

Allis Chalmers Energy Inc.
Form 10-K/A
July 09, 2008

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
Form 10-K/A
Amendment No. 2**

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2007
OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM TO
Commission file number 1-2199
ALLIS-CHALMERS ENERGY INC.
(Exact name of registrant as specified in its charter)**

Delaware
*(State or other jurisdiction of
incorporation or organization)*

39-0126090
*(I.R.S. Employer
Identification No.)*

**5075 WESTHEIMER, SUITE 890
HOUSTON, TEXAS**
(Address of principal executive offices)

77056
(Zip code)

(713) 369-0550

Registrant's telephone number, including area code

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

Title of Security:

Name of Exchange:

Common Stock, par value \$0.01 per share

New York Stock Exchange

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:

NONE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d). Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting
company

(Do not check if a smaller reporting company)

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

The aggregate market value of the common equity held by non-affiliates of the registrant, computed using the closing price of the common stock of \$22.99 per share on June 30, 2007, as reported on the New York Stock Exchange, was approximately \$462,009,706 (affiliates included for this computation only: directors, executive officers and holders of more than 5% of the registrant's common stock).

As of June 16, 2008 there were 35,190,284 shares of common stock issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE:

None

Explanatory Note

The purpose of this Amendment No. 2 on Form 10-K/A is to respond to comments received from the Securities and Exchange Commission's Division of Corporation Finance in its letter dated June 20, 2008 regarding our previously filed Annual Report on Form 10-K for the year ended December 31, 2007, filed with the Securities and Exchange Commission, or SEC, on March 7, 2008 (Original Form 10-K), and our Amendment No. 1 to the Original Form 10-K, filed with the SEC on April 29, 2008 (Amendment No. 1). This amendment amends the following disclosures: Form 10-K

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation, revised to expand our consolidated and segment results of operations discussion to provide greater insight into the underlying reasons for variances, and guidance on whether or not the results of operations are indicative of expected results beginning on page 3; and

Item 8. Financial Statements, revised to remove the label (unaudited) from the condensed consolidating statements of cash flow for the year ended December 31, 2006 on page 59 and to correct a label on the consolidated statements of cash flows for the years ended December 31, 2006 and 2005 on page 26;

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Item 11. Executive Compensation, revised to include the financial and non-financial goals or targets established for fiscal 2007 that were used to determine our named executive officers' incentive compensation on pages 67-69.

As required by Rule 12b-15 under the Securities Exchange Act of 1934, as amended, which we refer to as the Exchange Act, new certifications by our Chief Executive Officer and Chief Financial Officer are being filed as exhibits to this Amendment No. 2 on Form 10-K/A under Item 15 of Part IV.

There are no other changes to the Original Form 10-K or Amendment No. 1 thereto other than those outlined above. This Amendment does not reflect events occurring after the filing of the Original Form 10-K or Amendment No. 1 thereto nor does it modify or update disclosures therein in any way other than as required to reflect the amendment set forth below.

As used herein, Allis-Chalmers, we, our and us may refer to Allis-Chalmers Energy Inc. and its subsidiaries. The use of these terms is not intended to connote any particular corporate status or relationships.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Amendment No. 2 on Form 10-K/A 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 in Risk Factors beginning on page 14 of our Original Form 10-K. You should read those sections carefully. You should not place undue reliance on forward-looking statements. Forward-looking statements are only as of the date they are made. We undertake no obligation to update publicly any forward-looking statements in order to reflect any event or circumstance occurring after the date they are made or currently unknown facts or conditions or the occurrence of unanticipated events.

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PART II

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with our selected historical financial data included in our Original Form 10-K and our financial statements and the notes to those financial statements included elsewhere in this document. The following discussion contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that reflect our plans, estimates and beliefs. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of risks and uncertainties, including, but not limited to, those discussed under Item 1A. Risk Factors included in our Original Form 10-K.

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 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 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 the 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 1,763 as of February 29, 2008, according to the Baker Hughes rig count. Furthermore, directional and horizontal rig counts increased from 283 as of December 31, 2002 to 817 as of February 29, 2008, which accounted for 33% and 46% of the total U.S. rig count, respectively. The offshore Gulf of Mexico rig count, however, decreased to 58 rigs at February 29, 2008 from 90 rigs one year earlier. We believe this is due to the relocation of rigs to international markets as a result of the high oil prices.

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.

Results of Operations

In April 2005, we acquired all of the outstanding stock of Delta and, in May 2005, we acquired all of the outstanding stock of Capcoil. We report the operations of Downhole and Capcoil in our Production Services segment and the

operations of Safco and Delta in our Rental Services segment. In July 2005, we acquired the 45% interest of M-I in our Underbalanced Drilling subsidiary, AirComp, making us the 100% owner of AirComp. In addition, in July 2005, we acquired the underbalanced drilling assets of W. T. On August 1, 2005, we acquired all of the outstanding capital stock of Target. We included Target results in our Directional Drilling segment because Target's measurement while drilling equipment is utilized in that segment. On September 1, 2005, we acquired the

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casing and tubing service assets of Patterson Services, Inc. We consolidated the results of these acquisitions from the day they were acquired.

In January 2006, we acquired all of the outstanding stock of Specialty and in December 2006, we acquired substantially all of the assets of OGR. We report the operations of Specialty and OGR in our Rental Services segment. In April 2006, we acquired all of the outstanding stock of Rogers. We report the operations of Rogers in our Tubular Services segment. In August 2006, we acquired all of the outstanding stock of DLS and in December 2006, we acquired all of the outstanding stock of 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. We report the operations of Petro Rentals in our Production Services segment. We consolidated the results of these acquisitions from the day they were acquired.

In June 2007, we acquired all of the outstanding stock of Coker and in July 2007, we acquired all of the outstanding stock of Diggar and in November 2007, we acquired substantially all of the assets of Diamondback. We report the operations of Coker, Diggar and Diamondback in our Directional Drilling segment. In October 2007, we acquired all of the outstanding stock of Rebel. We report the operations of Rebel in our Tubular Services 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 Years Ended December 31, 2007 and December 31, 2006

Our revenues for the year ended December 31, 2007 were \$571.0 million, an increase of 83.6% compared to \$311.0 million for the year ended December 31, 2006. Revenues increased in all of our business segments due principally to the acquisitions completed during the two year period ended December 31, 2007, the investment in new equipment 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 established our International Drilling segment. The International Drilling segment generated \$215.8 million in revenues for the twelve months ended December 31, 2007 compared to \$69.5 million for the period from the date of the DLS acquisition to December 31, 2006. Revenues also increased significantly at our Rental Services segment due to the acquisition of the OGR assets on December 18, 2006. The OGR assets, including its two rental yards, expanded our assets available for rent. The OGR assets generated revenues of \$82.2 million for the twelve months ended December 31, 2007 compared to \$2.1 million for the period from the date of acquisition of the OGR assets to December 31, 2006. We experienced a decline in demand for our Rental Services in the last half of 2007 due to the hurricane season and a reduction of drilling activity in the U.S. Gulf of Mexico as rigs departed the U.S Gulf in favor of the international markets. Our Directional Drilling segment revenues increased in the 2007 period compared to the 2006 period due to acquisitions completed in the third and fourth quarters of 2007 which added downhole motors, measurement-while-drilling, or MWD, tools, and directional drilling personnel resulting in increased capacity and increased market penetration. Revenues increased at our Underbalanced Drilling segment due to the purchase of additional equipment, principally new compressor packages, and expansion of operations into new geographic regions. Revenues increased in our Production Services segment principally due to the \$20.6 million in revenues from the Petro-Rental acquisition completed October 16, 2006 and additional coil tubing equipment acquired in 2007, which was offset by a decrease in our revenue from capillary assets of \$6.7 million which were sold on June 29, 2007. Except for our Rental Services segment, we believe these gains in revenues are sustainable dependent on a favorable oil and natural gas price environment, a stable rig count and the level of capital expenditures of our customers. Future growth and increased revenues in our Rental Services segment is contingent upon achieving success in marketing our rental assets to the U.S. land drilling and international markets, and improvement in the offshore U.S. Gulf of Mexico activity.

Our gross margin for the year ended December 31, 2007 increased 69.9% to \$178.6 million, or 31.3% of revenues, compared to \$105.1 million, or 33.8%, of revenues for the year ended December 31, 2006. The increase in gross profit is due to the increase in revenues in all of our business segments. The decrease in gross profit as a percentage of revenues is primarily due to the 151.3% increase in depreciation expense to \$50.9 million in 2007 from \$20.3 million in 2006. The primary increase in depreciation expense is due to the acquisitions of the OGR assets, DLS and Petro-Rental and our capital expenditures. The increase in our depreciation expense related to the OGR assets was \$15.9 million to \$16.6 million for the year ended December 31, 2007 compared to \$650,000 for the

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period from the date of the acquisition of the OGR assets to December 31, 2006. Depreciation expense from DLS increased \$7.2 million to \$11.3 million for the year ended December 31, 2007 from \$4.1 million for the period from the date of the acquisition of DLS to December 31, 2006. Depreciation expense from Petro-Rental for the year ended December 31, 2007 was \$3.6 million compared to \$688,000 for the period from the date of acquisition of Petro-Rental to December 31, 2006. 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. The sustainability and growth in our gross margin is principally dependent upon the sustainability and growth in our revenues. However, factors affecting the performance of our Rental Services segment in 2007 as discussed previously have a negative impact on our gross margin percentage as our Rental Services segment operates at a higher gross margin than our other segments. Therefore, the level of revenues and gross margin from our Rental Services segment has a significant impact on our overall gross margin and gross margin percentage. We expect our depreciation expense to increase as we continue to purchase capital equipment to strengthen and enhance our existing operations.

General and administrative expense was \$58.6 million for the year ended December 31, 2007 compared to \$35.5 million for the year ended December 31, 2006. General and administrative expense increased due to the acquisitions, and the hiring of additional sales, operations, accounting and administrative personnel. As a percentage of revenues, general and administrative expenses were 10.3% in 2007 compared to 11.4% in 2006. General and administrative expense includes share-based compensation expense of \$4.7 million in 2007 and \$3.0 million in 2006. Without any significant acquisitions, we expect the growth of our general and administrative expense to decrease in the near future as our share-based compensation expense for future years is currently expected to decrease.

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

Amortization expense was \$4.1 million for the year ended December 31, 2007 compared to \$1.9 million for the year ended December 31, 2006. The increase in amortization expense is primarily due to the amortization of intangible assets in connection with our acquisition of the OGR assets, which increased \$2.2 million to \$2.3 million for the year ended December 31, 2007 compared to \$96,000 for the period from the date of the acquisition of the OGR assets to December 31, 2006. Without any significant acquisitions, we expect a slight increase in amortization expense as future years will include a full year of amortization of intangible assets related to acquisitions completed in 2007.

Income from operations for the year ended December 31, 2007 totaled \$124.8 million, an 84.2% increase over the \$67.7 million in income from operations for the year ended December 31, 2006, reflecting the increase in our revenues of \$260.0 million and the resulting increase in our gross profit of \$73.5 million, offset in part by increased general and administrative expense of \$23.1 million and increased amortization expense of \$2.2 million. Our income from operations as a percentage of revenues increased slightly to 21.9% in 2007 from 21.8% in 2006. Income from operations in the 2007 period includes an \$8.9 million gain from the sale of our capillary tubing assets in the second quarter of 2007.

Our net interest expense was \$46.3 million for the year ended December 31, 2007, compared to \$20.3 million for the year ended December 31, 2006. Interest expense increased in 2007 due to our increased debt. In August 2006 we issued \$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 \$300.0 million bridge loan utilized to complete the OGR acquisition and for working capital. This bridge loan was repaid on January 29, 2007. The average interest rate on the bridge loan was approximately 10.6%. Interest expense for 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 \$1.9 million and \$1.5 million for 2007 and 2006,

respectively. Our net interest expense is dependent upon our level of debt and cash on hand, which are principally dependent upon acquisitions we complete, our capital expenditures and our cash flows from operations.

Our provision for income taxes for the year ended December 31, 2007 was \$28.8 million, or 36.4% of our net income before income taxes, compared to \$11.4 million, or 24.3% of our net income before income taxes for 2006. The increase in our provision for income taxes is attributable to the increase in our operating income and a higher

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effective tax rate. The effective tax rate in 2006 was favorably impacted by the reversal of our 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.

We had net income attributed to common stockholders of \$50.4 million for the year ended December 31, 2007, an increase of 41.6%, compared to net income attributed to common stockholders of \$35.6 million for the year ended December 31, 2006.

The following table compares revenues and income from operations for each of our business segments for the years ended December 31, 2007 and December 31, 2006. Income from operations consists of our revenues less cost of revenues, general and administrative expenses, and depreciation and amortization:

	Revenues			Income (Loss) from Operations		
	2007	2006	Change	2007	2006	Change
	(In thousands)					
Rental Services	\$ 121,186	\$ 51,521	\$ 69,665	\$ 49,139	\$ 26,293	\$ 22,846
International Drilling	215,795	69,490	146,305	38,839	12,233	26,606
Directional Drilling	96,080	76,471	19,609	18,848	17,666	1,182
Tubular Services	53,524	50,887	2,637	10,744	12,544	(1,800)
Underbalanced Drilling	50,959	43,045	7,914	13,091	10,810	2,281
Production Services	33,423	19,550	13,873	10,535	2,137	8,398
General Corporate				(16,414)	(13,953)	(2,461)
Total	\$ 570,967	\$ 310,964	\$ 260,003	\$ 124,782	\$ 67,730	\$ 57,052

Rental Services. Our Rental Services revenues were \$121.2 million for the year ended December 31, 2007, an increase of 135.2% from the \$51.5 million in revenues for the year ended December 31, 2006. Income from operations increased 86.9% to \$49.1 million in 2007 compared to \$26.3 million in 2006. The increase in revenue and operating income is primarily attributable to the acquisition of the OGR assets in December 2006. The OGR assets, including its two rental yards, expanded our assets available for rent. We generated \$82.2 million for the twelve months ended December 31, 2007 compared to \$2.1 million for the period from the date of acquisition of the OGR assets to December 31, 2006. Income from operations as a percentage of revenues decreased to 40.5% for 2007 compared to 51.0% for the prior year as a result of higher depreciation expense associated with the OGR acquisition and capital expenditures. Our depreciation expense for the OGR assets increased \$15.9 million to \$16.6 million for the year ended December 31, 2007 compared to \$650,000 for the period from the date of acquisition of the OGR assets to December 31, 2006. Rental Services revenues and operating income was impacted by a more competitive market environment due to the decreased U.S. Gulf of Mexico drilling activity in the last half of 2007 attributed to the hurricane season and the departure of drilling rigs in favor of the international markets. Future growth and increased revenues in our Rental Services segment is contingent upon achieving success in marketing our rental assets to the U.S. land drilling and international markets, and improvement in the offshore U.S. Gulf of Mexico activity.

International Drilling. On August 14, 2006, we acquired DLS which established our International Drilling segment. Our International Drilling revenues were \$215.8 million for the year ended December 31, 2007, an increase from the \$69.5 million in revenues for the period from the date of the DLS acquisition until December 31, 2006. Income from operations increased to \$38.8 million in 2007 compared to \$12.2 million from the date of the DLS acquisition until December 31, 2006. Income from operations as percentage of revenue increased to 18.0% for 2007 compared to

17.6% for 2006. We believe the increase in the percentage was primarily due to price increases implemented in 2007. During 2007 we placed orders for 16 service rigs (workover rigs and pulling rigs) and four drilling rigs. Four of the service rigs were delivered in the fourth quarter of 2007. We expect all the rigs to be placed in service during the first three quarters of 2008. We believe these levels in revenues and operating income are sustainable assuming a stable rig count and a favorable oil and natural gas price environment in Argentina, labor-related disruptions affecting the oil and natural gas industry in Argentina and resulting cost increases can affect our revenues and operating margins until we are able to increase rig rates to offset such costs. We expect to benefit from the activation of the new rigs as they are delivered throughout 2008.

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Directional Drilling. Revenues for the year ended December 31, 2007 for our Directional Drilling segment were \$96.1 million, an increase of 25.6% from the \$76.5 million in revenues for the year ended December 31, 2006. The increase in revenues is due to the purchase of additional MWD tools and the benefit of acquisitions completed in the last half of 2007 which added downhole motors, MWDs, and directional drillers. The additional equipment and personnel enabled us to strengthen our presence in new geographic markets and increase our market penetration. The impact of the additional MWD tools and the acquisitions of Diggar and Coker completed in the last half of 2007 are not easily identifiable as they were quickly integrated with our pre-existing operations. The acquisition of Diamondback provided \$3.1 million of revenues from the date of acquisition to December 31, 2007. Income from operations increased 6.7% to \$18.8 million for 2007 from \$17.7 million for 2006. Income from operations as a percentage of revenues decreased to 19.6% for 2007 compared to 23.1% for the prior year. The decrease in our operating margin as a percentage of revenues is due to increased expenses for downhole motor rentals and repairs, experienced primarily in the first three quarters of 2007 prior to the recent additions to our downhole motor fleet, increased personnel costs and increased depreciation expense. We believe the gain in revenue is sustainable assuming a stable rig count, continued strength in the demand for directional and horizontal drilling services and a favorable oil and natural gas price environment in the U.S. We expect our operating results to benefit from the downhole motors acquired in the Diggar acquisition, the acquisitions of Coker and Diamondback and the purchase of additional MWDs and downhole motors in 2007. With more downhole motors we are able to reduce our reliance on third-party rental motors and the related costs.

Tubular Services. Revenues for the year ended December 31, 2007 for the Tubular Services segment were \$53.5 million, an increase of 5.2% from the \$50.9 million in revenues for the year ended December 31, 2006. Revenues from domestic operations increased to \$45.6 million in 2007 from \$44.4 million in 2006 as a result of the investment in new equipment. Revenues from Mexican operations increased to \$7.9 million in 2007 from \$6.5 million in 2006. Income from operations decreased 14.3% to \$10.7 million in 2007 from \$12.5 million in 2006. Income from operations as a percentage of revenues decreased to 20.1% for 2007 compared to 24.7% for the prior year. The results of our Tubular Services segment were impacted by an increasingly competitive environment domestically for casing and tubing services, exacerbated by the decline in drilling activity in the U.S. Gulf of Mexico in the last half of 2007, and decreased sales of power tongs in 2007 compared to 2006. While revenues from Mexican operations increased 21.5% in 2007 compared to 2006, they were impacted in the fourth quarter of 2007, by severe weather and flooding in Mexico. We believe these gains in revenues are sustainable assuming a stable rig count, a favorable oil and natural gas price environment and the absence of significant weather disruptions in the U.S. and in Mexico. We expect the competitive challenges in the domestic tubular services market to continue and limit improvement in our operating income margins.

