the high margin rental services business. Also contributing to the decrease in our gross margin percentage was the increase in downhole motor rental and repairs and increased personnel expenses in our Directional Drilling segment, a more competitive pricing environment in our domestic Tubular Services segment and decreased sales of power tongs. The increase in gross margin was partially offset by an increase in depreciation expense of 141.7% to $13.2 million for the third quarter of 2007 compared to $5.5 million for the third quarter of 2006. The increase is due to additional depreciable assets resulting from the acquisitions and capital expenditures. Our cost of revenues consists principally of our labor costs and benefits, equipment rentals, maintenance and repairs of our equipment, depreciation, insurance and fuel. Because many of our costs are fixed, our gross profit as a percentage of revenues is generally affected by our level of revenues.

General and administrative expense was $13.5 million in the third quarter of 2007 compared to $9.1 million for the third quarter of 2006. General and administrative expense increased due to the additional expenses associated with the acquisitions, and the hiring of additional sales and administrative personnel. As a percentage of revenues, general and administrative expenses were 9.1% in the third quarter of 2007 compared to 10.4% in the third quarter of 2006.

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We adopted SFAS No. 123R, *Share-Based Payment,* effective January 1, 2006. This statement requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their grant-date fair values. We adopted SFAS No. 123R using the modified prospective transition method, utilizing the Black-Scholes option pricing model for the calculation of the fair value of our employee stock options and restricted stock. Therefore, we recorded an expense of $1.0 million and $860,000 related to stock options and restricted stock for the three months ended September 30, 2007 and 2006, respectively. The amount of option and restricted stock expense recorded in general and administrative expense was $1.0 million for the third quarter of 2007 and $727,000 for the third quarter of 2006 with the balance being recorded as a direct cost.
Amortization expense was $989,000 in the third quarter of 2007 compared to $399,000 in the third quarter of 2006. The increase in amortization expense is due to the amortization of intangible assets obtained in connection with our acquisitions.
Income from operations for the three months ended September 30, 2007 totaled $31.1 million, a 61.1% increase over income from operations of $19.3 million for the three months ended September 30, 2006, reflecting the increase in our revenues and gross margin, offset in part by increased general and administrative expenses and amortization. Our income from operations as a percentage of revenues decreased to 21.1% for the third quarter of 2007 from 22.3% for the third quarter of 2006, due principally to the decrease in our gross margin as a percentage of revenues.
Our interest expense was $11.8 million in the third quarter of 2007, compared to $5.3 million for the third quarter of 2006. Interest expense increased in the third quarter of 2007 due to our increased debt. In August 2006 we issued an additional $95.0 million of senior notes bearing interest at 9.0% to fund a portion of the acquisition of DLS. In January 2007 we issued $250.0 million of senior notes bearing interest at 8.5% to pay off, in part, the bridge loan utilized to complete the OGR acquisition and for working capital. Interest expense includes amortization expense of deferred financing costs of $506,000 and $282,000 for the three months ended September 30, 2007 and September 30, 2006, respectively.
Our provision for income taxes for the quarter ended September 30, 2007 was $7.2 million, or 35.8% of our net income before income taxes, compared to $3.1 million, or 21.7% of our net income before income taxes for the three months ended September 30, 2006. The increase in income taxes is attributable to our higher operating income and a higher effective tax rate. The effective tax rate in the 2006 period was favorably impacted by the reversal of the valuation allowance on our deferred tax assets. The valuation allowance was reversed due to operating results that allowed for the realization of our deferred tax assets. As of January 1, 2007, no valuation allowance remained and had no impact on the 2007 effective tax rate.
We had net income of $13.0 million for the three months ended September 30, 2007, an increase of 15.4%, compared to net income of $11.3 million for the third quarter of 2006.
The following table compares revenues and income from operations for each of our business segments and loss of income for general corporate purposes. Income (loss) from operations consists of revenues less cost of revenues, general and administrative expenses, and depreciation and amortization:

	Revenues Three Months Ended September 30,			Income (Loss) from Operations Three Months Ended September 30,		
	2007	2006	Change	2007	2006	Change
	(in thousands)					
Rental Services	$ 28,903	$ 13,203	$ 15,700	$ 12,519	$ 6,575	$ 5,944
International Drilling	58,546	23,853	34,693	10,262	4,139	6,123
Directional Drilling	27,556	19,996	7,560	5,963	5,125	838
Tubular Services	12,582	13,762	(1,180)	2,313	3,734	(1,421)
Underbalanced Drilling	12,927	12,000	927	3,104	3,176	(72)
Production Services	7,367	3,958	3,409	402	119	283
General corporate				(3,415)	(3,532)	117

Total	$ 147,881	$ 86,772	$ 61,109	$ 31,148	$ 19,336	$ 11,812

Rental Services Segment

Revenues for the quarter ended September 30, 2007 for the Rental Services segment were $28.9 million, an increase from $13.2 million in revenues for the quarter ended September 30, 2006. Income from operations increased to $12.5 million in the third quarter of 2007 compared to $6.6 million in the third quarter of 2006. Our Rental Services segment revenues and operating income for the third quarter of 2007 increased compared to the prior year due primarily to the OGR acquisition on December 18, 2006. Income from operations as a percentage of revenues decreased to 43.3% for the quarter ended September 30, 2007 compared to 49.8% for the quarter ended September 30, 2006 as a result of higher depreciation expense associated with OGR acquisition and capital expenditures. The increase in revenues and operating income which resulted from the OGR acquisition was partially offset by the impact of decreased U.S. Gulf of Mexico drilling activity in the third quarter of 2007 compared to the previous year, including the impact of hurricanes during the quarter.