Underbalanced Drilling. Our Underbalanced Drilling revenues were \$51.0 million for the year ended December 31, 2007, an increase of 18.4% compared to \$43.0 million in revenues for the year ended December 31, 2006. Income from operations increased 21.1% to \$13.1 million in 2007 compared to income from operations of \$10.8 million in 2006. Income from operations as a percentage of revenues increased slightly to 25.7% in 2007 from 25.1% in 2006. Our Underbalanced Drilling revenues and operating income for the 2007 period increased compared to the 2006 period due in part to our investment in additional equipment, principally new compressors and new foam units. During 2007 Underbalanced Drilling was affected by a decrease in drilling activity in certain geographic areas by some of our customers, offset by an increased market presence and growth in drilling activity in other, more attractive geographic areas. We believe these gains in revenue are sustainable assuming a stable rig count and a favorable oil and natural gas price environment in the U.S. Future growth will be dependent on our ability to penetrate the new developing land drilling markets and our future investment in capital equipment.

Production Services Segment. Our Production Services revenues were \$33.4 million for the year ended December 31, 2007, compared to \$19.6 million in revenues for the year ended December 31, 2006. Income from operations was \$10.5 million in 2007 compared to income from operations of \$2.1 million in 2006. Revenues for 2007 increased

compared to 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, one unit in the first quarter of 2007 and one additional unit delivered at the end of the second quarter of 2007, offset in part by a reduction in revenue generated from our capillary tubing assets, which were sold in 2007. Our capillary tubing revenue decreased \$6.7 million to \$5.6 million for the period from January 1, 2007 until the date of sale, June 29, 2007, compared to \$12.3 million for the year ended December 31, 2006. The increase in income from operations can be attributed to an \$8.9 million gain on sale of our capillary tubing assets. During 2007 our Production Services segment experienced delays in the delivery and activation of new coil tubing units. As a result, we experienced low utilization for our coil tubing units and increases

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in personnel expenses, including increased lodging, relocation and training expenses for the crews without the benefit of corresponding increases in revenues. We expect 2008 revenues to be stable as the revenue reduction related to the sale of the capillary assets is expected to be offset by the new coil tubing units placed in service in 2007 and 2008, assuming a stable rig count and a favorable oil and natural gas environment in the U.S. Our income from operations is expected to decline as we will not have the gain from the sale of the capillary assets that we realized in 2007.

Comparison of Years Ended December 31, 2006 and December 31, 2005

Our revenues for the year ended December 31, 2006 was \$311.0 million, an increase of 187.9% compared to \$108.0 million for the year ended December 31, 2005. Revenues increased in all of our business segments due to the successful integration of acquisitions completed in the third quarter of 2005 and during 2006, the investment in new equipment, improved pricing for our services, the addition of operations and sales personnel and the opening of new operations offices. Revenues increased most significantly 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 acquisition of Specialty effective January 1, 2006. Our Tubular Services segment also had a substantial increase in revenue, primarily due to the acquisitions of the casing and tubing assets of Patterson Services, Inc. on September 1, 2005, and the acquisition of Rogers as of April 1, 2006, along with the investment in additional equipment, improved market conditions and increased market penetration for our services in South Texas, East Texas, Louisiana and the U.S. Gulf of Mexico. Revenues increased at our Underbalanced Drilling segment due to the purchase of additional equipment and improved pricing for our services. Our Directional Drilling segment revenues increased in the 2006 period compared to the 2005 period due to improved pricing for directional drilling services, the August 2005 acquisition of Target which provides MWD tools and the purchase of additional down-hole motors and MWDs which increased our capacity and market presence. The impact of the acquisitions of DLS, Rogers and Target, including the additional MWDs, was to increase consolidated revenues by \$69.5 million, \$10.8 million and \$7.6 million, respectively. The impact of the acquisitions of Specialty and the casing and tubing assets of Patterson Services, Inc. are not easily identifiable as they were quickly integrated with our pre-existing operations, but our Rental Services revenues improved to \$51.5 million for the year ended December 31, 2006 compared to \$5.1 million for the year ended December 31, 2005 and our Tubular Services revenues increased to \$50.9 million compared to \$20.9 million for the same period.

Our gross margin for the year ended December 31, 2006 increased 243.8% to \$105.1 million, or 33.8% of revenues, compared to \$30.6 million, or 28.3%, of revenues for the year ended December 31, 2005. The increase in gross profit is due to the increase in revenues in all of our business segments. The increase in gross profit as a percentage of revenues is primarily due to the acquisition of Specialty as of January 1, 2006, in the high margin rental tool business, the improved pricing for our services generally and the investments in new capital equipment. Also contributing to our improved gross margin was the acquisition of Target, the purchase of additional MWDs and the acquisition of Rogers. The increase in gross profit was partially offset by an increase in depreciation expense of 315.7% to \$20.3 million compared to \$4.9 million for 2005. The increase is due to additional depreciable assets resulting from acquisitions and capital expenditures. The acquisitions of DLS, Petro-Rental, Rogers and Target, including additional MWDs increased depreciation expense by \$4.1 million, \$688,000, \$530,000 and \$439,000, respectively. While we cannot specifically identify the impact that the Specialty acquisition had on our gross margin due to the reason described in the preceding paragraph, the gross margin on our total Rental Services segment increased \$28.9 million to \$32.1 million for the year ended December 31, 2006 from \$3.2 million for the year ended December 31, 2005 after the impact of an increase in depreciation expense of \$6.7 million to \$7.1 million for 2006 from \$385,000 for 2005. The gross margin provided from the acquisitions of Rogers and Target, including additional MWDs was \$4.7 million and \$3.3 million, respectively. 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 \$35.5 million for the year ended December 31, 2006 compared to \$15.6 million for the year ended December 31, 2005. General and administrative expense increased due to additional expenses associated with the acquisitions, and the hiring of additional sales, operations and

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administrative personnel. General and administrative expense also increased because of increased accounting and consulting fees and other expenses in connection with initiatives to strengthen our internal control processes, costs related to Sarbanes Oxley compliance efforts and increased corporate accounting and administrative staff. As a percentage of revenues, general and administrative expenses were 11.4% in 2006 compared to 14.4% in 2005.

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. 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. Therefore, we recorded an expense of \$3.4 million related to stock awards for the year ended December 31, 2006 of which \$3.0 million was recorded in general and administrative expense with the balance being recorded as a direct cost. Prior to January 1, 2006, we accounted for our stock-based compensation using Accounting Principle Board Opinion No. 25, or APB No. 25. Under APB No. 25, compensation expense is recognized for stock options with an exercise price that is less than the market price on the grant date of the option. Accordingly, no compensation cost was recognized under APB No. 25.

Amortization expense was \$1.9 million for the year ended December 31, 2006 compared to \$1.5 million for the year ended December 31, 2005. The increase in amortization expense is due to the amortization of intangible assets in connection with our acquisitions. The 2006 acquisitions of Rogers, the OGR assets, Petro and DLS resulted in amortization expense of \$166,000, \$96,000, \$63,000 and \$11,000, respectively.

Income from operations for the year ended December 31, 2006 totaled \$67.7 million, a 401.0% increase over the \$13.5 million in income from operations for the year ended December 31, 2005, reflecting the increase in our revenues of \$202.9 million and the resulting increase in our gross profit of \$74.5 million, offset in part by increased general and administrative expenses of \$20.0 million. Our income from operations as a percentage of revenues increased to 21.8% in 2006 from 12.5% in 2005 due to the increase in our gross margin which offset the increases in amortization expense and general and administrative expenses.

Our net interest expense was \$20.3 million for the year ended December 31, 2006, compared to \$4.7 million for the year ended December 31, 2005. Interest expense increased in 2006 due to our increased debt. In January of 2006 we issued \$160.0 million of senior notes bearing interest at 9.0% to fund the acquisition of Specialty, pay off other outstanding debt and for working capital. 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. On December 18, 2006, we borrowed \$300.0 million in a senior unsecured bridge loan to fund the acquisition of OGR. The average interest rate on the bridge loan was approximately 10.6%. Interest expense for 2006 includes the write-off of \$453,000 related to financing fees on the bridge loan. This bridge loan was repaid on January 29, 2007 and the remaining \$1.2 million of financing fees were written off in 2007. In the third quarter of 2005, we incurred debt retirement expense of \$1.1 million related to the refinancing of our debt. This amount includes prepayment penalties and the write-off of deferred financing fees from a previous financing.

Minority interest in income of subsidiaries for the year ended December 31, 2006 was \$0 compared to \$488,000 for the corresponding period in 2005 due to the our acquisition of the minority interest at AirComp on July 11, 2005.

Our provision for income taxes for the year ended December 31, 2006 was \$11.4 million, or 24.3% of our net income before income taxes, compared to \$1.3 million, or 15.8% of our net income before income taxes for 2005. The increase in our provision for income taxes is attributable to the significant increase in our operating income which

resulted in the utilization of our deferred tax assets including our net operating losses, and the increase in percentage of income taxes to net income before income taxes attributable to our operations in Argentina which are taxed at 35.0%.

We had net income attributed to common stockholders of \$35.6 million for the year ended December 31, 2006, an increase of 396.5%, compared to net income attributed to common stockholders of \$7.2 million for the year ended December 31, 2005.

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The following table compares revenues and income from operations for each of our business segments for the years ended December 31, 2006 and December 31, 2005. Income from operations consists of our revenues less cost of revenues, general and administrative expenses, and depreciation and amortization:

	Revenues			Income (Loss) from Operations		
	2006	2005	Change (In thousands)	2006	2005	Change
Rental Services	\$ 51,521	\$ 5,059	\$ 46,462	\$ 26,293	\$ 1,300	\$ 24,993
International Drilling	69,490		69,490	12,233		12,233
Directional Drilling	76,471	46,579	29,892	17,666	7,389	10,277
Tubular Services	50,887	20,932	29,955	12,544	4,994	7,550
Underbalanced Drilling	43,045	25,662	17,383	10,810	5,612	5,198
Production Services	19,550	9,790	9,760	2,137	(99)	2,236
General Corporate				(13,953)	(5,678)	(8,275)
Total	\$ 310,964	\$ 108,022	\$ 202,942	\$ 67,730	\$ 13,518	\$ 54,212

Rental Services Segment. Our rental services revenues were \$51.5 million for the year ended December 31, 2006, an increase from the \$5.1 million in revenues for the year ended December 31, 2005. Income from operations increased to \$26.3 million in 2006 compared to \$1.3 million in 2005. The increase in revenue and operating income is primarily attributable to the acquisition of Specialty effective January 1, 2006, improved pricing, improved utilization of our inventory of rental equipment and to a lesser extent, the acquisition of the OGR assets in December 2006. The impact of the Specialty acquisition is not easily identifiable as the acquisition was quickly integrated with our pre-existing operations. The acquisition of the OGR assets provided \$2.1 million in revenues in 2006.

International Drilling Segment. Our international drilling revenues were \$69.5 million for the year ended December 31, 2006, and our income from operations was \$12.2 million. This segment of our operations was created with the acquisition of DLS in August of 2006.

Directional Drilling Segment. Revenues for the year ended December 31, 2006 for our Directional Drilling segment were \$76.5 million, an increase of 64.2% from the \$46.6 million in revenues for the year ended December 31, 2005. Income from operations increased 139.1% to \$17.7 million for 2006 from \$7.4 million for 2005. The improved results for this segment are due to the increase in drilling activity in the Texas and Gulf Coast areas, improved pricing, the acquisition of Target as of August 1, 2005 and the purchase of an additional six MWDs. The acquisition of Target and the additional MWDs provided an additional \$7.6 million of revenue and \$2.8 million of operating income. Our increased operating expenses as a result of the addition of operations and personnel were more than offset by the growth in revenues and improved pricing for our services.

Tubular Services Segment. Revenues for the year ended December 31, 2006 for the Tubular Services segment were \$50.9 million, an increase of 143.1% from the \$20.9 million in revenues for the year ended December 31, 2005. Revenues from domestic operations increased to \$44.4 million in 2006 from \$14.5 million in 2005 as a result of the acquisition of Rogers, the acquisition of the casing and tubing assets of Patterson Services, Inc. on September 1, 2005 and investment in new equipment, all of which resulted in increased market penetration for our services in South Texas, East Texas, Louisiana and the U.S. Gulf of Mexico. The year ended December 2005 was also adversely impacted by hurricane activity in September of 2005. The impact of the acquisition of casing and tubing assets of Patterson Services, Inc. are not easily identifiable as they were quickly integrated into with our pre-existing

operations, but the Rogers acquisition generated an additional \$10.8 million in revenues in 2006. Revenues from Mexican operations increased to \$6.5 million in 2006 from \$6.4 million in 2005. Income from operations increased 151.2% to \$12.5 million in 2006 from \$5.0 million in 2005. The increase in this segment's operating income is due to increased revenues both domestically and in our Mexico operations.

Underbalanced Drilling Segment. Our underbalanced drilling revenues were \$43.0 million for the year ended December 31, 2006, an increase of 67.7% compared to \$25.7 million in revenues for the year ended December 31, 2005. Income from operations increased 92.6% to \$10.8 million in 2006 compared to income from operations of \$5.6 million in 2005. Our underbalanced drilling revenues and operating income for the 2006 period

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increased compared to the 2005 period due in part to the acquisition of the air drilling assets of W. T., our investment in additional equipment and improved pricing in West Texas. The impact of the acquisition of the air drilling assets of W.T. is not easily identifiable as they were quickly integrated into our pre-existing operations.

Production Services Segment. Our production services revenues were \$19.6 million for the year ended December 31, 2006, compared to \$9.8 million in revenues for the year ended December 31, 2005. Income from operations was \$2.1 million in 2006 compared to a loss from operations of \$99,000 in 2005. The increase in revenues is attributable to the acquisition of Petro-Rentals completed in October 2006, the acquisition of Capcoil on May 1, 2005 and improved utilization and pricing for our services. The increase in operating income is primarily related to the operations of Petro-Rental and the addition of two coil tubing units in the fourth quarter of 2006, which provided \$5.5 million of revenue in 2006.

Liquidity and Capital Resources

Our on-going capital requirements arise primarily from our need to service our debt, to acquire and maintain equipment, to fund our working capital requirements and to complete acquisitions. 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 \$43.7 million at December 31, 2007 compared to \$39.7 million at December 31, 2006.

Operating Activities

In the year ended December 31, 2007, we generated \$103.5 million in cash from operating activities. Net income for the year ended December 31, 2007 was \$50.4 million. Non-cash additions to net income totaled \$60.6 million in the 2007 period consisting primarily of \$55.0 million of depreciation and amortization, \$4.9 million related to the expensing of stock options as required under SFAS No. 123R, \$8.0 million of deferred income tax, \$730,000 for a provision for bad debts and \$3.2 million of amortization and write-off of deferred financing fees, partially offset by \$2.3 million of gain from the disposition of equipment and a \$8.9 million gain from the sale of capillary assets.

During the year ended December 31, 2007, changes in working capital used \$7.6 million in cash, principally due to an increase of \$30.8 million in accounts receivable, an increase of \$4.5 million in other assets and an increase in inventories of \$5.4 million, offset by a decrease of \$8.2 million in other current assets, an increase of \$10.7 million in accounts payable, an increase of \$6.0 million in accrued interest, an increase of \$4.0 million in accrued employee benefits and payroll taxes, an increase of \$1.5 million in accrued expenses and an increase in other long-term liabilities of \$2.7 million. Our accounts receivables increased at December 31, 2007 primarily due to the increase in our revenues in 2007. Other assets increase primarily due to the contract costs related to the deployment of new rigs for our International Drilling segment. 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. Accrued interest increased at December 31, 2007 due principally to interest accrued on our 8.5% senior notes issued in January 2007 and our 9.0% senior notes issued in August 2006 which are both payable semi-annually. Our accounts payable, accrued employee benefits and payroll taxes and other accrued expenses increased primarily due to the increase in costs due to our growth in revenues and acquisition completed in 2007. Other long-term liabilities increased primarily due to the deferral of contract revenue related to our new rigs being constructed in the International drilling segment.

In the year ended December 31, 2006, we generated \$53.7 million in cash from operating activities. Net income for the year ended December 31, 2006 was \$35.6 million. Non-cash additions to net income totaled \$27.6 million in the 2006 period consisting primarily of \$22.1 million of depreciation and amortization, \$3.4 million related to the expensing of stock options as required under SFAS No. 123R, \$2.2 million of deferred income tax, \$781,000 for a provision for bad debts and \$1.5 million for amortization of finance fees, including the bridge loan fees, partially

offset by \$2.4 million of gain from the disposition of equipment.

During the year ended December 31, 2006, changes in working capital used \$9.9 million in cash, principally due to an increase of \$23.2 million in accounts receivable, an increase of \$2.6 million in inventories, a decrease of \$2.3 million in accounts payable, offset in part by a decrease in other current assets of \$2.5 million, an increase of \$11.4 million in accrued interest, an increase of \$3.4 million in accrued employee benefits and payroll taxes and an

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increase of \$872,000 in accrued expenses. Our accounts receivables increased at December 31, 2006 primarily due to the increase in our revenues in 2006. Accrued interest increased at December 31, 2006 due principally to interest accrued on our 9.0% senior notes, which are payable semi-annually. Our accrued employee benefits and payroll taxes and other accrued expenses increased primarily due to the increase in costs due to our growth in revenues and acquisition completed in 2006.

In the year ended December 31, 2005, we generated \$3.6 million in cash from operating activities. Net income for the year ended December 31, 2005 was \$7.2 million. Non-cash additions to net income totaled \$7.4 million in the 2005 period consisting primarily of \$6.4 million of depreciation and amortization, \$488,000 of minority interest in the income of a subsidiary, \$962,000 in amortization and write-off of financing fees in conjunction with a refinancing and \$219,000 for a provision for bad debts, partially offset by \$669,000 of gain from the disposition of equipment.

During the year ended December 31, 2005, changes in working capital used \$11.0 million in cash, principally due to an increase of \$10.7 million in accounts receivable, an increase of \$3.1 million in inventories, an increase in other assets of \$936,000, a decrease in other liabilities of \$266,000 and a decrease of \$97,000 in accrued expenses, offset in part by a decrease in other current assets of \$929,000, an increase of \$2.4 million in accounts payable, an increase of \$324,000 in accrued interest and a increase of \$443,000 in accrued employee benefits and payroll taxes. Our accounts receivables increased at December 31, 2005 due primarily to the increase in our revenues in 2005. Accounts payable increased by \$2.4 million at December 31, 2005 due to the increase in our cost of sales associated with the increase in our revenues and the acquisitions completed in 2005 and 2004.

Investing Activities

During the year ended December 31, 2007, we used \$137.1 million in investing activities consisting of four acquisitions and our capital expenditures. During the year ended December 31, 2007, we completed the following acquisitions for a total net cash outlay of \$41.0 million, consisting of the purchase price and acquisition costs less cash acquired:

In June 2007, we acquired Coker for a purchase price of approximately \$3.6 million in cash and a promissory note for \$350,000.

In July 2007, we acquired Diggar for a purchase price of approximately \$6.7 million in cash, the payment of approximately \$2.8 million of debt and a promissory note for \$750,000.

In October 2007, we acquired Rebel for a purchase price of approximately \$5.0 million in cash, the payment of approximately \$1.8 million of debt and escrow and promissory notes for an aggregate of \$500,000.

In November 2007, we acquired substantially all of the assets of Diamondback for a purchase price of approximately \$23.1 million in cash.

In addition we made capital expenditures of approximately \$113.2 million during the year ended December 31, 2007, including \$34.9 million to increase our inventory of equipment and replace lost-in-hole equipment in the Rental Services segment, \$28.9 million to purchase, improve and replace equipment in our International Drilling segment, \$11.2 million to purchase equipment for our Directional Drilling segment, \$17.4 million to purchase and improve equipment in our Underbalanced Drilling segment, \$9.3 million to purchase and improve our Tubular Services equipment and approximately \$10.7 million to expand our Production Services segment. We received proceeds of \$16.3 million from the sale of our capillary assets. We also received \$12.8 million from the sale of assets during the year ended December 31, 2007, comprised mostly from equipment lost-in-hole from our Rental Services segment (\$11.0 million) and our Directional Drilling segment (\$1.4 million). We also made advance payments of \$11.5 million

on the purchase of new drilling and service rigs to be delivered in 2008 for our International Drilling segment.

During the year ended December 31, 2006, we used \$559.4 million in investing activities consisting of six acquisitions and our capital expenditures. During the year ended December 31, 2006, we completed the following

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acquisitions for a total net cash outlay of \$526.6 million, consisting of the purchase price and acquisition costs less cash acquired:

Effective January 1, 2006, we acquired Specialty for a purchase price of approximately \$95.3 million in cash.

Effective April 1, 2006, we acquired Rogers for a purchase price of approximately \$11.3 million in cash, 125,285 shares of our common stock and a promissory note for \$750,000.

On August 14, 2006, we acquired DLS for a purchase price of approximately \$93.7 million in cash, 2.5 million shares of our common stock and the assumption of \$9.1 million of indebtedness.

On October 16, 2006, we acquired Petro Rentals for a purchase price of approximately \$20.2 million in cash, 246,761 shares of our common stock and the payment of approximately \$9.6 million of debt.

Effective December 1, 2006, we acquired Tanus for a purchase price of \$2.5 million in cash.

On December 18, 2006, we acquired substantially all of the assets of OGR for a purchase price of approximately \$291.0 million in cash and 3.2 million shares of our common stock.

In addition we made capital expenditures of approximately \$39.7 million during the year ended December 31, 2006, including \$4.5 million to replace lost-in-hole equipment and to increase our inventory of equipment in the Rental Services segment, \$5.8 million to purchase, improve and replace equipment in our international drilling segment, \$5.1 million to purchase equipment for our Directional Drilling segment, \$7.7 million to purchase and improve equipment in our Underbalanced Drilling segment, \$11.0 million to purchase and improve our tubular services equipment and approximately \$5.3 million to expand our Production Services segment. We also received \$6.9 million from the sale of assets during the year ended December 31, 2006, comprised mostly from equipment lost-in-hole from our Rental Services segment (\$3.8 million) and our Directional Drilling segment (\$1.8 million).

During the year ended December 31, 2005, we used \$53.1 million in investing activities. During the year ended December 31, 2005, we completed the following acquisitions for a total net cash outlay of \$36.9 million, consisting of the purchase price and acquisition costs less cash acquired:

On April 1, 2005 we acquired Delta for a purchase price of approximately \$4.6 million in cash, 223,114 shares of our common stock and two promissory notes totaling \$350,000.

On May 1, 2005, we acquired Capcoil for a purchase price of approximately \$2.7 million in cash, 168,161 shares of our common stock and the payment or assumption of approximately \$1.3 million of debt.

On July 11, 2005, we acquired the compressed air drilling assets of W.T. for a purchase price of \$6.0 million in cash.

On July 11, 2005, we acquired from M-I its 45% interest in AirComp and subordinated note in the principal amount of \$4.8 million issued by AirComp, for which we paid M-I \$7.1 million in cash and reissued a \$4.0 million subordinated note.

Effective August 1, 2005, we acquired Target for a purchase price of approximately \$1.3 million in cash and forgiveness of a lease receivable of \$592,000.

On September 1, 2005, we acquired the casing and tubing service assets of Patterson Services, Inc. for a purchase price of approximately \$15.6 million.

In addition we made capital expenditures of approximately \$17.8 million during the year ended December 31, 2005, including \$2.9 million to purchase equipment for our Directional Drilling segment, \$7.0 million to purchase and improve equipment in our Underbalanced Drilling segment, \$5.2 million to purchase and improve our tubular services equipment and approximately \$1.5 million to expand our Production Services segment. We also received \$1.6 million from the sale of assets during the year ended December 31, 2005, comprised mostly from equipment lost in the hole from our Directional Drilling segment (\$1.0 million) and our Rental Services segment (\$408,000).

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Financing Activities

During the year ended December 31, 2007, financing activities provided a net of \$37.6 million in cash. We received \$250.0 million in borrowings from the issuance of our 8.5% senior notes due 2017. We also received \$100.1 million in net proceeds from the issuance of 6,000,000 shares of our common stock, \$1.7 million on the tax benefit of stock compensation plans and \$3.3 million from the proceeds of warrant and option exercises for 882,624 shares of our common stock. The proceeds were used to repay long-term debt totaling \$309.7 million and to pay \$7.8 million in debt issuance costs. The repayment of long-term debt consisted primarily of the repayment of our \$300.0 million bridge loan which was used to fund the acquisition of the OGR assets.

During the year ended December 31, 2006, financing activities provided a net of \$543.6 million in cash. We received \$557.8 million in borrowings under long-term debt facilities, consisting primarily of the issuance of \$255.0 million of our 9.0% senior notes due 2014 and a \$300.0 million senior unsecured bridge loan. The bridge loan, which was repaid on January 29, 2007, was used to fund the acquisition of the OGR assets. We also received \$46.3 million in net proceeds from the issuance of 3,450,000 shares of our common stock, \$6.4 million on the tax benefit of options and \$6.3 million from the proceeds of warrant and option exercises for 1,851,377 shares of our common stock. The proceeds were used to repay long-term debt totaling \$54.0 million, repay \$6.4 million in net borrowings under our revolving lines of credit, repay related party debt of \$3.0 million and to pay \$9.9 million in debt issuance costs.

During the year ended December 31, 2005, financing activities provided a net of \$44.1 million in cash. We received \$56.3 million in borrowings under long-term debt facilities, \$15.5 million in net proceeds from the issuance of 1,761,034 shares of our common stock, \$2.5 million in net borrowings under our revolving lines of credit and \$1.4 million from the proceeds of warrant and option exercises for 1,076,154 shares of our common stock. The proceeds were used to repay long-term debt totaling \$28.2 million, repay related party debt of \$1.5 million and to pay \$1.8 million in debt issuance costs.

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 \$160.0 million 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. Debt repaid included all outstanding balances under our credit agreement, including a \$42.1 million term loan and \$6.4 million in working capital advances, a \$4.0 million subordinated note issued in connection with acquisition of AirComp, approximately \$3.0 million subordinated note issued in connection with the acquisition of Tubular, approximately \$548,000 on a real estate loan and approximately \$350,000 on outstanding equipment financing.

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 had 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 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 January 18, 2006, we also executed an amended and restated credit agreement which provides for a \$25.0 million revolving line of credit with a maturity of January 2010. This 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 agreement are secured by substantially

all of our assets excluding the DLS assets, but including 2/3 of our shares of DLS. 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. On December 3, 2007, we entered into a First Amendment to Second Amended and Restated Credit Agreement, which increased our revolving line of credit to \$90.0 million. 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

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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. At December 31, 2007 and 2006, no amounts were borrowed on the facility but availability is reduced by outstanding letters of credit of \$8.4 million and \$9.7 million, respectively.

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 on these loans was 6.7% and 7.0% at December 31, 2007 and 2006, respectively. The bank loans are denominated in U.S. dollars and the outstanding amount due as of December 31, 2007 and 2006 was \$4.9 million and \$7.3 million, respectively.

As part of the acquisition of MCA in 2001, we issued a note to the sellers of MCA 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. In March 2005, we reached an agreement with the sellers and holders of the note as a result of an action brought against us by the sellers. Under the terms of the agreement, we paid the holders of the note \$1.0 million in cash, and agreed to pay an additional \$350,000 on June 1, 2006, and an additional \$150,000 on June 1, 2007, in settlement of all claims. At December 31, 2007 and 2006 the outstanding amounts due were \$0 and \$150,000, respectively.

In connection with the purchase of Delta, we issued to the sellers a note in the amount of \$350,000. The note bore interest at 2% and the principal and accrued interest was repaid on its maturity of April 1, 2006. In connection with the acquisition of 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 purchase 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 purchase 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 Rebel, we issued to the sellers notes in the amount of \$500,000. The notes bear interest at 5.0% and are due October 23, 2008.

In connection with the purchase of Tubular, we agreed to pay a total of \$1.2 million to the seller in exchange for a non-compete agreement. Monthly payments of \$20,576 were due under this agreement through January 31, 2007. 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 were required to make annual payments of \$50,000 through September 30, 2007. In connection with the purchase of 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 December 31, 2007 and 2006 were \$110,000 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 bear interest at the rate of 5.0%. At December 31, 2007 and 2006, the principal and accrued interest on these notes totaled approximately \$32,000.

We have various rig and equipment financing loans with interest rates ranging from 7.8% to 8.7% and terms of 2 to 5 years. As of December 31, 2007 and 2006, the outstanding balances for rig and equipment financing loans were \$595,000 and \$3.5 million, respectively. In January 2006, we prepaid \$350,000 of the outstanding equipment loans with proceeds from our senior notes offering.

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. The outstanding balance of these notes was

approximately \$1.0 million as of December 31, 2006. In April 2007 and August 2007, we obtained insurance premium financings in the amount of \$3.2 million and \$1.3 with fixed interest rates of 5.9% and 5.7%, respectively. Under terms of the agreements, amounts outstanding are paid over 11 month repayment schedules. The outstanding balance of these notes was approximately \$1.7 million as of December 31, 2007.

We also have various capital leases with terms that expire in 2008. As of December 31, 2007 and 2006, amounts outstanding under capital leases were \$14,000 and \$414,000, respectively.

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The following table summarizes our obligations and commitments to make future payments under our notes payable, operating leases, employment contracts and consulting agreements for the periods specified as of December 31, 2007.

	Total	Payments by Period			After 5 Years
		Less Than 1 Year	1-3 Years (In thousands)	3-5 Years	
Contractual Obligations					
Long-term debt	\$ 514,720	\$ 6,420	\$ 2,950	\$ 350	\$ 505,000
Capital leases	14	14			
Interest payments on long-term debt	334,018	44,588	88,577	88,406	112,447
Operating leases	5,941	2,618	2,354	593	376
Employment contracts	7,511	3,543	3,968		
Total contractual cash obligations	\$ 862,204	\$ 57,183	\$ 97,849	\$ 89,349	\$ 617,823

We have identified capital expenditure projects that will require up to approximately \$140.0 million in 2008, exclusive of any acquisitions, of which \$82.7 million is committed as of December 31, 2007. We believe that our cash generated from operations, cash on hand and cash available under our credit facilities 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. We 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 natural 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 will require additional equity or debt financing in excess of our current working capital and amounts available under credit facilities. 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 January 23, 2008, we entered into an Agreement and Plan of Merger with Bronco Drilling Company, Inc., or Bronco, whereby Bronco will become a wholly-owned subsidiary of Allis-Chalmers. The merger agreement, which was approved by our Board of Directors and the Board of Directors of Bronco, provides that the Bronco stockholders will receive aggregate merger consideration with a value of approximately \$437.8 million, consisting of (a) \$280.0 million in cash and (b) shares of our common stock, par value \$0.01 per share, having an aggregate value of approximately \$157.8 million. The number of shares of our common stock to be issued will be based on the average closing price of our common stock for the ten-trading day period ending two days prior to the closing. Completion of the merger is conditioned upon, among other things, adoption of the merger agreement by Bronco's stockholders and approval by our stockholders of the issuance of shares of our common stock to be used as merger consideration.

In order to finance some or all of the cash component of the merger consideration, the repayment of outstanding Bronco debt and transaction expenses, we expect to incur debt of up to \$350.0 million. We intend to obtain up to \$350.0 million from either (1) a permanent debt financing of up to \$350.0 million or (2) if the permanent debt financing cannot be consummated prior to the closing date of the merger, the draw down under a senior unsecured bridge loan facility in an aggregate principal amount of up to \$350.0 million to be arranged by RBC Capital Markets Corporation and Goldman Sachs Credit Partners L.P., acting as joint lead arrangers and joint bookrunners. We executed a commitment letter, dated January 28, 2008, with Royal Bank of Canada and Goldman Sachs who have each, subject to certain conditions, severally committed to provide 50% of the loans under the senior unsecured bridge facility to us. This commitment for the bridge loan facility will terminate on July 31, 2008,

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if we have not drawn the bridge facility by such date and the merger is not consummated by such date. The commitment may also terminate prior to July 31, 2008, if the merger is abandoned or a material condition to the merger is not satisfied or we breach our obligations under the commitment letter. We may use the proceeds of the bridge facility to finance the cash component of the merger consideration, repay outstanding Bronco debt and pay transaction expenses.

On January 29, 2008, Burt A. Adams resigned as our President and Chief Operating Officer, effective February 28, 2008. Mr. Adams will remain as a member of our Board of Directors. On January 29, 2008, Mark C. Patterson was elected our Senior Vice-President Rental Services. On January 29, 2008, Terrence P. Keane was elected our Senior Vice-President Oilfield Services.

On January 31, 2008, we entered into an agreement with BCH Ltd., or BCH, to invest \$40.0 million in cash in BCH in the form of a 15% Convertible Subordinated Secured debenture. The debenture is convertible, at any time, at our option into 49% of the common equity of BCH. At the end of two years, we have the option to acquire the remaining 51% of BCH from its parent, BrazAlta Resources Corp., or BrazAlta, based on an independent valuation from a mutually acceptable investment bank. BCH is a Canadian-based oilfield services company engaged in contract drilling operations exclusively in Brazil.

On February 15, 2008, through our DLS subsidiary in Argentina, we entered into a \$25.0 million import finance facility with a bank. Borrowings under this facility will be used to fund a portion of the purchase price of the new drilling and service rigs ordered for our international drilling operation. The facility is available for borrowings until December 31, 2008. Each drawdown shall be repaid over four years in equal semi-annual instalments beginning one year after each disbursement with the final principal payment due not later than March 15, 2013. Interest is payable every six months. The import finance facility is unsecured and contains customary events of default and financial covenants and limits DLS ability to incur additional indebtedness, make capital expenditures, create liens and sell assets.

Critical Accounting Policies

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

Allowance For Doubtful Accounts. The determination of the collectibility of amounts due from our customers requires us to use estimates and make judgments regarding future events and trends, including monitoring our customer payment history and current credit worthiness to determine that collectibility is reasonably assured, as well as consideration of the overall business climate in which our customers operate. Those uncertainties require us to make frequent judgments and estimates regarding our customers' ability to pay amounts due us in order to determine the appropriate amount of valuation allowances required for doubtful accounts. Provisions for doubtful accounts are recorded when it becomes evident that the customers will not be able to make the required payments at either contractual due dates or in the future.

Revenue Recognition. We provide rental equipment and drilling services to our customers at per day, or daywork, and per job contractual rates and recognize the drilling related revenue as the work progresses and when collectibility is reasonably assured. Revenue from daywork contracts is recognized when it is realized or realizable and earned. On daywork contracts, revenue is recognized based on the number of days completed at fixed rates stipulated by the contract. For certain contracts, we receive lump-sum and other fees for equipment and other mobilization costs. Mobilization fees and the related costs are deferred and amortized over the contract terms when material. The Securities and Exchange Commission's Staff Accounting Bulletin No. 104, *Revenue Recognition in Financial Statements*, provides guidance on the SEC staff's views on application of generally accepted accounting

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principles to selected revenue recognition issues. Our revenue recognition policy is in accordance with generally accepted accounting principles and SAB No. 104.

Impairment Of Long-Lived Assets. Long-lived assets, which include property, plant and equipment, goodwill and other intangibles, comprise a significant amount of our total assets. We make judgments and estimates in conjunction with the carrying value of these assets, including amounts to be capitalized, depreciation and amortization methods and useful lives. Additionally, the carrying values of these assets are reviewed for impairment or whenever events or changes in circumstances indicate that the carrying amounts may not be recoverable. An impairment loss is recorded in the period in which it is determined that the carrying amount is not recoverable. This requires us to make long-term forecasts of our future revenues and costs related to the assets subject to review. These forecasts require assumptions about demand for our products and services, future market conditions and technological developments. Significant and unanticipated changes to these assumptions could require a provision for impairment in a future period.