International Drilling Segment

On August 14, 2006, we acquired DLS which established our International Drilling segment. Revenues for the quarter ended September 30, 2007 for the International Drilling segment were $58.5 million, an increase from $23.9 million in revenues for the quarter ended September 30, 2006. Income from operations increased to $10.3 million in the third quarter of 2007 compared to $4.1 million in the third quarter of 2006.

Directional Drilling Segment

Revenues for the quarter ended September 30, 2007 for our Directional Drilling segment were $27.6 million, an increase of 37.8% from the $20.0 million in revenues for the quarter ended September 30, 2006. Income from operations increased 16.4% to $6.0 million for the third quarter of 2007 from $5.1 million for the comparable 2006 period. The increase in revenues and operating income is due to the purchase of additional MWD tools and downhole motors and the addition of directional drillers. Operating income as a percentage of revenues decreased to 21.6% for the third quarter of 2007 compared to 25.6% for the prior year period due to increased expenses for downhole motor rentals and repairs along with increased personnel costs.

Tubular Services Segment

Revenues for the quarter ended September 30, 2007 for the Tubular Services segment were $12.6 million, a decrease of 8.6% from the $13.8 million in revenues for the quarter ended September 30, 2006. Revenues from domestic operations decreased to $10.4 million in the third quarter of 2007 from $12.3 million in the third quarter of 2006. Revenues from operations in Mexico were $2.2 million for the third quarter of 2007 compared to $1.5 million for the third quarter of 2006. Income from operations decreased 38.1% to $2.3 million in the third quarter of 2007 from $3.7 million in the third quarter of 2006. The decrease in this segment s revenues and operating income was due to an increased competitive pricing environment domestically for casing and tubing services, and decreased sales of power tongs in the third quarter of 2007 compared to the third quarter of 2006.

Underbalanced Drilling Segment

Revenues for the quarter ended September 30, 2007 for the Underbalanced Drilling segment were $12.9 million, an increase of 7.7% compared to $12.0 million in revenues for the quarter ended September 30, 2006. Income from operations decreased to $3.1 million in the third quarter of 2007 compared to income from operations of $3.2 million in the third quarter of 2006. Revenues and operating income in our Underbalanced Drilling segment were affected by a decrease in drilling activity in certain geographic areas by some of our customers, partially offset by an increased market presence and growth in drilling activity in other geographic areas and the benefits of our investment in additional equipment.

Production Services Segment

Revenues were $7.4 million for the quarter ended September 30, 2007 for the Production Services segment, an increase of 86.1% compared to $4.0 million in revenues for the quarter ended September 30, 2006. Income from operations increased to $402,000 in the third quarter of 2007 compared to $119,000 in the third quarter of 2006. Our Production Services segment revenues and operating income for the third quarter of 2007 increased compared to the third quarter of 2006 due primarily to our acquisition of Petro Rentals on October 17, 2006, the addition of two coil tubing units in the fourth quarter of 2006 and one additional unit in the first quarter of 2007, offset in part by the sale of our capillary tubing assets in June 2007, and an increase in personnel and training expenses for the crews in

anticipation of the delivery and activation of new coil tubing units which were delayed in being delivered.

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General Corporate

General corporate expenses decreased $117,000 to $3.4 million for the quarter ended September 30, 2007 compared to $3.5 million for the quarter ended September 30, 2006. The decrease was due to reduced consulting fees in connection with our Sarbanes Oxley compliance efforts and reduced expenses for stock options.

Comparison of Nine Months Ended September 30, 2007 and 2006

Our revenues for the nine months ended September 30, 2007 were $427.1 million, an increase of 117.9% compared to $196.1 million for the nine months ended September 30, 2006. Revenues increased in all of our business segments due to acquisitions completed in 2006, the investment in new capital equipment, improved pricing and the opening of new operating locations. The most significant increase in revenues was due to the acquisition of DLS on August 14, 2006, which expanded our operations to a sixth operating segment, International Drilling. Revenues also increased significantly at our Rental Services segment due to the OGR asset acquisition on December 18, 2006. Revenues for our Production Services segment increased due to the acquisition of Petro Rentals on October 17, 2006 and the addition of two coil tubing units in the fourth quarter of 2006 and one in the first quarter of 2007. Our Directional Drilling segment revenues increased in the 2007 period compared to the 2006 period due to improved pricing for directional drilling and the purchase of additional downhole motors and MWD tools which increased our capacity and market presence. Our Tubular Services segment also had an increase in revenue, primarily due to the acquisition of Rogers as of April 3, 2006 and the purchase of additional equipment. Revenues increased at our Underbalanced Drilling segment due to the purchase of additional equipment, principally new compressor packages.