Goodwill And Other Intangibles. As of December 31, 2007, we have recorded approximately \$138.4 million of goodwill and \$35.2 million of other identifiable intangible assets. We perform purchase price allocations to intangible assets when we make a business combination. Business combinations and purchase price allocations have been consummated for acquisitions in all of our reportable segments. The excess of the purchase price after allocation of fair values to tangible assets is allocated to identifiable intangibles and thereafter to goodwill. Subsequently, we perform our initial impairment tests and annual impairment tests in accordance with Financial Accounting Standards Board No. 141, *Business Combinations*, and Financial Accounting Standards Board No. 142, *Goodwill and Other Intangible Assets*. These initial valuations used two approaches to determine the carrying amount of the individual reporting units. The first approach is the Discounted Cash Flow Method, which focuses on our expected cash flow. In applying this approach, the cash flow available for distribution is projected for a finite period of years. Cash flow available for distribution is defined as the amount of cash that could be distributed as a dividend without impairing our future profitability or operations. The cash flow available for distribution and the terminal value (our value at the end of the estimation period) are then discounted to present value to derive an indication of value of the business enterprise. This valuation method is dependent upon the assumptions made regarding future cash flow and cash requirements. The second approach is the Guideline Company Method which focuses on comparing us to selected reasonably similar publicly traded companies. Under this method, valuation multiples are: (i) derived from operating data of selected similar companies; (ii) evaluated and adjusted based on our strengths and weaknesses relative to the selected guideline companies; and (iii) applied to our operating data to arrive at an indication of value. This valuation method is dependent upon the assumption that our value can be evaluated by analysis of our earnings and our strengths and weaknesses relative to the selected similar companies. Significant and unanticipated changes to these assumptions could require a provision for impairment in a future period.

Income Taxes. The determination and evaluation of our annual income tax provision involves the interpretation of tax laws in various jurisdictions in which we operate and requires significant judgment and the use of estimates and assumptions regarding significant future events such as the amount, timing and character of income, deductions and tax credits. Changes in tax laws, regulations and our level of operations or profitability in each jurisdiction may impact our tax liability in any given year. While our annual tax provision is based on the information available to us at the time, a number of years may elapse before the ultimate tax liabilities in certain tax jurisdictions are determined. Current income tax expense reflects an estimate of our income tax liability for the current year, withholding taxes, changes in tax rates and changes in prior year tax estimates as returns are filed. Deferred tax assets and liabilities are recognized for the anticipated future tax effects of temporary differences between the financial statement basis and the tax basis of our assets and liabilities using the enacted tax rates in effect at year end. A valuation allowance for deferred tax assets is recorded when it is more-likely-than-not that the benefit from the deferred tax asset will not be realized. We provide for uncertain tax positions pursuant to FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109*.

It is our intention to permanently reinvest all of the undistributed earnings of our non-U.S. subsidiaries in such subsidiaries. Accordingly, we have not provided for U.S. deferred taxes on the undistributed earnings of our non-U.S. subsidiaries. If a distribution is made to us from the undistributed earnings of these subsidiaries, we could be required to record additional taxes. Because we cannot predict when, if at all, we will make a distribution of these undistributed earnings, we are unable to make a determination of the amount of unrecognized deferred tax liability.

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Recently Issued Accounting Standards

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 clarifies the principle that fair value should be based on the assumptions that market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years, with early adoption permitted. Subsequently, the FASB provided for a one-year deferral of the provisions of Statement No. 157 for non-financial assets and liabilities that are recognized or disclosed at fair value in the consolidated financial statements on a non-recurring basis. We believe that the adoption of SFAS No. 157 will not have a material impact on our financial position, results of operations or cash flows.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations*. This statement retains the fundamental requirements in SFAS No. 141, *Business Combinations* that the acquisition method of accounting be used for all business combinations and expands the same method of accounting to all transactions and other events in which one entity obtains control over one or more other businesses or assets at the acquisition date and in subsequent periods. This statement replaces SFAS No. 141 by requiring measurement at the acquisition date of the fair value of assets acquired, liabilities assumed and any non-controlling interest. Additionally, SFAS No. 141(R) requires that acquisition-related costs, including restructuring costs, be recognized as expense separately from the acquisition. SFAS No. 141(R) applies prospectively to business combinations for fiscal years beginning after December 15, 2008. We will adopt SFAS No. 141(R) beginning January 1, 2009 and apply to future acquisitions.

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, which permits entities to elect to measure many financial instruments and certain other items at fair value. Upon adoption of SFAS No. 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 No. 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 No. 159 and have not yet determined the impact, if any, on our financial statements.

In December 2007, the FASB issued SFAS No. 160, *Non-controlling Interests in Consolidated Financial Statements an amendment of ARB No. 51*. SFAS No. 160 requires (i) that non-controlling (minority) interests be reported as a component of shareholders' equity, (ii) that net income attributable to the parent and to the non-controlling interest be separately identified in the consolidated statement of operations, (iii) that changes in a parent's ownership interest while the parent retains its controlling interest be accounted for as equity transactions, (iv) that any retained non-controlling equity investment upon the deconsolidation of a subsidiary be initially measured at fair value, and (v) that sufficient disclosures are provided that clearly identify and distinguish between the interests of the parent and the interests of the non-controlling owners. SFAS No. 160 is effective for annual periods beginning after December 15, 2008 and should be applied prospectively. The presentation and disclosure requirements of the statement shall be applied retrospectively for all periods presented. We believe the adoption of SFAS No. 160 will not have a material impact on our financial position or results of operations.

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 have a \$90.0 million revolving line of credit with a maturity of January 2010. At December 31, 2007, no amounts were borrowed on the facility but availability is reduced by outstanding letters of credit of \$8.4 million. We do not guarantee obligations of any unconsolidated entities.

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ITEM 8. FINANCIAL STATEMENTS.

INDEX TO FINANCIAL STATEMENTS

ALLIS-CHALMERS ENERGY INC. AND SUBSIDIARIES

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MANAGEMENT'S REPORT TO THE STOCKHOLDERS OF ALLIS-CHALMERS ENERGY INC.

Management's Report on Internal Control Over Financial Reporting

As management, we are responsible for establishing and maintaining adequate internal control over financial reporting for Allis-Chalmers Energy Inc. and its subsidiaries, or Allis-Chalmers. In order to evaluate the effectiveness of internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act of 2002, we have conducted an assessment, including testing, using the criteria in *Internal Control-Integral Framework* issued by the Committee of Sponsoring Organization of the Treadway Commission (COSO). Allis-Chalmers' system of internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. Because of its inherent limitation, internal control over financial reporting may not prevent or detect misstatements.

Based on our assessment, we have concluded that Allis-Chalmers maintained effective internal control over financial reporting as of December 31, 2007, based on criteria in *Internal Control-Integrated Framework* issued by the COSO. The effectiveness of Allis-Chalmers internal control over financial reporting as of December 31, 2007 has been audited by UHY LLP, an independent registered public accounting firm, as stated in their report, which is included herein.

Management's Certifications

The certifications of Allis-Chalmers' Chief Executive Officer and Chief Financial Officer required by the Sarbanes-Oxley Act of 2002 have been included as Exhibits 31 and 32 in Allis-Chalmers' Form 10-K.

ALLIS-CHALMERS ENERGY INC.

By: /s/ Munawar H. Hidayatallah
Munawar H. Hidayatallah
Chief Executive Officer

By: /s/ Victor M. Perez
Victor Perez
Chief Financial Officer

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders
Allis-Chalmers Energy Inc.
Houston, Texas

We have audited the accompanying consolidated balance sheets of Allis-Chalmers Energy Inc. and subsidiaries (the Company) as of December 31, 2007 and 2006, and the related consolidated statements of operations, stockholders equity and cash flows for each of the three years in the period ended December 31, 2007. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Allis-Chalmers Energy Inc. and subsidiaries as of December 31, 2007 and 2006, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 6 to the consolidated financial statements, effective January 1, 2007, the Company adopted FASB Interpretations No. 48: *Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109* and, as discussed in Note 1, effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (Revised 2004): *Share Based Payment*.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Allis-Chalmers Energy Inc. s internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 6, 2008 expressed an unqualified opinion thereon.

/s/ UHY LLP

Houston, Texas
March 6, 2008

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and
Stockholders of Allis-Chalmers Energy Inc.:

We have audited Allis-Chalmers Energy Inc.'s internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Allis-Chalmers Energy Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting of Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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

In our opinion, Allis-Chalmers Energy Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on the COSO criteria.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Allis-Chalmers Energy Inc. and subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2007, and our report dated March 6, 2008 expressed an unqualified opinion thereon.

/s/ UHY LLP

Houston, Texas

March 6, 2008

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ALLIS-CHALMERS ENERGY INC.
CONSOLIDATED BALANCE SHEETS

	December 31,	
	2007	2006
	(In thousands, except for share and per share amounts)	
ASSETS		
Cash and cash equivalents	\$ 43,693	\$ 39,745
Trade receivables, net of allowance for doubtful accounts of \$1,924 and \$826 at December 31, 2007 and 2006, respectively	130,094	95,766
Inventories	32,209	28,615
Prepaid expenses and other	11,898	16,636
Total current assets	217,894	180,762
Property and equipment, at cost net of accumulated depreciation of \$77,008 and \$29,743 at December 31, 2007 and 2006, respectively	626,668	554,258
Goodwill	138,398	125,835
Other intangible assets, net of accumulated amortization of \$6,218 and \$4,475 at December 31, 2007 and 2006, respectively	35,180	32,840
Debt issuance costs, net of accumulated amortization of \$2,718 and \$1,501 at December 31, 2007 and 2006, respectively	14,228	9,633
Other assets	21,217	4,998
Total assets	\$ 1,053,585	\$ 908,326
LIABILITIES AND STOCKHOLDERS EQUITY		
Current maturities of long-term debt	\$ 6,434	\$ 6,999
Trade accounts payable	37,464	25,666
Accrued salaries, benefits and payroll taxes	15,283	10,888
Accrued interest	17,817	11,867
Accrued expenses	20,545	16,951
Total current liabilities	97,543	72,371
Deferred income tax liability	30,090	19,953
Long-term debt, net of current maturities	508,300	561,446
Other long-term liabilities	3,323	623
Total liabilities	639,256	654,393
Commitments and Contingencies		
Stockholders Equity		
Preferred stock, \$0.01 par value (25,000,000 shares authorized, none issued)		

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Common stock, \$0.01 par value (100,000,000 shares authorized; 35,116,035 issued and outstanding at December 31, 2007 and 28,233,411 issued and outstanding at December 31, 2006)	351	282
Capital in excess of par value	326,095	216,208
Retained earnings	87,883	37,443
Total stockholders' equity	414,329	253,933
Total liabilities and stockholders' equity	\$ 1,053,585	\$ 908,326

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

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Table of Contents**ALLIS-CHALMERS ENERGY INC.****CONSOLIDATED STATEMENTS OF OPERATIONS**

	Years Ended December 31,		
	2007	2006	2005
	(In thousands, except per share amounts)		
Revenues	\$ 570,967	\$ 310,964	\$ 108,022
Cost of revenues			
Direct costs	341,450	185,579	72,567
Depreciation	50,914	20,261	4,874
Gross margin	178,603	105,124	30,581
General and administrative expenses	58,622	35,536	15,576
Gain on capillary asset sale	(8,868)		
Amortization	4,067	1,858	1,487
Income from operations	124,782	67,730	13,518
Other income (expense):			
Interest expense	(49,534)	(21,309)	(4,746)
Interest income	3,259	972	49
Other	776	(347)	186
Total other expense	(45,499)	(20,684)	(4,511)
Income before minority interest and income taxes	79,283	47,046	9,007
Minority interest in income of subsidiaries			(488)
Provision for income taxes	(28,843)	(11,420)	(1,344)
Net income	\$ 50,440	\$ 35,626	\$ 7,175
Income per common share:			
Basic	\$ 1.48	\$ 1.73	\$ 0.48
Diluted	\$ 1.45	\$ 1.66	\$ 0.44
Weighted average number of common shares outstanding:			
Basic	34,158	20,548	14,832
Diluted	34,701	21,410	16,238

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

Table of Contents**ALLIS-CHALMERS ENERGY INC.****CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY**

	Common Stock Shares	Amount	Capital in Excess of Par Value	Retained Earnings (Deficit)	Total Stockholders Equity
	(In thousands, except share amounts)				
Balances, December 31, 2004	13,611,525	\$ 136	\$ 40,331	\$ (5,358)	\$ 35,109
Net income				7,175	7,175
Issuance of common stock:					
Acquisitions	411,275	4	1,746		1,750
Secondary public offering, net of offering costs	1,761,034	18	15,441		15,459
Stock options and warrants exercised	1,076,154	11	1,371		1,382
Balances, December 31, 2005	16,859,988	169	58,889	1,817	60,875
Net income				35,626	35,626
Issuance of common stock:					
Acquisitions	6,072,046	61	94,919		94,980
Secondary public offering, net of offering costs	3,450,000	34	46,263		46,297
Issuance under stock plans	1,851,377	18	6,303		6,321
Stock-based compensation			3,394		3,394
Tax benefits on stock plans			6,440		6,440
Balances, December 31, 2006	28,233,411	282	216,208	37,443	253,933
Net income				50,440	50,440
Issuance of common stock:					
Secondary public offering, net of offering costs	6,000,000	60	99,995		100,055
Issuance under stock plans	882,624	9	3,310		3,319
Stock-based compensation			4,863		4,863
Tax benefits on stock plans			1,719		1,719
Balances, December 31, 2007	35,116,035	\$ 351	\$ 326,095	\$ 87,883	\$ 414,329

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

Table of Contents**ALLIS-CHALMERS ENERGY INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Years Ended December 31,		
	2007	2006	2005
	(In thousands)		
Cash Flows from Operating Activities:			
Net income	\$ 50,440	\$ 35,626	\$ 7,175
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	54,981	22,119	6,361
Amortization and write-off of deferred financing fees	3,197	1,527	962
Stock-based compensation	4,863	3,394	
Allowance for bad debts	730	781	219
Imputed interest		355	
Deferred taxes	8,017	2,215	
Minority interest in income of subsidiaries			488
Gain on sale of property and equipment	(2,323)	(2,444)	(669)
Gain on capillary asset sale	(8,868)		
Changes in operating assets and liabilities, net of acquisitions:			
Increase in accounts receivable	(30,825)	(23,175)	(10,656)
Increase in inventories	(5,375)	(2,637)	(3,072)
Decrease in prepaid expenses and other assets	8,202	2,505	929
(Increase) decrease in other assets	(4,492)	308	(936)
Increase (decrease) in trade accounts payable	10,732	(2,337)	2,373
Increase in accrued interest	5,950	11,382	324
Increase (decrease) in accrued expenses	1,508	872	(97)
Increase (decrease) in other liabilities	2,700	(224)	(266)
Increase in accrued salaries, benefits and payroll taxes	4,031	3,392	443
Net cash provided by operating activities	103,468	53,659	3,578
Cash Flows from Investing Activities:			
Acquisitions, net of cash acquired	(41,000)	(526,572)	(36,888)
Purchase of investment interests	(498)		
Purchase of property and equipment	(113,151)	(39,697)	(17,767)
Deposits on asset commitments	(11,488)		
Proceeds from sale of capillary assets	16,250		
Proceeds from sale of property and equipment	12,811	6,881	1,579
Net cash used in investing activities	(137,076)	(559,388)	(53,076)
Cash Flows from Financing Activities:			
Proceeds from issuance of long-term debt	250,000	557,820	56,251

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Payments on long-term debt	(309,745)	(54,030)	(28,202)
Payments on related party debt		(3,031)	(1,522)
Net (repayments) borrowings on lines of credit		(6,400)	2,527
Proceeds from issuance of common stock, net of offering costs	100,055	46,297	15,459
Proceeds from exercise of options and warrants	3,319	6,321	1,382
Tax benefit on stock plans	1,719	6,440	
Debt issuance costs	(7,792)	(9,863)	(1,821)
Net cash provided by financing activities	37,556	543,554	44,074
Net increase (decrease) in cash and cash equivalents	3,948	37,825	(5,424)
Cash and cash equivalents at beginning of year	39,745	1,920	7,344
Cash and cash equivalents at end of year	\$ 43,693	\$ 39,745	\$ 1,920

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

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ALLIS-CHALMERS ENERGY INC.

Notes to Consolidated Financial Statements

NOTE 1 NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization of Business

Allis-Chalmers Energy Inc. (Allis-Chalmers , we , our or us) was incorporated in Delaware in 1913. We provide 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.

The nature of our operations and the many regions in which we operate subject us to changing economic, regulatory and political conditions. We are vulnerable to near-term and long-term changes in the demand for and prices of oil and natural gas and the related demand for oilfield service operations.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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.

Principles of Consolidation

The consolidated financial statements include the accounts of Allis-Chalmers and its subsidiaries. Our subsidiaries at December 31, 2007 are AirComp LLC (AirComp), Allis-Chalmers Tubular Services LLC (Tubular), Strata Directional Technology LLC (Strata), Allis-Chalmers Rental Services LLC (Rental), Allis-Chalmers Production Services LLC (Production), Allis-Chalmers Management LLC, Allis-Chalmers Holdings Inc., DLS Drilling, Logistics & Services Corporation (DLS), DLS Argentina Limited, Tanus Argentina S.A. (Tanus), Petro-Rentals LLC (Petro-Rental) and Rebel Rentals LLC (Rebel). All significant inter-company transactions have been eliminated.

Revenue Recognition

We provide rental equipment and drilling services to our customers at per day, or daywork, and per job contractual rates and recognize the drilling related revenue as the work progresses and when collectibility is reasonably assured. Revenue from daywork contracts is recognized when it is realized or realizable and earned. On daywork contracts,

revenue is recognized based on the number of days completed at fixed rates stipulated by the contract. For certain contracts, we receive lump-sum and other fees for equipment and other mobilization costs. Mobilization fees and the related costs are deferred and amortized over the contract terms when material. We recognize reimbursements received for out-of-pocket expenses incurred as revenues and account for out-of-pocket expenses as direct costs. Payments from customers for the cost of oilfield rental equipment that is damaged or lost-in-hole are reflected as revenues. We recognized revenue from damaged or lost-in-hole equipment of \$12.6 million, \$2.4 million and \$970,000 for the years ended December 31, 2007, 2006 and 2005, respectively. The Securities and Exchange Commission's (SEC) Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition*

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ALLIS-CHALMERS ENERGY INC.

Notes to Consolidated Financial Statements (Continued)

In Financial Statements (SAB No. 104), provides guidance on the SEC staff's views on the application of generally accepted accounting principles to selected revenue recognition issues. Our revenue recognition policy is in accordance with generally accepted accounting principles and SAB No. 104.

Allowance for Doubtful Accounts

Accounts receivable are customer obligations due under normal trade terms. We sell our services to oil and natural gas exploration and production companies. We perform continuing credit evaluations of its customers' financial condition and although we generally do not require collateral, letters of credit may be required from customers in certain circumstances.

The allowance for doubtful accounts represents our estimate of the amount of probable credit losses existing in our accounts receivable. Significant individual accounts receivable balances which have been outstanding greater than 90 days are reviewed individually for collectibility. We have a limited number of customers with individually large amounts due at any given date. Any unanticipated change in any one of these customer's credit worthiness or other matters affecting the collectibility of amounts due from such customers could have a material effect on the results of operations in the period in which such changes or events occur. After all attempts to collect a receivable have failed, the receivable is written off against the allowance. As of December 31, 2007 and 2006, we had recorded an allowance for doubtful accounts of \$1.9 million and \$826,000 respectively. Bad debt expense was \$1.3 million, \$781,000 and \$219,000 for the years ended December 31, 2007, 2006 and 2005, respectively.

Cash Equivalents

We consider all highly liquid investments with an original maturity of three months or less at the time of purchase to be cash equivalents.

Inventories

Inventories are stated at the lower of cost or market. Cost is determined using the first in, first out (FIFO) method or the average cost method, which approximates FIFO, and includes the cost of materials, labor and manufacturing overhead.

Property and Equipment

Property and equipment is recorded at cost less accumulated depreciation. Certain equipment held under capital leases are classified as equipment and the related obligations are recorded as liabilities.

Maintenance and repairs, which do not improve or extend the life of the related assets, are charged to operations when incurred. Refurbishments and renewals are capitalized when the value of the equipment is enhanced for an extended period. When property and equipment are sold or otherwise disposed of, the asset account and related accumulated depreciation account are relieved, and any gain or loss is included in operations.

The cost of property and equipment currently in service is depreciated over the estimated useful lives of the related assets, which range from three to twenty years. Depreciation is computed on the straight-line method for financial

reporting purposes. Capital leases are amortized using the straight-line method over the estimated useful lives of the assets and lease amortization is included in depreciation expense. Depreciation expense charged to operations was \$50.9 million, \$20.3 million and \$4.9 million for the years ended December 31, 2007, 2006 and 2005, respectively.

Goodwill, Intangible Assets and Amortization

Goodwill, including goodwill associated with equity method investments, and other intangible assets with infinite lives are not amortized, but tested for impairment annually or more frequently if circumstances indicate that

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ALLIS-CHALMERS ENERGY INC.

Notes to Consolidated Financial Statements (Continued)

impairment may exist. Intangible assets with finite useful lives are amortized either on a straight-line basis over the asset's estimated useful life or on a basis that reflects the pattern in which the economic benefits of the intangible assets are realized.

The impairment test requires the allocation of goodwill and all other assets and liabilities to reporting units. If the fair value of the reporting unit is less than the book value (including goodwill) then goodwill is reduced to its implied fair value and the amount of the write-down is charged against earnings. We perform impairment tests on the carrying value of our goodwill on an annual basis as of December 31st for each of our reportable segments. As of December 31, 2007 and 2006, no impairment was deemed necessary. Increases in estimated future costs or decreases in projected revenues could lead to an impairment of all or a portion of our goodwill in future period.

Impairment of Long-Lived Assets

Long-lived assets, which include property, plant and equipment, and other intangible assets, and certain other assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recorded in the period in which it is determined that the carrying amount is not recoverable. The determination of recoverability is made based upon the estimated undiscounted future net cash flows, excluding interest expense. The impairment loss is determined by comparing the fair value, as determined by a discounted cash flow analysis, with the carrying value of the related assets.

Financial Instruments

Financial instruments consist of cash and cash equivalents, accounts receivable and payable, and debt. The carrying value of cash and cash equivalents and accounts receivable and payable approximate fair value due to their short-term nature. We believe the fair values and the carrying value of our debt would not be materially different due to the instruments' interest rates approximating market rates for similar borrowings at December 31, 2007 and 2006.

Concentration of Credit and Customer Risk

Financial instruments that potentially subject us to concentrations of credit risk consist principally of cash and cash equivalents and trade accounts receivable. As of December 31, 2007, we have approximately \$2.5 million of cash and cash equivalents residing in Argentina. We transact our business with several financial institutions. However, the amount on deposit in six financial institutions exceeded the \$100,000 federally insured limit at December 31, 2007 by a total of \$13.2 million. Management believes that the financial institutions are financially sound and the risk of loss is minimal.

We sell our services to major and independent domestic and international oil and natural gas companies. We perform ongoing credit valuations of our customers and provide allowances for probable credit losses where appropriate. In 2007 and 2006, one of our customers, Pan American Energy LLC Sucursal Argentina, or Pan American Energy, represented 20.7% and 11.7% of our consolidated revenues, respectively. In 2005 none of our customers accounted for more than 10% of our consolidated revenues. Revenues from Materiales y Equipo Petroleo, or Matyep, represented 3.4%, 8.3% and 94.5% of our international revenues in 2007, 2006 and 2005, respectively. Revenues from Pan American Energy represented 51.0% and 45.6% of our international revenues in 2007 and 2006, respectively.

Debt Issuance Costs

The costs related to the issuance of debt are capitalized and amortized to interest expense using the straight-line method, which approximates the interest method, over the maturity periods of the related debt.

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ALLIS-CHALMERS ENERGY INC.

Notes to Consolidated Financial Statements (Continued)

Income Taxes

Our income tax expense is based on our income, statutory tax rates and tax planning opportunities available to us in the various jurisdictions in which we operate. We provide for income taxes based on the tax laws and rates in effect in the countries in which operations are conducted and income is earned. Our income tax expense is expected to fluctuate from year to year as our operations are conducted in different taxing jurisdictions and the amount of pre-tax income fluctuates.

The determination and evaluation of our annual income tax provision involves the interpretation of tax laws in various jurisdictions in which we operate and requires significant judgment and the use of estimates and assumptions regarding significant future events such as the amount, timing and character of income, deductions and tax credits. Changes in tax laws, regulations and our level of operations or profitability in each jurisdiction may impact our tax liability in any given year. While our annual tax provision is based on the information available to us at the time, a number of years may elapse before the ultimate tax liabilities in certain tax jurisdictions are determined.

Current income tax expense reflects an estimate of our income tax liability for the current year, withholding taxes, changes in tax rates and changes in prior year tax estimates as returns are filed. Deferred tax assets and liabilities are recognized for the anticipated future tax effects of temporary differences between the financial statement basis and the tax basis of our assets and liabilities using the enacted tax rates in effect at year end. A valuation allowance for deferred tax assets is recorded when it is more-likely-than-not that the benefit from the deferred tax asset will not be realized. We provide for uncertain tax positions pursuant to FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109* (FIN 48). 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.

It is our intention to permanently reinvest all of the undistributed earnings of our non-U.S. subsidiaries in such subsidiaries. Accordingly, we have not provided for U.S. deferred taxes on the undistributed earnings of our non-U.S. subsidiaries. If a distribution is made to us from the undistributed earnings of these subsidiaries, we could be required to record additional taxes. Because we cannot predict when, if at all, we will make a distribution of these undistributed earnings, we are unable to make a determination of the amount of unrecognized deferred tax liability.

Stock-Based Compensation

We adopted SFAS No. 123R, *Share-Based Payment* (SFAS No. 123R), 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, *Accounting for Stock-Based Compensation* (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 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

Table of Contents**ALLIS-CHALMERS ENERGY INC.****Notes to Consolidated Financial Statements (Continued)**

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.

Prior to January 1, 2006, we accounted for our stock-based compensation using Accounting Principle Board Opinion No. 25 (APB No. 25). Under APB No. 25, compensation expense is recognized for stock options with an exercise price that is less than the market price on the grant date of the option. For stock options with exercise prices at or above the market value of the stock on the grant date, we adopted the disclosure-only provisions of SFAS No. 123. We also adopted the disclosure-only provisions of SFAS No. 123 for the stock options granted to our employees and directors. Accordingly, no compensation cost was recognized under APB No. 25. Our net income for the years ended December 31, 2007 and 2006 includes approximately \$4.9 million and \$3.4 million of compensation costs related to share-based payments, respectively. The tax benefit recorded in association with the share-based payments was \$1.7 million and \$6.4 million for the years-ended December 31, 2007 and 2006, respectively. As of December 31, 2007 there is \$16.3 million of unrecognized compensation expense related to non-vested stock based compensation grants.

Had compensation expense for the options granted been recorded based on the fair value at the grant date for the options, consistent with the provisions of SFAS 123, our net income and net income per common share for the year ended December 31, 2005 would have been decreased to the pro forma amounts indicated below (in thousands, except per share amounts):

		For the Year Ended December 31, 2005
Net income attributed to common stockholders as reported:	\$	7,175
Less total stock based employee compensation expense determined under fair value based method for all awards net of tax related effects		(4,284)
Pro-forma net income attributed to common stockholders	\$	2,891
Net income per common share:		
Basic	As reported \$	0.48
	Pro forma \$	0.19
Diluted	As reported \$	0.44
	Pro forma \$	0.18

Options were granted in 2007, 2006 and 2005. See Note 10 for further disclosures regarding stock options. The following assumptions were applied in determining the compensation costs:

	For the Years Ended December 31,		
	2007	2006	2005
Expected dividend yield			

Expected price volatility	66.21%	72.28%	84.28%
Risk-free interest rate	4.8%	5.1%	5.6%
Expected life of options	5 years	7 years	7 years
Weighted average fair value of options granted at market value	\$ 12.86	\$ 10.58	\$ 5.02

Segments of an Enterprise and Related Information

We disclose the results of our segments in accordance with SFAS No. 131, *Disclosures About Segments Of An Enterprise And Related Information* (SFAS No. 131). We designate the internal organization that is used by management for allocating resources and assessing performance as the source of our reportable segments. SFAS No. 131 also requires disclosures about products and services, geographic areas and major customers. Please see Note 14 for further disclosure of segment information in accordance with SFAS No. 131.

Table of Contents**ALLIS-CHALMERS ENERGY INC.****Notes to Consolidated Financial Statements (Continued)*****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). 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. Restricted stock grants are legally considered issued and outstanding, but are included in basic and diluted earnings per share only to the extent that they are vested. Unvested restricted stock is included in the computation of diluted earnings per share using the treasury stock method. 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 Years Ended December 31,		
	2007	2006	2005
Numerator:			
Net income	\$ 50,440	\$ 35,626	\$ 7,175
Denominator:			
Weighted average common shares outstanding excluding nonvested restricted stock	34,158	20,548	14,832
Effect of potentially dilutive common shares:			
Warrants and employee and director stock options and restricted shares	543	862	1,406
Weighted average common shares outstanding and assumed conversions	34,701	21,410	16,238
Income per common share:			
Basic	\$ 1.48	\$ 1.73	\$ 0.48
Diluted	\$ 1.45	\$ 1.66	\$ 0.44
Potentially dilutive securities excluded as anti-dilutive	1,108	53	599

Reclassification

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

New Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 clarifies the principle that fair value should be based on the assumptions that market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years, with early adoption permitted. Subsequently, the FASB provided for a one-year deferral of the provisions of SFAS 157 for non-financial assets and liabilities that are recognized or disclosed at fair value in the consolidated financial statements on a non-recurring basis. We

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ALLIS-CHALMERS ENERGY INC.

Notes to Consolidated Financial Statements (Continued)

believe that the adoption of SFAS 157 will not have a material impact on our financial position, results of operations or cash flows.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* (SFAS 141(R)). This statement retains the fundamental requirements in SFAS No. 141, *Business Combinations* that the acquisition method of accounting be used for all business combinations and expands the same method of accounting to all transactions and other events in which one entity obtains control over one or more other businesses or assets at the acquisition date and in subsequent periods. This statement replaces SFAS No. 141 by requiring measurement at the acquisition date of the fair value of assets acquired, liabilities assumed and any non-controlling interest. Additionally, SFAS 141(R) requires that acquisition-related costs, including restructuring costs, be recognized as expense separately from the acquisition. SFAS 141(R) applies prospectively to business combinations for fiscal years beginning after December 15, 2008. We will adopt SFAS 141(R) beginning January 1, 2009 and apply to future acquisitions.

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 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.

In December 2007, the FASB issued SFAS No. 160, *Non-controlling Interests in Consolidated Financial Statements an amendment of ARB No. 51* (SFAS 160). SFAS 160 requires (i) that non-controlling (minority) interests be reported as a component of shareholders' equity, (ii) that net income attributable to the parent and to the non-controlling interest be separately identified in the consolidated statement of operations, (iii) that changes in a parent's ownership interest while the parent retains its controlling interest be accounted for as equity transactions, (iv) that any retained non-controlling equity investment upon the deconsolidation of a subsidiary be initially measured at fair value, and (v) that sufficient disclosures are provided that clearly identify and distinguish between the interests of the parent and the interests of the non-controlling owners. SFAS 160 is effective for annual periods beginning after December 15, 2008 and should be applied prospectively. The presentation and disclosure requirements of the statement shall be applied retrospectively for all periods presented. We believe the adoption of SFAS 160 will not have a material impact on our financial position or results of operations.

NOTE 2 POST RETIREMENT BENEFIT OBLIGATIONS

Medical And Life

Pursuant to the Plan of Reorganization that was confirmed by the Bankruptcy Court after acceptances by our creditors and stockholders and was consummated on December 2, 1988, we assumed the contractual obligation to Simplicity Manufacturing, Inc. (SMI) to reimburse SMI for 50% of the actual cost of medical and life insurance claims for a select group of retirees (SMI Retirees) of the prior Simplicity Manufacturing Division of Allis-Chalmers. The

actuarial present value of the expected retiree benefit obligation is determined by an actuary and is the amount that results from applying actuarial assumptions to (1) historical claims-cost data, (2) estimates for the time value of money (through discounts for interest) and (3) the probability of payment (including decrements for death, disability, withdrawal, or retirement) between today and expected date of benefit payments. As of December 31, 2007 and 2006, we have post-retirement benefit obligations of \$31,000 and \$304,000, respectively.

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ALLIS-CHALMERS ENERGY INC.

Notes to Consolidated Financial Statements (Continued)

401(k) Savings Plan

On June 30, 2003, we adopted the 401(k) Profit Sharing Plan (the Plan). The Plan is a defined contribution savings plan designed to provide retirement income to our eligible employees. The Plan is intended to be qualified under Section 401(k) of the Internal Revenue Code of 1986, as amended. It is funded by voluntary pre-tax contributions from eligible employees who may contribute a percentage of their eligible compensation, limited and subject to statutory limits. The Plan is also funded by discretionary matching employer contributions from us. Eligible employees cannot participate in the Plan until they have attained the age of 21 and completed three-months of service with us. Each participant is 100% vested with respect to the participants contributions while our matching contributions are vested over a three-year period in accordance with the Plan document. Contributions are invested, as directed by the participant, in investment funds available under the Plan. Matching contributions of approximately \$1.8 million, \$735,000 and \$114,000 were paid in 2007, 2006 and 2005, respectively.

NOTE 3 ACQUISITIONS AND SALE OF CAPILLARY ASSETS

On April 1, 2005, we acquired 100% of the outstanding stock of Delta Rental Service, Inc., or Delta, for approximately \$4.6 million in cash, 223,114 shares of our common stock and two promissory notes totaling \$350,000. The purchase price was allocated to fixed assets and inventory. Delta, located in Lafayette, Louisiana, was a rental tool company providing specialty rental items to the oil and gas industry such as spiral heavy weight drill pipe, test plugs used to test blow-out preventors, well head retrieval tools, spacer spools and assorted handling tools. The results of Delta since the acquisition are included in our Rental Services segment.

On May 1, 2005, we acquired 100% of the outstanding capital stock of Capcoil Tubing Services, Inc., or Capcoil, for approximately \$2.7 million in cash, 168,161 shares of our common stock and the payment or assumption of approximately \$1.3 million of debt. Capcoil, located in Kilgore, Texas, is engaged in downhole well servicing by providing coil tubing services to enhance production from existing wells. Goodwill of \$184,000 and other identifiable intangible assets of \$1.4 million were recorded in connection with the acquisition. The results of Capcoil since the acquisition are included in our Production Services segment.

On July 11, 2005, we acquired the compressed air drilling assets of W.T Enterprises, Inc., or W.T., based in South Texas, for \$6.0 million in cash. The equipment includes compressors, boosters, mist pumps and vehicles. Goodwill of \$82,000 and other identifiable intangible assets of \$1.5 million were recorded in connection with the acquisition. The results of the W.T. assets since their acquisition are included in our Underbalanced Drilling segment.

On July 11, 2005, we acquired from M-I L.L.C. (M-I) its 45% interest in AirComp and subordinated note in the principal amount of \$4.8 million issued by AirComp, for which we paid M-I \$7.1 million in cash and issued to M-I a \$4.0 million subordinated note bearing interest at 5% per annum. As a result, we now own 100% of AirComp. The results of AirComp are included in our Underbalanced Drilling segment.

Effective August 1, 2005, we acquired 100% of the outstanding capital stock of Target Energy Inc., or Target, for approximately \$1.3 million in cash and forgiveness of a lease receivable of approximately \$0.6 million. The purchase price was allocated to the fixed assets of Target. The results of Target are included in our directional and horizontal drilling segment as their Measure While Drilling equipment is utilized in that segment.

On September 1, 2005, we acquired the casing and tubing service assets of Patterson Services, Inc. for approximately \$15.6 million. These assets are located in Corpus Christi, Texas; Kilgore, Texas; Lafayette, Louisiana and Houma, Louisiana. The results of these assets since their acquisition are included in our Tubular Services segment.