Our gross margin for the nine months ended September 30, 2007 increased 99.9% to $140.0 million, or 32.8% of revenues, compared to $70.1 million, or 35.7% of revenues for the nine months ended September 30, 2006. The increase in gross margin is due to the increase in revenues in all of our business segments, but primarily due to the acquisition of the OGR assets on December 18, 2006 and the acquisition of DLS on August 14, 2006. Also, contributing to our gross margin was the purchase of additional MWD tools and downhole motors, the acquisition of Rogers and Petro Rentals, and the addition of two coil tubing units in the fourth quarter of 2006. The decrease in gross margin as a percentage of revenues is primarily due to the lower gross margin percentage that DLS achieves in the International Drilling segment partly offset by the acquisition of the OGR assets in the high margin rental services business and the improved pricing for our services generally. Also contributing to the decrease in our gross margin percentage was the increase in downhole motor rental and repairs and increased personnel expenses in our Directional Drilling segment, a more competitive pricing environment in our domestic Tubular Services segment and decreased sales of power tongs. The increase in gross margin was partially offset by an increase in depreciation expense of 195.4% to $37.2 million for the nine months ended September 30, 2007 compared to $12.6 million for the nine months ended September 30, 2006. The increase is due to additional depreciable assets resulting from the acquisitions and capital expenditures. Our cost of revenues consists principally of our labor costs and benefits, equipment rentals, maintenance and repairs of our equipment, depreciation, insurance and fuel. Because many of our costs are fixed, our gross margin as a percentage of revenues is generally affected by our level of revenues.

General and administrative expense was $41.7 million in the first nine months of 2007 compared to $24.5 million for the first nine months of 2006. General and administrative expense increased due to the additional expenses associated with the acquisitions, and the hiring of additional sales and administrative personnel. General and administrative expense also increased because of increased corporate accounting and administrative staff. As a percentage of revenues, general and administrative expenses were 9.8% for the nine months ended September 30, 2007 compared to 12.5% in the same period of 2006.

We adopted SFAS No. 123R, *Share-Based Payment,* effective January 1, 2006. This statement requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their grant-date fair values. We adopted SFAS No. 123R using the modified prospective transition method, utilizing the Black-Scholes option pricing model for the calculation of the fair value of our employee stock options and restricted stock. Therefore, we recorded an expense of $2.1 million and $2.6 million related to stock options and restricted stock for the nine months ended September 30, 2007 and 2006, respectively. The amount of option and restricted stock expense recorded in general and administrative expense was $2.0 million for the first nine months of 2007 and $2.3 million for the first nine months of 2006 with the balance being recorded as

a direct cost.

On June 29, 2007, we sold our capillary tubing assets that were part of our Production Services segment. The total sale agreement was $16.3 million in cash. We recognized a gain of $8.9 million related to the sale of these assets.

Amortization expense was $3.0 million in the first nine months of 2007 compared to $1.2 million in the first nine months of 2006. The increase in amortization expense is due to the amortization of intangible assets in connection with our acquisitions.

Income from operations for the nine months ended September 30, 2007 totaled $104.1 million, a 135.0% increase over income from operations of $44.3 million for the nine months ended September 30, 2006, reflecting the increase in our revenues and gross margin, the gain from the sale of assets, offset in part by increased general and administrative expenses and amortization. Our income from operations as a percentage of revenues increased to 24.4% for the first nine months of 2007 from 22.6% for the first nine months of 2006, due principally to the decrease in general, administrative and amortization expenses as a percentage of revenue and the gain from the sale of assets.

Our interest expense was $37.7 million in the first nine months of 2007, compared to $13.3 million for the first nine months of 2006. Interest expense increased in the first nine months of 2007, compared to the first nine months of 2006, due to our increased debt. In August 2006 we issued an additional $95.0 million of senior notes bearing interest at 9.0% to fund a portion of the acquisition of DLS. In January 2007 we issued $250.0 million of senior notes bearing interest at 8.5% to pay off, in part, the bridge loan utilized to complete the OGR acquisition and for working capital. The bridge loan was outstanding until January 29, 2007 and had an average interest rate of 10.6%. Interest expense for the first nine months of 2007 includes the write-off of deferred financing fees of $1.2 million related to the repayment of the bridge loan. Interest expense includes amortization expense of deferred financing costs of $1.5 million and $742,000 for the nine months ended September 30, 2007 and September 30, 2006, respectively.