Table of Contents**ALLIS-CHALMERS ENERGY INC.****Notes to Consolidated Financial Statements (Continued)**

Effective January 1, 2006, we acquired 100% of the outstanding stock of Specialty Rental Tools, Inc., or Specialty, for approximately \$95.3 million in cash. In addition, approximately \$588,000 of costs were incurred in relation to the Specialty acquisition. Specialty, located in Lafayette, Louisiana, was engaged in the rental of high quality drill pipe, heavy weight spiral drill pipe, tubing work strings, blow-out preventors, choke manifolds and various valves and handling tools for oil and natural gas drilling. The following table summarizes the allocation of the purchase price and related acquisition costs to the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition (in thousands):

Current assets	\$ 7,645
Property and equipment	90,622
Total assets acquired	98,267
Current liabilities	2,193
Long-term debt	74
Total liabilities assumed	2,267
Net assets acquired	\$ 96,000

Specialty's historical property and equipment values were increased by approximately \$71.6 million based on third-party valuations. The results of Specialty since the acquisition are included in our Rental Services segment.

Effective April 1, 2006, we acquired 100% of the outstanding stock of Rogers Oil Tools, Inc., or Rogers, based in Lafayette, Louisiana, for a total consideration of approximately \$13.7 million, which includes approximately \$11.3 million in cash, \$1.6 million in our common stock and a \$750,000 three-year promissory note. In addition, approximately \$380,000 of costs were incurred in relation to the Rogers acquisition. Rogers sells, services and rents power drill pipe tongs and accessories and rental tongs for snubbing and well control applications. Rogers also provides specialized tong operators for rental jobs. The following table summarizes the allocation of the purchase price and related acquisition costs to the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition (in thousands):

Current assets	\$ 4,520
Property and equipment	9,866
Intangible assets, including goodwill	4,941
Total assets acquired	19,327
Current liabilities	1,376
Deferred income tax liabilities	3,760
Other long-term liabilities	150

Total liabilities assumed	5,286
Net assets acquired	\$ 14,041

Rogers' historical property and equipment values were increased by approximately \$8.4 million based on third-party valuations. Intangible assets include approximately \$2.4 million assigned to goodwill, \$1.2 million assigned to patents, \$1.1 million assigned to customer list and \$150,000 assigned to non-compete based on third-party valuations and employment contracts. The amortizable intangibles have a weighted-average useful life of 10.5 years. The results of Rogers since the acquisition are included in our Tubular Services segment.

Table of Contents**ALLIS-CHALMERS ENERGY INC.****Notes to Consolidated Financial Statements (Continued)**

Effective August 14, 2006, we acquired 100% of the outstanding stock of DLS, based in Argentina, for a total consideration of approximately \$114.5 million, which includes approximately \$93.7 million in cash, \$38.1 million in our common stock, less approximately \$17.3 million of debt assigned to us. In addition, approximately \$3.4 million of costs were incurred in relation to the DLS acquisition. DLS operates a fleet of 51 rigs, including 20 drilling rigs, 18 workover rigs and 12 pulling rigs in Argentina and one drilling rig in Bolivia. The following table summarizes the allocation of the purchase price and related acquisition costs to the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition (in thousands):

Current assets	\$ 52,033
Property and equipment	130,389
Other long-term assets	21
Total assets acquired	182,443
Current liabilities	34,386
Long-term debt, less current portion	5,921
Intercompany note	17,256
Deferred tax liabilities	6,948
Total liabilities assumed	64,511
Net assets acquired	\$ 117,932

DLS historical property and equipment values were increased by approximately \$22.7 million based on third-party valuations. The results of DLS since the acquisition are included in our International Drilling segment.

On October 16, 2006, we acquired 100% of the outstanding stock of Petro Rental, based in Lafayette, Louisiana, for a total consideration of approximately \$33.6 million, which includes approximately \$20.2 million in cash, \$3.8 million in our common stock and repaid \$9.6 million of existing Petro Rental debt. In addition, approximately \$82,000 of costs were incurred in relation to the Petro-Rental acquisition. Petro-Rental provides a variety of production-related rental tools and equipment and services, including wire line services and equipment, land and offshore pumping services and coiled tubing. The following table summarizes the allocation of the purchase price and related acquisition costs to the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition (in thousands):

Current assets	\$ 8,175
Property and equipment	28,792
Intangible assets, including goodwill	5,811
Other long-term assets	2
Total assets acquired	42,780

Current liabilities	2,135
Deferred tax liabilities	6,954
Total liabilities assumed	9,089
Net assets acquired	\$ 33,691

Petro Rental's historical property and equipment values were increased by approximately \$13.4 million based on third-party valuations. Intangible assets include approximately \$3.6 million assigned to goodwill and \$2.2 million assigned to customer relationships based on third-party valuations. The amortizable intangibles have a weighted-average useful life of 10 years. The results of Petro-Rental since the acquisition are included in our Production Services segment.

Table of Contents**ALLIS-CHALMERS ENERGY INC.****Notes to Consolidated Financial Statements (Continued)**

Effective December 1, 2006, we acquired 100% of the outstanding stock of Tanus, based in Argentina, for a total consideration of \$2.5 million. In addition, approximately \$17,000 of costs were incurred in relation to the Tanus acquisition. Tanus is engaged in the research and manufacturing of additives for the oil, natural gas and water well drilling and completion fluids in Argentina. The following table summarizes the allocation of the purchase price and related acquisition costs to the estimated fair value of the assets acquired and liabilities assumed at the date of the acquisition (in thousands).

Current assets	\$ 2,254
Property and equipment	2
Goodwill	1,504
Total assets acquired	3,760
Current liabilities	1,243
Net assets acquired	\$ 2,517

The results of Tanus are reported with DLS under our International Drilling segment.

On December 18, 2006, we acquired substantially all of the assets of Oil & Gas Rental Services, Inc, or OGR, based in Morgan City, Louisiana, for a total consideration of approximately \$342.4 million, which includes approximately \$291.0 million in cash, and \$51.4 million in our common stock. In addition, approximately \$3.0 million of costs were incurred in relation to the acquisition of the assets of OGR. The following table summarizes the allocation of the purchase price and related acquisition costs to the estimated fair value of the assets acquired at the date of acquisition (in thousands):

Current assets	\$ 12,735
Property and equipment	199,015
Investments	4,618
Intangible assets, including goodwill	128,976
Total assets acquired	\$ 345,344

OGR's historical property and equipment values were increased by approximately \$168.9 million based on third-party valuations. Intangible assets include approximately \$106.1 million assigned to goodwill, \$22.0 million to customer relations, \$831,000 to patents and \$35,000 assigned to employment agreements based on third-party valuations. The amortizable intangibles have a weighted-average useful life of 10.1 years. The results of the OGR assets since their acquisition are included in our Rental Services segment.

On June 29 2007, we acquired Coker Directional, Inc., or Coker, for a total consideration of approximately \$3.9 million, which includes approximately \$3.6 million in cash and a promissory note for \$350,000. In addition,

approximately \$5,000 of costs were incurred in relation to the Coker acquisition. The following table summarizes the preliminary allocation of the purchase price and related acquisition costs to the estimated fair value of the assets acquired and liabilities assumed at the date of the acquisition (in thousands):

Property and equipment	3
Intangible assets, including goodwill	3,902
Net assets acquired	\$ 3,905

Intangible assets include approximately \$1.8 million assigned to goodwill and \$2.1 million assigned to customer relationships and non-compete. The amortizable intangibles have a weighted-average useful life of 9.4 years. The results of Coker since the acquisition are included in our Directional Drilling segment. We do not expect any material differences from the preliminary allocation of the purchase price and the final purchase price allocations.

Table of Contents**ALLIS-CHALMERS ENERGY INC.****Notes to Consolidated Financial Statements (Continued)**

On July 26, 2007, we acquired Diggar Tools, LLC, or Diggar, for a total consideration of approximately \$10.3 million, which includes approximately \$6.7 million in cash, a promissory note for \$750,000 and payment of approximately \$2.8 million of existing Diggar debt. In addition, approximately \$29,000 of costs were incurred in relation to the Diggar acquisition. The following table summarizes the preliminary allocation of the purchase price and related acquisition costs to the estimated fair value of the assets acquired at the date of acquisition (in thousands):

Current assets	\$ 1,113
Property and equipment	7,204
Intangible assets, including goodwill	2,675
 Total assets acquired	 10,992
 Current liabilities	 622
 Net assets acquired	 \$ 10,370

Diggar's historical property and equipment values were increased by approximately \$3.4 million based on third-party valuations. Intangible assets include approximately \$2.7 million assigned to goodwill. The results of Diggar since the acquisition are included in our Directional Drilling segment. We do not expect any material differences from the preliminary allocation of the purchase price and the final purchase price allocations.

On October 23, 2007, we acquired Rebel for a total consideration of approximately \$7.3 million, which includes approximately \$5.0 million in cash, promissory notes for an aggregate of \$500,000, payment of approximately \$1.5 million of existing Rebel debt and the deposit of \$305,000 in escrow to cover distributions owed under the Rebel Defined Benefit Pension Plan & Trust. In addition, approximately \$214,000 of costs were incurred in relation to the Rebel acquisition. The following table summarizes the preliminary allocation of the purchase price and related acquisition costs to the estimated fair value of the assets acquired at the date of acquisition (in thousands):

Current assets	\$ 944
Land, Property and equipment	8,736
Intangible assets, including goodwill	1,144
 Total assets acquired	 10,824
 Current liabilities	 218
Deferred tax liabilities	3,095
 Total liabilities assumed	 3,313
 Net assets acquired	 \$ 7,511

Rebel's historical property and equipment values were increased by approximately \$8.5 million based on third-party valuations. Intangible assets include approximately \$461,000 assigned to goodwill and \$683,000 assigned to customer relations. The amortizable intangibles have a useful life of 15 years. The results of Rebel since the acquisition are included in our Tubular services segment. We do not expect any material differences from the preliminary allocation of the purchase price and the final purchase price allocations.

Table of Contents**ALLIS-CHALMERS ENERGY INC.****Notes to Consolidated Financial Statements (Continued)**

On November 1, 2007, we acquired substantially all the assets Diamondback Oilfield Services, Inc. or Diamondback, for a total consideration of approximately \$23.1 million in cash. Approximately \$89,000 of costs were incurred in relation to the Diamondback acquisition. The following table summarizes the preliminary allocation of the purchase price and related acquisition costs to the estimated fair value of the assets acquired at the date of acquisition (in thousands):

Current assets	\$ 3,350
Property and equipment	8,701
Intangible assets, including goodwill	12,232
Other noncurrent assets	10
 Total assets acquired	 24,293
 Current liabilities	 1,160
 Net assets acquired	 \$ 23,133

Diamondback's historical property and equipment values were increased by approximately \$2.0 million based on third-party valuations. Intangible assets include approximately \$7.6 million assigned to goodwill, \$650,000 assigned to non-compete, \$620,000 assigned to trade name and \$3.4 million assigned to customer relations based on third-party valuations. The amortizable intangibles have a weighted-average useful life of 13.3 years. The sellers are entitled to a future cash earn-out payment upon the business attaining certain earning objectives. The results of the Diamondback assets since their acquisition are included in our Directional Drilling segment. We do not expect any material differences from the preliminary allocation of the purchase price and the final purchase price allocations.

The acquisitions were accounted for using the purchase method of accounting. The results of operations of the acquired entities since the date of acquisition are included in our consolidated income statement.

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.

The following unaudited pro forma consolidated summary financial information for the year ended December 31, 2006 illustrates the effects of the acquisitions and the related public offerings of debt and equity for Rogers, DLS, Petro-Rental and OGR as if the acquisitions occurred as of January 1, 2006, based on the historical results of the acquisitions. The following unaudited pro forma consolidated summary financial information for the year ended December 31, 2005 illustrates the effects of the acquisitions and the related public offerings of debt and equity for Delta, Capcoil, W.T., the minority interest in AirComp, Specialty, Rogers, DLS, Petro-Rental and OGR as if the acquisitions had occurred as of January 1, 2005, based on the historical results of the acquisitions. The historical results for OGR are based on their historical year end of October 31 (in thousands, except per share amounts):

	Years Ended December 31,	
	2006	2005
Revenues	\$ 502,418	\$ 346,230
Operating income	\$ 93,082	\$ 49,868
Net income	\$ 32,358	\$ 1,264
Net income per common share		
Basic	\$ 0.96	\$ 0.04
Diluted	\$ 0.94	\$ 0.04

Table of Contents**ALLIS-CHALMERS ENERGY INC.****Notes to Consolidated Financial Statements (Continued)****NOTE 4 INVENTORIES**

Inventories are comprised of the following as of December 31 (in thousands):

	2007	2006
Manufactured		
Finished goods	\$ 2,198	\$ 1,476
Work in process	1,781	2,266
Raw materials	4,464	2,638
Total manufactured	8,443	6,380
Hammers	1,434	1,016
Drive pipe	420	716
Rental supplies	2,261	1,845
Chemicals and drilling fluids	3,236	2,673
Rig parts and related inventory	9,985	9,762
Coiled tubing and related inventory	1,014	1,627
Shop supplies and related inventory	5,416	4,596
Total inventories	\$ 32,209	\$ 28,615

NOTE 5 PROPERTY AND OTHER INTANGIBLE ASSETS

Property and equipment is comprised of the following as of December 31 (in thousands):

	Depreciation Period	2007	2006
Land		\$ 2,040	\$ 1,810
Building and improvements	15-20 years	6,986	5,392
Transportation equipment	3-10 years	26,132	22,744
Drill pipe and rental equipment	3-20 years	350,202	321,821
Drilling, workover and pulling rigs	20 years	127,725	120,517
Machinery and equipment	3-20 years	157,626	105,926
Furniture, computers, software and leasehold improvements	3-10 years	5,817	3,522
Construction in progress equipment	N/A	27,148	2,269
Total		703,676	584,001
Less: accumulated depreciation		(77,008)	(29,743)

Property and equipment, net	\$ 626,668	\$ 554,258
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The net book value of equipment recorded under capital leases was \$285,000 and \$1.0 million as of December 31, 2007 and 2006, respectively.

Table of Contents**ALLIS-CHALMERS ENERGY INC.****Notes to Consolidated Financial Statements (Continued)**

Other intangible assets are as follows as of December 31 (in thousands):

	Amortization Period	2007	2006
Intellectual property	10-20 years	\$ 1,629	\$ 1,009
Non-compete agreements	3-5 years	2,852	4,580
Customer relationships	10-15 years	33,528	27,552
Patents	12-15 years	2,560	3,327
Other intangible assets	2-10 years	829	847
Total		41,398	37,315
Less: accumulated amortization		(6,218)	(4,475)
Other intangibles assets, net		\$ 35,180	\$ 32,840

	2007		2006	
	Gross Value	Accumulated Amortization	Gross Value	Accumulated Amortization
Intellectual property	\$ 1,629	\$ 410	\$ 1,009	\$ 349
Non-compete agreements	2,852	1,367	4,580	2,707
Customer relationships	33,528	3,497	27,552	789
Patents	2,560	423	3,327	203
Other intangible assets	829	521	847	427
Total	\$ 41,398	\$ 6,218	\$ 37,315	\$ 4,475

Amortization expense related to other intangibles was \$4.1 million, \$1.9 million and \$1.5 million for the years ended December 31, 2007, 2006 and 2005, respectively. Future amortization of intangible assets at December 31, 2007 is as follows (in thousands):

	Intangible Amortization by Period Years Ended December 31,				
	2008	2009	2010	2011	2012 and Thereafter
Intellectual property	\$ 96	\$ 96	\$ 96	\$ 96	\$ 835
Non-compete agreements	627	494	291	48	25

Customer relationships	3,227	3,227	3,227	3,227	17,123
Patents	202	202	202	202	1,329
Other intangible assets	107	90	79	30	2
Total Intangible Amortization	\$ 4,259	\$ 4,109	\$ 3,895	\$ 3,603	\$ 19,314

NOTE 6 INCOME TAXES

We had income before income taxes of \$41.7 million, \$35.9 million and \$8.5 million for U.S. tax purposes for the years ended December 31, 2007, 2006 and 2005, respectively. We also had income before income taxes of \$37.6 million and \$11.1 million reported in non-U.S. countries for the years ended December 31, 2007 and 2006, respectively. We treat the withholding taxes incurred by our U.S. subsidiaries in foreign countries as foreign tax, and we anticipate using those tax payments to offset U.S. tax.

Table of Contents**ALLIS-CHALMERS ENERGY INC.****Notes to Consolidated Financial Statements (Continued)**

The income tax provision consists of the following (in thousands):

	Years Ended December 31,		
	2007	2006	2005
Current income tax expense:			
Federal	\$ 6,814	\$ 5,865	\$ 123
State	1,053	898	595
Foreign	12,959	2,442	626
	20,826	9,205	1,344
Deferred income tax expense (benefit):			
Federal	7,081	(946)	
State	349	573	
Foreign	587	2,588	
	8,017	2,215	
	\$ 28,843	\$ 11,420	\$ 1,344

We are required to file a consolidated U.S. federal income tax return. We pay foreign income taxes in Argentina related to our International Drilling's operations and in Mexico related to Tubular's revenues from Matyep.

The following table reconciles the U.S. statutory tax rate to our actual tax rate:

	Years Ended December 31,		
	2007	2006	2005
Statutory income tax rate	35.0%	35.0%	34.0%
State taxes, net of federal benefit	1.8	2.1	6.1
Valuation allowances		(57.7)	(98.7)
Nondeductible items, permanent differences and other	(0.4)	44.9	74.4
Effective tax rate	36.4%	24.3%	15.8%

Significant components of deferred income tax assets as of December 31, were as follows (in thousands):

2007 **2006**

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Deferred income tax assets:		
Net future (taxable) deductible items	\$ 874	\$ 899
Share-based compensation	1,898	578
Net operating loss carryforwards	2,681	1,698
Foreign tax credits		2,420
A-C Reorganization Trust and Product Liability Trust	4,099	5,500
Total deferred income tax assets	9,552	11,095
Deferred income tax liabilities		
Depreciation and amortization	(37,795)	(28,226)
Net deferred income tax liabilities	\$ (28,243)	\$ (17,131)
Net current deferred income tax asset	\$ 1,847	\$ 2,822
Net noncurrent deferred income tax liability	(30,090)	(19,953)
Net deferred income tax liabilities	\$ (28,243)	\$ (17,131)

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ALLIS-CHALMERS ENERGY INC.