Our provision for income taxes for the nine months ended September 30, 2007 was $24.8 million, or 35.7% of our net income before income taxes, compared to $6.2 million, or 19.7% of our net income before income taxes for the nine months ended September 30, 2006. The increase in income taxes is attributable to our higher operating income and a higher effective tax rate. The effective tax rate in the 2006 period was favorably impacted by the reversal of the valuation allowance on our deferred tax assets. The valuation allowance was reversed due to operating results that allowed for the realization of our deferred tax assets. As of January 1, 2007, no valuation allowance remained and had no impact on the 2007 effective tax rate.

We had net income of $44.7 million for the nine months ended September 30, 2007, an increase of 76.7%, compared to net income of $25.3 million for the nine months ended September 30, 2006.

The following table compares revenues and income from operations for each of our business segments and loss of income for general corporate purposes. Income (loss) from operations consists of revenues less cost of revenues, general and administrative expenses, and depreciation and amortization:

	Revenues Nine Months Ended September 30,			Income (Loss) from Operations Nine Months Ended September 30,		
	2007	2006	Change	2007	2006	Change
			(in thousands)			
Rental Services	$ 92,863	$ 36,331	$ 56,532	$ 41,212	$ 18,881	$ 22,331
International Drilling	160,295	23,853	136,442	30,094	4,139	25,955
Directional Drilling	69,352	55,161	14,191	14,252	12,097	2,155
Tubular Services	41,029	37,790	3,239	8,673	9,899	(1,226)
Underbalanced Drilling	36,448	32,048	4,400	9,240	8,617	623
Production Services	27,156	10,883	16,273	11,904	737	11,167
General corporate				(11,283)	(10,070)	(1,213)
Total	$ 427,143	$ 196,066	$ 231,077	$ 104,092	$ 44,300	$ 59,792

Rental Services Segment

Revenues for the nine months ended September 30, 2007 for the Rental Services segment were $92.9 million, an increase from $36.3 million in revenues for the nine months ended September 30, 2006. Income from operations increased to $41.2 million in the first nine months of 2007 compared to $18.9 million in the first nine months of 2006. Our Rental Services segment revenues and operating income for the first nine months of 2007 increased compared to

the prior year due primarily to the OGR acquisition on December 18, 2006. Income from operations as a percentage of revenues decreased to 44.4% for the nine months ended September 30, 2007 compared to 52.0% for the nine months ended September 30, 2006 as a result of higher depreciation expense associated with OGR acquisition and capital expenditures. The increase in revenues and operating income which resulted from the OGR acquisition was partially offset by the impact of decreased U.S. Gulf of Mexico drilling activity in 2007 compared to the previous year, including the impact of hurricanes during the 2007 third quarter.

International Drilling Segment

On August 14, 2006, we acquired DLS which established our International Drilling segment. Revenues for the nine months ended September 30, 2007 for the International Drilling segment were $160.3 million, an increase from $23.9 million in revenues for the nine months ended September 30, 2006. Income from operations increased to $30.1 million for the nine months ended September 30, 2007 compared to $4.1 million for the nine months ended September 30, 2006.

Directional Drilling Segment

Revenues for the nine months ended September 30, 2007 for our Directional Drilling segment were $69.4 million, an increase of 25.7% from the $55.2 million in revenues for the nine months ended September 30, 2006. Income from operations increased 17.8% to $14.3 million for the first nine months of 2007 from $12.1 million for the comparable 2006 period. The improved results for this segment are due to improved pricing for directional and horizontal drilling and the purchase of additional MWD tools and downhole motors, offset in part by increased expenses for the downhole motor rentals and repairs and increased labor costs.

Tubular Services Segment

Revenues for the nine months ended September 30, 2007 for the Tubular Services segment were $41.0 million, an increase of 8.6% from the $37.8 million in revenues for the nine months ended September 30, 2006. Revenues from domestic operations increased to $34.8 million in the first nine months of 2007 from $33.1 million in the first nine months of 2006 as a result of the acquisition of Rogers. Revenues from operations in Mexico were $6.2 million for the first nine months of 2007 and $4.7 million for the first nine months of 2006. Income from operations decreased 12.4% to $8.7 million in the first nine months of 2007 from $9.9 million in the first nine months of 2006. The decrease in this segment s operating income was due to an increased competitive pricing environment domestically and decreased sales of power tongs from the same period in the preceding year.

Underbalanced Drilling Segment

Our Underbalanced Drilling segment revenues were $36.4 million for the nine months ended September 30, 2007, an increase of 13.7% compared to $32.0 million in revenues for the nine months ended September 30, 2006. Income from operations increased to $9.2 million in the first nine months of 2007 compared to income from operations of $8.6 million in the first nine months of 2006. Our Underbalanced Drilling segment revenues and operating income for the first nine months of 2007 increased compared to the first nine months of 2006 primarily due to our investment in additional equipment.