Notes to Consolidated Financial Statements (Continued)

Net future tax-deductible items relate primarily to timing differences. Timing differences are differences between the tax basis of assets and liabilities and their reported amounts in the financial statements that will result in differences between income for tax purposes and income for financial statement purposes in future years.

The Tax Reform Act of 1986 contains provisions that limit the utilization of net operating loss and tax credit carry forwards if there has been a change of ownership as described in Section 382 of the Internal Revenue Code. Such a change of ownership may limit our utilization of our net operating loss and tax credit carryforwards, and could be triggered by a public offering or by subsequent sales of securities by us or our stockholders. This provision has limited the amount of net operating losses available to us currently. Net operating loss carryforwards for tax purposes at December 31, 2007 and 2006 were \$7.7 million and \$4.9 million, respectively, expiring through 2024.

Prior to 2006, we did not record an asset for the U.S. foreign tax credits as we believed they would not be recoverable based on our taxable income. We now project that all of the U.S. foreign tax credits will be utilized against U.S. income tax.

Our 1988 Plan of Reorganization established the A-C Reorganization Trust to settle claims and to make distributions to creditors and certain stockholders. We transferred cash and certain other property to the A-C Reorganization Trust on December 2, 1988. Payments made by us to the A-C Reorganization Trust did not generate tax deductions for us upon the transfer but generate deductions for us as the A-C Reorganization Trust makes payments to holders of claims and for administrative expenses. The Plan of Reorganization also created a trust to process and liquidate product liability claims. Payments made by the A-C Reorganization Trust to the Product Liability Trust did not generate current tax deductions for us upon the payment but generates deductions for us as the Product Liability Trust makes payments to liquidate claims or incurs administrative expenses. We believe the aforementioned trusts are grantor trusts and therefore we include the income or loss of these trusts in our income or loss for tax purposes. The income or loss of these trusts is not included in our results of operations for financial reporting purposes.

A valuation allowance is established for deferred tax assets when management, based upon available information, considers it more likely than not that a benefit from such assets will not be realized. As of December 31, 2007 and 2006, the valuation allowance was zero.

Approximately \$9.7 million and \$5.5 million of ad valorem, franchise, income, sales and other tax accruals are included in our accrued expense balances of \$20.5 million and \$17.0 million as of December 31, 2007 and 2006, respectively.

We adopted the provisions of FIN 48 on January 1, 2007. This interpretation clarifies the accounting for uncertain tax positions and requires companies to recognize the impact of a tax position in their financial statements, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The adoption of FIN 48 did not have any impact on the total liabilities or stockholders' equity.

Table of Contents**ALLIS-CHALMERS ENERGY INC.****Notes to Consolidated Financial Statements (Continued)****NOTE 7 DEBT**

Our long-term debt consists of the following as of December 31 (in thousands):

	2007	2006
Senior notes	\$ 505,000	\$ 255,000
Bridge loan		300,000
Bank term loans	4,926	7,302
Revolving line of credit		
Seller notes	2,350	900
Notes payable to former directors	32	32
Equipment & vehicle installment notes	595	3,502
Insurance premium financing notes	1,707	1,025
Obligations under non-compete agreements	110	270
Capital lease obligations	14	414
Total debt	514,734	568,445
Less: current maturities of long-term debt	6,434	6,999
Long-term debt	\$ 508,300	\$ 561,446

Our weighted average interest rate for all of our outstanding debt was approximately 8.7% as of December 31, 2007 and 9.8% as of December 31, 2006.

Maturities of debt obligations as of December 31, 2007 are as follows (in thousands):

	Debt	Capital Leases	Total
Year Ending:			
December 31, 2008	\$ 6,420	\$ 14	\$ 6,434
December 31, 2009	2,250		2,250
December 31, 2010	700		700
December 31, 2011	350		350
December 31, 2012			
Thereafter	505,000		505,000
Total	\$ 514,720	\$ 14	\$ 514,734

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 and DLS, to repay existing debt and for general corporate purposes.

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.

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ALLIS-CHALMERS ENERGY INC.

Notes to Consolidated Financial Statements (Continued)

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 had 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 OGR.

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 are secured by substantially all of our assets excluding the DLS assets, but including 2/3 of our shares of DLS. 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 had a final maturity date of April 26, 2012. On December 3, 2007, we entered into a First Amendment to Second Amended and Restated Credit Agreement, which increased our revolving line of credit to \$90.0 million. 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 of December 31, 2007 and 2006, no amounts were borrowed on the facility but availability is reduced by outstanding letters of credit of \$8.4 million and \$9.7 million, respectively.

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 on these loans was 6.7% and 7.0% as of December 31, 2007 and 2006, respectively. The bank loans are denominated in U.S. dollars and the outstanding amount due as of December 31, 2007 and 2006 was \$4.9 million and \$7.3 million, respectively.

Notes payable

As part of the acquisition of Mountain Compressed Air, Inc., or MCA, in 2001, we issued a note to the sellers of MCA 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. In March 2005, we reached an agreement with the sellers and holders of the note as a result of an action brought against us by the sellers. Under the terms of the agreement, we paid the holders of the note \$1.0 million in cash, and agreed to pay an additional \$350,000 on June 1, 2006, and an additional \$150,000 on June 1, 2007, in settlement of all claims. As of December 31, 2007 and 2006 the outstanding amounts due were \$0 and \$150,000, respectively.

In connection with the acquisition of 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 purchase 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 purchase 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 Rebel, we issued to the sellers notes in the amount of \$500,000. The notes bear interest at 5.0% and are due October 23, 2008

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 bear interest at the rate of 5.0%. As of December 31, 2007 and 2006, the principal and accrued interest on these

notes totaled approximately \$32,000.

We have various rig and equipment financing loans with interest rates ranging from 7.8% to 8.7% and terms of 2 to 5 years. As of December 31, 2007 and 2006, the outstanding balances for rig and equipment financing loans were \$595,000 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

Table of Contents**ALLIS-CHALMERS ENERGY INC.****Notes to Consolidated Financial Statements (Continued)**

outstanding are paid over 10 month and 11 month repayment schedules. The outstanding balance of these notes was approximately \$1.0 million as of December 31, 2006. In April 2007 and August 2007, we obtained insurance premium financings in the amount of \$3.2 million and \$1.3 with fixed interest rates of 5.9% and 5.7%, respectively. Under terms of the agreements, amounts outstanding are paid over 11 month repayment schedules. The outstanding balance of these notes was approximately \$1.7 million as of December 31, 2007.

Other debt

In connection with the purchase of Tubular, we agreed to pay a total of \$1.2 million to the seller in exchange for a non-compete agreement. Monthly payments of \$20,576 were due under this agreement through January 31, 2007. 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 were required to make annual payments of \$50,000 through September 30, 2007. In connection with the purchase of 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 as of December 31, 2007 and 2006 were \$110,000 and \$270,000, respectively.

We also have various capital leases with terms that expire in 2008. As of December 31, 2007 and 2006, amounts outstanding under capital leases were \$14,000 and \$414,000, respectively.

NOTE 8 COMMITMENTS AND CONTINGENCIES

We have placed orders for capital equipment totaling \$82.7 million to be received and paid for through 2008. Approximately \$46.2 million is for drilling and service rigs for our International Drilling segment, \$26.0 million is for six new coiled tubing units and related equipment for our Production Services segment, \$5.3 million is for rental equipment, principally drill pipe, for our Rental Services segment and \$5.2 million is for casing and tubing tools and equipment. The orders are subject to cancellation with minimal loss of prior cash deposits, if any.

We rent office space and certain other facilities and shop yards for equipment storage and maintenance. Facility rent expense for the years ended December 31, 2007, 2006 and 2005 was \$2.7 million, \$1.6 million and \$987,000, respectively.

At December 31, 2007, future minimum rental commitments for all operating leases are as follows (in thousands):

Years Ending:	
December 31, 2008	\$ 2,618
December 31, 2009	1,633
December 31, 2010	721
December 31, 2011	437
December 31, 2012	156
Thereafter	376
Total	\$ 5,941

NOTE 9 STOCKHOLDERS EQUITY

As of January 1, 2005, in relation to the acquisition of Downhole Injection Services, LLC, or Downhole, we executed a business development agreement with CTTV Investments LLC, an affiliate of ChevronTexaco Inc., whereby we issued 20,000 shares of our common stock to CTTV and further agreed to issue up to an additional 60,000 shares to CTTV contingent upon our subsidiaries receiving certain levels of revenues in 2005 from

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ALLIS-CHALMERS ENERGY INC.

Notes to Consolidated Financial Statements (Continued)

ChevronTexaco and its affiliates. CTTV was a minority owner of Downhole, which we acquired in 2004. Based on the terms of the agreement, no additional shares have been issued.

During 2005, we issued 223,114 and 168,161 shares of our common stock in relation to the Delta and Capcoil acquisitions, respectively (see Note 3).

In August 2005, our stockholders approved an amendment to our certificate of incorporation to increase the authorized number of shares of our common stock from 20 million to 100 million and to increase our authorized preferred stock from 10 million shares to 25 million shares and, we completed a secondary public offering in which we sold 1,761,034 shares for approximately \$15.5 million, net of expenses.

We also had options and warrants exercised during 2005. Those exercises resulted in 1,076,154 shares of our common stock being issued for approximately \$1.4 million.

During 2006, we issued 125,285, 2.5 million, 246,761 and 3.2 million shares of our common stock in relation to the Rogers, DLS, Petro Rental and OGR asset acquisitions, respectively (see Note 3).

On August 14, 2006 we closed on a public offering of 3,450,000 shares of our common stock at a public offering price of \$14.50 per share. Net proceeds from the public offering of approximately \$46.3 million were used to fund a portion of our acquisition of DLS.

During 2006, we had options and warrants exercised in 2006, which resulted in 1,851,377 shares of our common stock being issued for approximately \$6.3 million. We recognized approximately \$3.4 million of compensation expense related to stock options in 2006 that was recorded as capital in excess of par value (see Note 1). We also recorded approximately \$6.4 million of tax benefit related to our stock compensation plans.

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 restricted stock award grants, and options and warrants exercised during 2007, which resulted in 882,624 shares of our common stock being issued for approximately \$3.3 million. We recognized approximately \$4.9 million of compensation expense related to share based payments that was recorded as capital in excess of par value (see Note 1). We also recorded approximately \$1.7 million of tax benefit related to our stock compensation plans.

NOTE 10 STOCK OPTIONS

In 2000, we issued stock options and promissory notes to certain current and former directors as compensation for services as directors (See Note 7), and our Board of Directors granted stock options to these same individuals. Options to purchase 4,800 shares of our common stock were granted with an exercise price of \$13.75 per share. These options vested immediately and may be exercised any time prior to March 28, 2010. As of December 31, 2007, 4,000 of the stock options remain outstanding. No compensation expense has been recorded for these options that were issued with

an exercise price equal to the fair value of the common stock at the date of grant.

On May 31, 2001, the Board granted to Leonard Toboroff, one of our directors, an option to purchase 100,000 shares of our common stock at \$2.50 per share, exercisable for 10 years from October 15, 2001. The option was granted for services provided by Mr. Toboroff to Oil Quip Rentals, Inc., or Oil Quip, prior to the merger, including providing financial advisory services, assisting in Oil Quip's capital structure and assisting Oil Quip in finding strategic acquisition opportunities. We recorded compensation expense of \$500,000 for the issuance of the option for the year ended December 31, 2001. As of December 31, 2007, all of the stock options have been exercised.

Table of Contents**ALLIS-CHALMERS ENERGY INC.****Notes to Consolidated Financial Statements (Continued)**

The 2003 Incentive Stock Plan (2003 Plan), as amended, permits us to grant to our key employees and outside directors various forms of stock incentives, including, among others, incentive and non-qualified stock options and restricted stock. The 2003 Plan is administered by the Compensation Committee of the Board, which consists of two or more directors appointed by the Board. The following benefits may be granted under the 2003 Plan: (a) stock appreciation rights; (b) restricted stock; (c) performance awards; (d) incentive stock options; (e) nonqualified stock options; and (f) other stock-based awards. Stock incentive terms are not to be in excess of ten years. The maximum number of shares that may be issued under the 2003 Plan shall be the lesser of 3,000,000 shares and 15% of the total number of shares of common stock outstanding.

The 2006 Incentive Plan (2006 Plan), was approved by our stockholders in November 2006. The 2006 Plan is administered by the Compensation Committee of the Board, which consists of two or more directors appointed by the Board. The maximum number of shares of the Company's common stock, par value \$0.01 per share (Common Stock), that may be issued under the 2006 Plan is equal to 1,500,000 shares, subject to adjustment in the event of stock splits and certain other corporate events. The 2006 Plan provides for the grant of any or all of the following types of awards: (i) stock options, including incentive stock options and non-qualified stock options; (ii) bonus stock; (iii) restricted stock awards; (iv) performance awards; and (v) other stock-based awards. Except with respect to awards of incentive stock options, all employees, consultants and non-employee directors of the Company and its affiliates are eligible to participate in the 2006 Plan. The term of each Award shall be for such period as may be determined by the Committee; provided, that in no event shall the term of any Award exceed a period of ten (10) years from the date of its grant.

A summary of our stock option activity and related information is as follows:

	December 31, 2007		December 31, 2006		December 31, 2005	
	Shares	Weighted	Shares	Weighted	Shares	Weighted
	Under	Ave.	Under	Ave.	Under	Avg.
	Option	Exercise	Option	Exercise	Option	Exercise
		Price		Price		Price
Beginning balance	1,350,365	\$ 6.88	2,860,867	\$ 5.10	1,215,000	\$ 3.20
Granted	220,000	21.83	15,000	14.74	1,695,000	6.44
Canceled	(17,334)	8.45	(54,567)	5.97	(15,300)	3.33
Exercised	(566,268)	5.86	(1,470,935)	3.54	(33,833)	2.80
Ending balance	986,763	\$ 10.77	1,350,365	\$ 6.88	2,860,867	\$ 5.10

The total intrinsic value of stock options (the amount by which the market price of the underlying stock on the date of exercise exceeds the exercise price of the option) exercised was approximately \$6.6 million, \$18.8 million and \$343,000 during the years ended December 31, 2007, 2006 and 2005, respectively. As of December 31, 2007, there was approximately \$2.4 million of total unrecognized compensation cost related to stock option, with \$939,000, \$918,000 and \$532,000 to be recognized during the years ended December 31, 2008, 2009 and 2010, respectively.

The following table summarizes additional information about our stock options outstanding as of December 31, 2007:

Range of Exercise Prices	Number of options	Options Outstanding		Options Exercisable		
		Weighted Average Remaining Contractual Life (in Years)	Weighted Average Exercise Price	Number of options	Weighted Average Remaining Contractual Life (in Years)	Weighted Average Exercise Price
\$ 2.75-4.87	380,699	7.02	\$ 4.14	380,699	7.02	\$ 4.14
10.85-14.74	386,064	7.92	11.01	381,069	7.92	10.96
16.50-21.95	220,000	9.59	21.83			
2.75-21.95	986,763	7.95	\$ 10.77	761,768	7.47	\$ 7.55

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Table of Contents**ALLIS-CHALMERS ENERGY INC.****Notes to Consolidated Financial Statements (Continued)**

The aggregate pretax intrinsic value of stock options outstanding and exercisable was approximately \$5.5 million at December 31, 2007. The amount represents the value that would have been received by the option holders had the respective options been exercised on December 31, 2007.

Restricted Stock Awards

In addition to stock options, our 2003 and 2006 Plans allow for the grant of restricted stock awards (RSA). A time-lapse RSA is an award of common stock, where each unit represents the right to receive at the end of a stipulated period one unrestricted share of stock with no exercise price. The time-lapse RSA restrictions lapse periodically over an extended period of time not exceeding 10 years. 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. A performance-based RSA is an award of common stock, where each unit represents the right to receive one unrestricted share of stock with no exercise price at the attainment of established performance criteria. During 2007, we granted 710,000 performance based RSAs with market conditions. The performance-based RSAs are granted, but not earned and issued until certain annual total shareholder return criteria are attained over the next 3 years. The fair value of the performance-based RSAs were based on third-party valuations.

The following table summarizes activity in our nonvested restricted stock awards:

	December 31, 2007		December 31, 2006	
	Number	Weighted Ave.	Number	Weighted Ave.
	of	Grant Date	of	Grant Date
	Fair	Fair	Fair	Fair
	Value Per	Value Per	Value Per	Value Per
	Share	Share	Share	Share
	Shares		Shares	
Beginning balance	27,000	\$ 18.30		\$
Granted	996,203	17.44	27,000	18.30
Vested	(30,000)	18.01		
Forfeited				
Ending balance	993,203	\$ 17.45	27,000	\$ 18.30

The total fair value of RSA shares that vested during 2007 was approximately \$577,000. As of December 31, 2007, there was approximately \$13.9 million of total unrecognized compensation cost related to nonvested RSAs, with \$6.6 million, \$5.0 million, \$1.8 million, \$278,000 and \$208,000 to be recognized during the years ended December 31, 2008, 2009, 2010, 2011 and 2012, respectively.

NOTE 11 STOCK PURCHASE WARRANTS

In conjunction with the MCA purchase by Oil Quip in February of 2001, MCA issued a common stock warrant for 620,000 shares to a third-party investment firm that assisted us in its initial identification and purchase of the MCA assets. The warrant entitles the holder to acquire up to 620,000 shares of common stock of MCA at an exercise price of \$.01 per share over a nine-year period commencing on February 7, 2001.

We issued two warrants (Warrants A and B) for the purchase of 233,000 total shares of our common stock at an exercise price of \$0.75 per share and one warrant for the purchase of 67,000 shares of our common stock at an exercise price of \$5.00 per share (Warrant C) in connection with our subordinated debt financing for MCA in 2001. Warrants A and B were paid off on December 7, 2004. Warrant C was exercised during November 2006.

On February 6, 2002, in connection with the acquisition of substantially all of the outstanding stock of Strata, we issued a warrant for the purchase of 87,500 shares of our common stock at an exercise price of \$0.75 per share over the term of four years. The warrants were exercised in August of 2005.