Production Services Segment

Revenues were $27.2 million for the nine months ended September 30, 2007 for the Production Services segment, an increase of 149.5% compared to $10.9 million in revenues for the nine months ended September 30, 2006. Income from operations increased to $11.9 million in the first nine months of 2007 compared to $737,000 in the first nine months of 2006. Our Production Services segment revenues and operating income for the first nine months of 2007 increased compared to the first nine months of 2006 due primarily to our acquisition of Petro Rentals on October 17, 2006, the gain from the sale of capillary assets and the addition of two coil tubing units in the fourth quarter of 2006 and one additional unit in the first quarter of 2007. Operating results for this segment for the first nine months of 2007 were impacted by the sale of our capillary tubing assets and an increase in personnel and training expenses for the crews in anticipation of the delivery and activation of new coil tubing units which were delayed in their delivery.

General Corporate

General corporate expenses increased $1.2 million to $11.3 million for the nine months ended September 30, 2007 compared to $10.1 million for the nine months ended September 30, 2006. The increase was due to the increase in payroll costs and benefits for additional management, accounting and administrative staff as a result of the acquisitions and to support our growing organization and increased franchise taxes based on our increased authorized shares.

Liquidity and Capital Resources

Our on-going capital requirements arise primarily from our need to service our debt, to complete acquisitions, to acquire and maintain equipment, and to fund our working capital requirements. Our primary sources of liquidity are proceeds from the issuance of debt and equity securities and cash flows from operations. We had cash and cash

equivalents of $63.1 million at September 30, 2007 compared to $39.7 million at December 31, 2006.

Operating Activities

In the nine months ended September 30, 2007, our operating activities provided $60.8 million in cash. Net income for the nine months ended September 30, 2007 was $44.7 million. Net non-cash expenses totaled $38.7 million during the first nine months of 2007 consisting of $40.2 million of depreciation and amortization, $3.1 million for deferred income taxes, $2.7 million for the amortization and write-off of financing fees, $2.1 million from the expensing of stock options, $441,000 from increases to the allowance for doubtful accounts receivables, less $10.0 million on the gain from asset disposals.

During the nine months ended September 30, 2007, changes in operating assets and liabilities used $22.5 million in cash, principally due to an increase of $36.8 million in accounts receivable, an increase of $5.0 million in inventory, and a decrease of $5.1 million in accrued interest, offset in part by a decrease in other current assets of $10.6 million, an increase of $1.3 million in accounts payable, an increase of $10.0 million in accrued expenses and an increase in accrued salaries, benefits and payroll taxes of $2.4 million. Accounts receivable increased primarily due to the increase in our revenues in the first nine months of 2007. Other inventory increased primarily due to the build-up of inventory to meet the demands of increased activity levels in our International Drilling segment. The decrease in accrued interest is due to the semi-annual payment of interest on our 9.0% senior notes. The decrease in other current assets is principally due to the collection of the working capital adjustment from the OGR acquisition for approximately $7.1 million in the first quarter of 2007. The increase in accounts payable, accrued expenses and accrued salaries, benefits and payroll taxes is attributed to additional expenses related to higher activity levels.

In the nine months ended September 30, 2006, our operating activities provided $33.3 million in cash. Net income for the nine months ended September 30, 2006 was $25.3 million. Non-cash expenses totaled $17.7 million during the first nine months of 2006 consisting of $13.8 million of depreciation and amortization, $494,000 for deferred income taxes, $2.6 million from the expensing of stock options, $742,000 of amortization of financing fees, $355,000 of imputed interest related to the effective date of the Specialty acquisition, $353,000 related to increases to the allowance for doubtful accounts receivables, less $728,000 on the gain from asset retirements.

During the nine months ended September 30, 2006, changes in operating assets and liabilities used $9.6 million in cash, principally due to an increase of $17.2 million in accounts receivable, an increase of $2.2 million in inventory, a decrease of $1.6 million in accounts payable, offset in part by an increase of $4.7 million in accrued interest and an increase of $2.5 million in accrued expenses. Accounts receivable increased due to the increase in our revenues in the first nine months of 2006. Other inventory increased primarily due to increased activity levels. The increase in accrued interest relates to our 9.0% senior notes issued in 2006 which is only payable in January and July. The increase in accrued expenses can be attributed to additional income tax liability due to profitability and additional expenses related to higher activity levels.

Investing Activities

During the nine months ended September 30, 2007, we used $77.2 million in investing activities, consisting of $86.1 million for capital expenditures, $12.9 million for business acquisitions and $498,000 for oil and gas investments, offset by $22.2 million of proceeds from asset sales. Included in the $86.1 million for capital expenditures was $31.1 million for drill pipe and other equipment used in our Rental Services segment, $16.9 million for additional equipment in our International Drilling segment, $15.3 million for additional equipment in our Underbalanced Drilling segment, $8.6 million for additional equipment in our Production Services segment, $6.9 million for additional equipment in our Tubular Services segment and $6.7 million primarily for additional MWD equipment used in the Directional Drilling segment,. We received proceeds of $16.3 million from the sale of our capillary assets and $6.0 million from the proceeds from asset sales in connection with items lost in hole by our customers or other asset sales.

During the nine months ended September 30, 2006, we used $225.5 million in investing activities, consisting of $95.8 million for the acquisition of Specialty, net of cash received, $10.7 million for the acquisition of Rogers, net of cash received, $96.6 million for the acquisition of DLS, net of cash received and $25.8 million for capital expenditures, offset by $3.5 million of proceeds from equipment sales. Included in the $25.8 million for capital expenditures was $ 7.8 million for equipment used in our casing and tubing segment, $3.0 million for the expansion of our MWD equipment used in the directional drilling segment, $6.3 million for additional equipment in our

compressed air drilling services segment and $3.1 million for our international drilling segment. A majority of our equipment sales relate to items lost in hole by our customers.

Financing Activities

During the nine months ended September 30, 2007, financing activities provided $39.7 million in cash. We received $250.0 million in proceeds from long-term debt, repaid $307.5 million in borrowings under long-term debt facilities, including the repayment of the bridge loan, and paid $7.6 million in debt issuance costs. We also received $100.1 million from the issuance of our common stock in a public offering, net of expenses along with $3.3 million in proceeds from the exercise of options and warrants. We recognized a tax benefit of $1.6 million related to our stock compensation plans.

During the nine months ended September 30, 2006, financing activities provided $240.5 million in cash. We received $257.8 million in proceeds from long-term debt, repaid $51.7 million in borrowings under long-term debt facilities, repaid $3.0 million in related party debt, repaid $6.4 million net under our line of credit and paid $8.0 million in debt issuance costs. We also received $46.5 million from the issuance of our common stock in a public offering, net of expenses along with $5.4 million in proceeds from the exercise of options and warrants..

At September 30, 2007, we had $516.5 million in outstanding indebtedness, of which $508.9 million was long term debt and $7.6 million is due within one year.

On January 18, 2006 and August 14, 2006, we closed on private offerings, to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933, of $160.0 and $95.0 million aggregate principal amount of our senior notes, respectively. The senior notes are due January 15, 2014 and bear interest at 9.0%. The proceeds were used to fund the acquisitions of Specialty and DLS to repay existing debt and for general corporate purposes.

On January 18, 2006, we also executed an amended and restated credit agreement which provided for a $25.0 million revolving line of credit with a maturity of January 2010. Our January 2006 amended and restated credit agreement contained customary events of default and financial covenants and limits our ability to incur additional indebtedness, make capital expenditures, pay dividends or make other distributions, create liens and sell assets. Our obligations under the January 2006 amended and restated credit agreement were secured by substantially all of our assets located in the United States.

On December 18, 2006, we closed on a $300.0 million senior unsecured bridge loan. The bridge loan was due 18 months after closing and bore a weighted average interest rate of 10.6%. The bridge loan, which was repaid on January 29, 2007, was used to fund the acquisition of substantially all of the assets of OGR.

In January 2007, we closed on a private offering, to qualified institutional buyers pursuant to Rule 144A under the Securities Act, of $250.0 million principal amount of 8.5% senior notes due 2017. The proceeds of the senior notes offering, together with a portion of the proceeds of our concurrent common stock offering, were used to repay the debt outstanding under our $300.0 million bridge loan facility which we incurred to finance our acquisition of substantially all the assets of OGR.

On April 26, 2007, we entered into a Second Amended and Restated Credit Agreement, which increased our revolving line of credit to $62.0 million, and has a final maturity date of April 26, 2012. The amended and restated credit agreement contains customary events of default and financial covenants and limits our ability to incur additional indebtedness, make capital expenditures, pay dividends or make other distributions, create liens and sell assets. Our obligations under the amended and restated credit agreement are secured by substantially all of our assets located in the United States.

As part of our acquisition of DLS, we assumed various bank loans with floating interest rates based on LIBOR plus a margin and terms ranging from 2 to 5 years. The weighted average interest rates were 6.72% and 7.0% at September 30, 2007 and December 31, 2006, respectively. The bank loans are denominated in U.S. dollars and the outstanding amounts due as of September 30, 2007 and December 31, 2006 were $5.5 million and $7.3 million, respectively.

As part of the acquisition of Mountain Compressed Air Inc., or Mountain Air, in 2001, we issued a note to the sellers of Mountain Air in the original amount of $2.2 million accruing interest at a rate of 5.75% per annum. The note was reduced to $1.5 million as a result of the settlement of a legal action against the sellers in 2003. At September 30, 2007 and December 31, 2006 the outstanding amounts due were $0 and $150,000, respectively.

In connection with the acquisition of Rogers Oil Tool Services, Inc., or Rogers, we issued to the seller a note in the amount of $750,000. The note bears interest at 5.0% and is due April 3, 2009. In connection with the acquisition of

Coker Directional Inc., we issued to the seller a note in the amount of $350,000. The note bears interest at 8.25% and is due June 29, 2008. In connection with the acquisition of Diggar we issued to the seller a note in the amount of $750,000. The note bears interest at 6.0% and is due July 26, 2008.

In connection with the purchase of Safco-Oil Field Products, Inc., or Safco, we also agreed to pay a total of $150,000 to the sellers in exchange for a non-compete agreement. We are required to make annual payments of $50,000 through September 30, 2007. In connection with the purchase of Capcoil Tubing Services, Inc., or Capcoil, we agreed to pay a total of $500,000 to two management employees in exchange for non-compete agreements. We are required to make annual payments of $110,000 through May 2008. Total amounts due under these non-compete agreements at September 30, 2007 and December 31, 2006 were $160,000 and $270,000, respectively.

In 2000 we compensated directors, including current directors Nederlander and Toboroff, who served on the board of directors from 1989 to March 31, 1999 without compensation, by issuing promissory notes totaling $325,000. The notes bore interest at the rate of 5.0%. At September 30 2007 and December 31, 2006, the principal and accrued interest on these notes totaled approximately $32,000. We have various equipment and vehicle financing loans with interest rates ranging from 7.85% to 8.7% and terms of 2 to 3 years. As of September 30, 2007 and December 31, 2006, the outstanding balances for equipment and vehicle financing loans were $942,000 and $3.5 million, respectively. In April 2006 and August 2006, we obtained insurance premium financings in the amount of $1.9 million and $896,000 with fixed interest rates of 5.6% and 6.0%, respectively. Under terms of the agreements, amounts outstanding are paid over 10 month and 11 month repayment schedules. In April 2007, we renewed the insurance premium financing in an amount of $3.2 million with a fixed interest rate of 5.9% and a repayment schedule of 11 months. The outstanding balance of these notes was approximately $2.9 million and $1.0 million as of September 30, 2007 and December 31, 2006, respectively. We also have various capital leases with terms that expire in 2008. As of September 30, 2007 and December 31, 2006, amounts outstanding under capital leases were $42,000 and $414,000, respectively.

Off Balance Sheet Arrangements

We have no off balance sheet arrangements, other than normal operating leases and employee contracts, that have or are likely to have a current or future material effect on our financial condition, changes in financial condition, revenues, expenses, results of operations, liquidity, capital expenditures or capital resources. We do not guarantee obligations of any unconsolidated entities. At September 30, 2007, we had a $62.0 million revolving line of credit with a maturity of April 2012. At September 30, 2007, no amounts were borrowed on the facility but availability is reduced by outstanding letters of credit of $8.8 million.

Capital Requirements

We have identified capital expenditure projects that will require approximately $38.0 million for the remainder of 2007, exclusive of any acquisitions. We believe that our current cash generated from operations, cash available under our credit facilities and cash on hand will provide sufficient funds for our identified projects.

We intend to implement a growth strategy of increasing the scope of services through both internal growth and acquisitions. We are regularly involved in discussions with a number of potential acquisition candidates. The acquisition of assets could require additional financing. We also expect to make capital expenditures to acquire and to maintain our existing equipment. Our performance and cash flow from operations will be determined by the demand for our services which in turn are affected by our customers expenditures for oil and gas exploration and development, and industry perceptions and expectations of future oil and natural gas prices in the areas where we operate. We will need to refinance our existing debt facilities as they become due and provide funds for capital expenditures and acquisitions. To effect our expansion plans, we may require additional equity or debt financing. There can be no assurance that we will be successful in raising the additional debt or equity capital or that we can do so on terms that will be acceptable to us.

Recent Developments

On October 23, 2007, we purchased all of the issued and outstanding stock of Rebel Rentals, Inc., or Rebel Rentals, for an aggregate purchase price of $6.75 million. The acquisition of Rebel Rentals adds additional equipment and support to our casing and tubing operations in our Tubular Services segment.

On November 1, 2007, we purchased substantially all the assets of Diamondback Oilfield Services, Inc., or Diamondback, for a purchase price of $22.0 million. This acquisition expands the operations of Allis-Chalmers Directional Drilling segment further into the Texas Panhandle and Oklahoma. The acquisition of Diamondback adds additional personnel and equipment, including approximately 18 directional drillers, 30 downhole motors, five

measurement-while-drilling tools, and eight wireline steering vehicles

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Critical Accounting Policies

Please see our Annual Report on Form 10-K for the year ended December 31, 2006 for a description of other policies that are 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. No material changes to such information have occurred during the nine months ended September 30, 2007.

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48). FIN 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*. It prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. We adopted the provisions of FIN 48 effective January 1, 2007 and such adoption did not have a material effect on our financial statements.

Our policy is that we recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. As of the date of adoption of FIN 48, we did not have any accrued interest or penalties associated with any unrecognized tax benefits. For United States federal tax purposes, our tax returns for the tax years 2001 through 2006 remain open for examination by the tax authorities. Our foreign tax returns remain open for examination for the tax years 2001 through 2006. Generally, for state tax purposes, our 2002 through 2006 tax years remain open for examination by the tax authorities under a four year statute of limitations, however, certain states may keep their statute open for six to ten years.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157), which is intended to increase consistency and comparability in fair value measurements by defining fair value, establishing a framework for measuring fair value and expanding disclosures about fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We are currently evaluating the provisions of SFAS 157 and have not yet determined the impact, if any, on our financial statements.

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159), which permits entities to elect to measure many financial instruments and certain other items at fair value. Upon adoption of SFAS 159, an entity may elect the fair value option for eligible items that exist at the adoption date. Subsequent to the initial adoption, the election of the fair value option should only be made at the initial recognition of the asset or liability or upon a re-measurement event that gives rise to the new-basis of accounting. All subsequent changes in fair value for that instrument are reported in earnings. SFAS No. 159 does not affect any existing accounting literature that requires certain assets and liabilities to be recorded at fair value nor does it eliminate disclosure requirements included in other accounting standards. SFAS 159 is effective as of the beginning of each reporting entity s first fiscal year that begins after November 15, 2007. We are currently evaluating the provisions of SFAS 159 and have not yet determined the impact, if any, on our financial statements.

Forward-Looking Statements

This quarterly report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, regarding our business, financial condition, results of operations and prospects. Words such as expects, anticipates, intends, plans, believes, seeks, estimates and similar expressions or variations of such words are intended to identify forward-looking statements. However, these are not the exclusive means of identifying forward-looking statements. Although such forward-looking statements reflect our good faith judgment, such statements can only be based on facts and factors currently known to us. Consequently, forward-looking statements are inherently subject to risks and uncertainties, and actual outcomes may differ materially from the results and outcomes discussed in the forward-looking statements. Further information about the risks and uncertainties that may impact us are described under Item 1A Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2006. You should read those sections carefully. You should not place undue reliance on forward-looking statements, which speak only as of the date of this quarterly report. We undertake no obligation to update publicly any forward-looking statements in order to reflect any event or circumstance occurring after the date of this quarterly report or currently unknown facts or conditions or the occurrence of unanticipated events.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK.

We are exposed to market risk primarily from changes in interest rates and foreign currency exchange risks.

Interest Rate Risk.

Fluctuations in the general level of interest rates on our current and future fixed and variable rate debt obligations expose us to market risk. We are vulnerable to significant fluctuations in interest rates affecting our adjustable rate debt, and any future refinancing of our fixed rate debt and our future debt.

As part of our acquisition of DLS, we assumed various bank loans carrying variable interest rates with an outstanding balance of $5.5 million as of September 30, 2007.

We have also been subject to interest rate market risk for short-term invested cash and cash equivalents. The principal of such invested funds would not be subject to fluctuating value because of their highly liquid short-term nature. As of September 30, 2007, we had $63.7 million invested in short-term investments.

Foreign Currency Exchange Rate Risk.

We have designated the U.S. dollar as the functional currency for our operations in international locations as we contract with customers, purchase equipment and finance capital using the U.S. dollar. Local currency transaction gains and losses, arising from remeasurement of certain assets and liabilities denominated in local currency, are included in our consolidated statements of income. We conduct business in Mexico through our Mexican partner, Matyep. This business exposes us to foreign exchange risk. To control this risk, we provide for payment in U.S. dollars. However, we have historically provided our partner a discount upon payment equal to 50% of any loss suffered by our partner as a result of devaluation of the Mexican peso between the date of invoicing and the date of payment. To date, such payments have not been material in amount.

ITEM 4. CONTROLS AND PROCEDURES.

(a) Evaluation of Disclosure Controls and Procedures.

As of the end of the period covered by this quarterly report, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15(e) and 15d 15(e) of the Securities Exchange Act of 1934, as amended, or the Exchange Act . This evaluation was carried out under the supervision and with the participation of our management, including our chief executive officer and chief financial officer. Based on this evaluation, these officers have concluded that, as of September 30, 2007, our disclosure controls and procedures are effective at a reasonable assurance level in ensuring that the information required to be disclosed by us in reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission, or SEC, rules and forms.

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports under the Exchange Act, are recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosures.

(b) Change in Internal Control Over Financial Reporting.

There have not been any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended September 30, 2007 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 6. EXHIBITS

(a) The exhibits listed on the Exhibit Index immediately following the signature page of this Quarterly Report on Form 10-Q are filed as part of this report.

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 November 6, 2007.

Allis-Chalmers Energy Inc.

(Registrant)

/s/ Munawar H. Hidayatallah

Munawar H. Hidayatallah
Chief Executive Officer and Chairman

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EXHIBIT INDEX

10.1 Employment Agreement, effective July 1, 2007, by and between Strata Directional Technology, Inc. and David K. Bryan (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed July 13, 2007).

10.2 Employment Agreement, effective April 1, 2007, by and between AirComp, LLC and Terrence P. Keane (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed July 24, 2007).

10.3* Employment Agreement, effective April 1, 2007, by and between Allis-Chalmers Energy Inc. and Munawar H. Hidayatallah.

10.4* Employment Agreement, effective April 3, 2007, by and between Allis-Chalmers Energy Inc. and Victor M. Perez.

10.5* Form of Performance Award Agreement under the Allis-Chalmers Energy Inc. 2006 Incentive Plan.

31.1* Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2* Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1* Certification of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Filed herewith