In connection with the Strata Acquisition, on February 19, 2003, we issued Energy Spectrum an additional warrant to purchase 175,000 shares of our common stock at an exercise price of \$0.75 per share. The warrants were exercised in August of 2005.

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ALLIS-CHALMERS ENERGY INC.

Notes to Consolidated Financial Statements (Continued)

In March 2004, we issued a warrant to purchase 340,000 shares of our common stock at an exercise price of \$2.50 per share to Morgan Joseph & Co., in consideration of financial advisory services to be provided by Morgan Joseph pursuant to a consulting agreement. The warrants were exercised in August 2005.

In April 2004, we issued warrants to purchase 20,000 shares of common stock at an exercise price of \$0.75 per share to Wells Fargo Credit, Inc., in connection with the extension of credit by Wells Fargo Credit Inc. The warrants were exercised in August 2005.

In April 2004, we completed a private placement of 620,000 shares of common stock and warrants to purchase 800,000 shares of common stock to the following investors: Christopher Engel; Donald Engel; the Engel Defined Benefit Plan; RER Corp., a corporation wholly-owned by director Robert Nederlander; and Leonard Toboroff, a director. The investors invested \$1,550,000 in exchange for 620,000 shares of common stock for a purchase price equal to \$2.50 per share, and invested \$450,000 in exchange for warrants to purchase 800,000 shares of common stock at an exercise of \$2.50 per share, expiring on April 1, 2006. A total of 486,557 of these warrants were exercised in 2005 with the remaining portion exercised during 2006.

In May 2004, we issued a warrant to purchase 3,000 shares of our common stock at an exercise price of \$4.75 per share to a consultant in consideration of financial advisory services to be provided pursuant to a consulting agreement. The warrants were exercised in May 2004. This consultant was also granted 16,000 warrants in May of 2004 exercisable at \$4.65 per share. These warrants were exercised in November of 2005. Warrants for 4,000 shares of our common stock at an exercise price of \$4.65 were also issued to this consultant in May 2004 and were exercised in January 2007.

NOTE 12 CONDENSED CONSOLIDATED 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). 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.

Table of Contents**ALLIS-CHALMERS ENERGY INC.****Notes to Consolidated Financial Statements (Continued)****CONDENSED CONSOLIDATING BALANCE SHEETS
December 31, 2007**

	Allis- Chalmers (Parent/ Guarantor)	Subsidiary Guarantors	Subsidiary Non- Guarantors	Consolidating Adjustments	Consolidated Total
Assets					
Cash and cash equivalents	\$	\$ 41,176	\$ 2,517	\$	\$ 43,693
Trade receivables, net		83,126	46,973	(5)	130,094
Inventories		15,699	16,510		32,209
Intercompany receivables	76,583			(76,583)	
Note receivable from affiliate	8,270			(8,270)	
Prepaid expenses and other	7,731	2,564	1,603		11,898
Total current assets	92,584	142,565	67,603	(84,858)	217,894
Property and equipment, net		477,055	149,613		626,668
Goodwill		136,875	1,523		138,398
Other intangible assets, net	552	34,572	56		35,180
Debt issuance costs, net	14,228				14,228
Note receivable from affiliates	16,380			(16,380)	
Investments in affiliates	824,410			(824,410)	
Other assets	15	4,977	16,225		21,217
Total assets	\$ 948,169	\$ 796,044	\$ 235,020	\$ (925,648)	\$ 1,053,585
Liabilities and Stockholders Equity					
Current maturities of long-term debt	\$ 32	\$ 4,026	\$ 2,376	\$	\$ 6,434
Trade accounts payable		16,815	20,654	(5)	37,464
Accrued salaries, benefits and payroll taxes		3,712	11,571		15,283
Accrued interest	17,709	33	75		17,817
Accrued expenses	1,660	7,127	11,758		20,545
Intercompany payables		433,116	1,185	(434,301)	
Note payable to affiliate			8,270	(8,270)	
Total current liabilities	19,401	464,829	55,889	(442,576)	97,543
Long-term debt, net of current maturities	505,750		2,550		508,300
Note payable to affiliate			16,380	(16,380)	

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Deferred income tax liability	8,658	13,809	7,623		30,090
Other long-term liabilities	31	242	3,050		3,323
Total liabilities	533,840	478,880	85,492	(458,956)	639,256
Commitments and contingencies					
Stockholders' Equity					
Common stock	351	3,526	42,963	(46,489)	351
Capital in excess of par value	326,095	167,508	74,969	(242,477)	326,095
Retained earnings	87,883	146,130	31,596	(177,726)	87,883
Total stockholders' equity	414,329	317,164	149,528	(466,692)	414,329
Total liabilities and stockholders' equity	\$ 948,169	\$ 796,044	\$ 235,020	\$ (925,648)	\$ 1,053,585

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Table of Contents**ALLIS-CHALMERS ENERGY INC.****Notes to Consolidated Financial Statements (Continued)****CONDENSED CONSOLIDATING INCOME STATEMENTS
For the Year Ended December 31, 2007**

	Allis-Chalmers (Parent/ Guarantor)	Subsidiary Guarantors	Subsidiary Non- Guarantors	Consolidating Adjustments	Consolidated Total
Revenues	\$	\$ 355,172	\$ 215,795	\$	\$ 570,967
Cost of revenues					
Direct costs		185,617	155,833		341,450
Depreciation		39,659	11,255		50,914
Gross margin		129,896	48,707		178,603
General and administrative	4,349	44,439	9,834		58,622
Gain on capillary asset sale		(8,868)			(8,868)
Amortization	46	3,988	33		4,067
Income (loss) from operations	(4,395)	90,337	38,840		124,782
Other income (expense):					
Equity earnings in affiliates, net of tax	102,208			(102,208)	
Interest, net	(47,677)	2,796	(1,394)		(46,275)
Other	304	336	136		776
Total other income (expense)	54,835	3,132	(1,258)	(102,208)	(45,499)
Income before income taxes	50,440	93,469	37,582	(102,208)	79,283
Provision for income taxes		(16,085)	(12,758)		(28,843)
Net income (loss)	\$ 50,440	\$ 77,384	\$ 24,824	\$ (102,208)	\$ 50,440

Table of Contents**ALLIS-CHALMERS ENERGY INC.****Notes to Consolidated Financial Statements (Continued)****CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOW
For the Year Ended December 31, 2007**

	Allis- Chalmers (Parent/ Guarantor)	Subsidiary Guarantors	Other Subsidiaries (Non- Guarantors)	Consolidating Adjustments	Consolidated Total
Cash Flows from Operating Activities:					
Net income (loss)	\$ 50,440	\$ 77,384	\$ 24,824	\$ (102,208)	\$ 50,440
Adjustments to reconcile net income (loss) to net cash provided by operating activities:					
Depreciation & amortization	46	43,647	11,288		54,981
Amortization and write-off of deferred financing fees	3,197				3,197
Stock based compensation	4,863				4,863
Allowance for bad debts		730			730
Equity earnings in affiliates	(102,208)			102,208	
Deferred taxes	7,430		587		8,017
Gain on sale of equipment		(2,182)	(141)		(2,323)
Gain on capillary asset sale		(8,868)			(8,868)
Changes in operating assets and liabilities, net of acquisitions:					
Increase in accounts receivables		(17,823)	(13,002)		(30,825)
Increase in inventories		(4,286)	(1,089)		(5,375)
(Increase) Decrease in other current assets	(3,003)	12,075	(870)		8,202
(Increase) decrease in other assets	242		(4,734)		(4,492)
(Decrease) increase in accounts payable	(31)	2,234	8,529		10,732
(Decrease) increase in accrued interest	5,954	33	(37)		5,950
(Decrease) increase in accrued expenses	1,525	(3,912)	3,895		1,508
(Decrease) increase in other liabilities	(273)	(77)	3,050		2,700
Increase in accrued salaries, benefits and payroll taxes		355	3,676		4,031
Net cash provided (used) by operating activities	(31,818)	99,310	35,976		103,468

Table of Contents**ALLIS-CHALMERS ENERGY INC.****Notes to Consolidated Financial Statements (Continued)**

	Allis- Chalmers (Parent/ Guarantor)	Subsidiary Guarantors	Other Subsidiaries (Non- Guarantors)	Consolidating Adjustments	Consolidated Total
Cash Flows from Investing Activities:					
Acquisitions, net of cash acquired		(41,000)			(41,000)
Purchase of investment interests		(498)			(498)
Purchase of property and equipment		(84,240)	(28,911)		(113,151)
Deposits on asset commitments			(11,488)		(11,488)
Notes receivable from affiliates	(6,809)			6,809	
Proceeds from sale of capillary assets		16,250			16,250
Proceeds from sale of property and equipment		12,666	145		12,811
Net cash provided (used) in investing activities	(6,809)	(96,822)	(40,254)	6,809	(137,076)
Cash Flows from Financing Activities:					
Proceeds from issuance of long-term debt	250,000				250,000
Payments on long-term debt	(300,000)	(6,587)	(3,158)		(309,745)
Accounts receivable from affiliates	(8,674)			8,674	
Accounts payable to affiliates		7,506	1,168	(8,674)	
Note payable to affiliate			6,809	(6,809)	
Proceeds from issuance of common stock, net of offering costs	100,055				100,055
Proceeds from exercise of options and warrants	3,319				3,319
Tax benefit on stock plans	1,719				1,719
Debt issuance costs	(7,792)				(7,792)
Net cash provided (used) by financing activities	38,627	919	4,819	(6,809)	37,556
Net change in cash and cash equivalents		3,407	541		3,948

Cash and cash equivalents at beginning of year		37,769		1,976				39,745
Cash and cash equivalents at end of period	\$	\$	41,176	\$	2,517	\$	\$	43,693

Table of Contents**ALLIS-CHALMERS ENERGY INC.****Notes to Consolidated Financial Statements (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
Inventories		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)	

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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 stockholders' equity	\$ 824,143	\$ 706,752	\$ 185,677	\$ (808,246)	\$ 908,326

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Table of Contents**ALLIS-CHALMERS ENERGY INC.****Notes to Consolidated Financial Statements (Continued)****CONDENSED CONSOLIDATING INCOME STATEMENTS
For the Year Ended December 31, 2006**

	Allis-Chalmers (Parent/ Guarantor)	Subsidiary Guarantors	Subsidiary Non- Guarantors	Consolidating Adjustments	Consolidated Total
Revenues	\$	\$ 241,474	\$ 69,490	\$	\$ 310,964
Cost of revenues					
Direct costs		134,638	50,941		185,579
Depreciation		16,198	4,063		20,261
Gross margin		90,638	14,486		105,124
General and administrative	2,643	30,651	2,242		35,536
Amortization	46	1,801	11		1,858
Income (loss) from operations	(2,689)	58,186	12,233		67,730
Other income (expense):					
Equity earnings in affiliates, net of tax	58,077			(58,077)	
Interest, net	(19,807)	67	(597)		(20,337)
Other	45	97	(489)		(347)
Total other income (expense)	38,315	164	(1,086)	(58,077)	(20,684)
Income (loss) before income taxes	35,626	58,350	11,147	(58,077)	47,046
Provision for income taxes		(7,045)	(4,375)		(11,420)
Net income (loss)	\$ 35,626	\$ 51,305	\$ 6,772	\$ (58,077)	\$ 35,626

Table of Contents**ALLIS-CHALMERS ENERGY INC.****Notes to Consolidated Financial Statements (Continued)****CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOW
For the Year Ended December 31, 2006**

	Allis- Chalmers (Parent/ Guarantor)	Subsidiary Guarantors	Other Subsidiaries (Non- Guarantors)	Consolidating Adjustments	Consolidated Total
Cash Flows from Operating Activities:					
Net income (loss)	\$ 35,626	\$ 51,305	\$ 6,772	\$ (58,077)	\$ 35,626
Adjustments to reconcile net income (loss) to net cash provided by operating activities:					
Depreciation & amortization	46	17,999	4,074		22,119
Amortization & write-off of deferred financing fees	1,527				1,527
Stock based compensation	3,394				3,394
Provision for bad debts		781			781
Imputed interest		355			355
Equity earnings in affiliates	(58,077)			58,077	
Deferred taxes	(619)	247	2,587		2,215
Gain on sale of equipment		(2,428)	(16)		(2,444)
Changes in operating assets and liabilities, net of acquisitions:					
Increase in accounts receivables		(23,144)	(31)		(23,175)
(Increase) decrease in inventories		(2,989)	352		(2,637)
(Increase) decrease in other current assets	(2,482)	4,120	867		2,505
(Increase) decrease in other assets	296	101	(89)		308
(Decrease) increase in accounts payable	(82)	3,587	(5,842)		(2,337)
(Decrease) increase in accrued interest	11,508	(45)	(81)		11,382
(Decrease) increase in accrued expenses	(390)	1,633	(371)		872
(Decrease) in other liabilities	(31)	(193)			(224)
(Decrease) increase in accrued salaries, benefits and payroll taxes	(1,951)	2,780	2,563		3,392
Net cash provided (used) by operating activities	(11,235)	54,109	10,785		53,659

Table of Contents**ALLIS-CHALMERS ENERGY INC.****Notes to Consolidated Financial Statements (Continued)**

	Allis- Chalmers (Parent/ Guarantor)	Subsidiary Guarantors	Other Subsidiaries (Non- Guarantors)	Consolidating Adjustments	Consolidated Total
Cash Flows from Investing Activities:					
Acquisitions, net of cash acquired	(528,167)	3,649	(2,054)		(526,572)
Notes receivable from affiliates	(585)			585	
Purchase of property and equipment		(33,930)	(5,767)		(39,697)
Proceeds from sale of property and equipment		6,730	151		6,881
Net cash provided (used) in investing activities	(528,752)	(23,551)	(7,670)	585	(559,388)
Cash Flows from Financing Activities:					
Proceeds from long-term debt	555,000	2,820			557,820
Payments on long-term debt	(42,414)	(9,875)	(1,741)		(54,030)
Payments on related party debt		(3,031)			(3,031)
Net (payments) borrowings on lines of credit	(6,400)				(6,400)
Accounts receivable from affiliates	(16,444)			16,444	
Accounts payable to affiliates		16,427	17	(16,444)	
Note payable to affiliate			585	(585)	
Proceeds from issuance of common stock, net of offering costs	46,297				46,297
Proceeds from exercise of options and warrants	6,321				6,321
Tax benefit on stock plans	6,440				6,440
Debt issuance costs	(9,863)				(9,863)
Net cash provided (used) by financing activities	538,937	6,341	(1,139)	(585)	543,554
Net change in cash and cash equivalents	(1,050)	36,899	1,976		37,825
Cash and cash equivalents at beginning of year	1,050	870			1,920

Cash and cash equivalents at end of period	\$	\$ 37,769	\$ 1,976	\$	\$ 39,745
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NOTE 13 RELATED PARTY TRANSACTIONS

DLS was acquired from three British Virgin Island corporations. Two of our Directors; Alejandro P. Bulgheroni and Carlos A. Bulgheroni, indirectly beneficially own substantially all of the shares of the DLS sellers. DLS largest customer is Pan American Energy which is a joint venture by British Petroleum and Bidas Corporation. Alejandro P. Bulgheroni and Carlos A. Bulgheroni, indirectly beneficially own substantially all of the shares of the Bidas Corporation.

We purchased approximately \$3.5 million of general oilfield supplies and materials from Ralow Services, Inc., or Ralow in 2007 for our Rental Services segment. Ralow is owned by Brad A. Adams and Bruce A. Adams who are brothers of Burt A. Adams, one of our directors and our former President and Chief Operating Officer. In addition, Brad A. Adams and Bruce A. Adams were employed as officers of Rental during 2007.

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Table of Contents**ALLIS-CHALMERS ENERGY INC.****Notes to Consolidated Financial Statements (Continued)****NOTE 14 SEGMENT INFORMATION**

At December 31, 2007, we had six operating segments including: 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 assets of each of the reporting segments plus the corporate function are reported below (in thousands):

	Years Ended December 31,		
	2007	2006	2005
Revenues:			
Rental Services	\$ 121,186	\$ 51,521	\$ 5,059
International Drilling	215,795	69,490	
Directional Drilling	96,080	76,471	46,579
Tubular Services	53,524	50,887	20,932
Underbalanced Drilling	50,959	43,045	25,662
Production Services	33,423	19,550	9,790
Total revenues	\$ 570,967	\$ 310,964	\$ 108,022
Operating Income (Loss):			
Rental Services	\$ 49,139	\$ 26,293	\$ 1,300
International Drilling	38,839	12,233	
Directional Drilling	18,848	17,666	7,389
Tubular Services	10,744	12,544	4,994
Underbalanced Drilling	13,091	10,810	5,612
Production Services	10,535	2,137	(99)
General corporate	(16,414)	(13,953)	(5,678)
Total income from operations	\$ 124,782	\$ 67,730	\$ 13,518
Depreciation and Amortization Expense:			
Rental Services	\$ 26,353	\$ 7,268	\$ 492
International Drilling	11,288	4,074	
Directional Drilling	3,063	1,464	887
Tubular Services	5,164	3,908	2,006
Underbalanced Drilling	3,692	3,057	1,946
Production Services	4,919	2,005	912
General corporate	502	343	118
Total depreciation and amortization expense	\$ 54,981	\$ 22,119	\$ 6,361
Capital Expenditures:			

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Rental Services	\$ 34,883	\$ 4,538	\$ 435
International Drilling	28,911	5,770	
Directional Drilling	11,177	5,128	2,922
Tubular Services	9,250	10,980	5,207
Underbalanced Drilling	17,443	7,716	7,008
Production Services	10,740	5,253	1,514
General corporate	747	312	681
Total capital expenditures	\$ 113,151	\$ 39,697	\$ 17,767

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Table of Contents**ALLIS-CHALMERS ENERGY INC.****Notes to Consolidated Financial Statements (Continued)**

	As of December 31,		
	2007	2006	2005
Goodwill:			
Rental Services	\$ 106,382	\$ 106,132	\$
International Drilling	1,523	1,504	
Directional Drilling	16,300	4,168	4,168
Tubular Services	6,564	6,464	3,673
Underbalanced Drilling	3,950	3,950	3,950
Production Services	3,679	3,617	626
General corporate			
Total goodwill	\$ 138,398	\$ 125,835	\$ 12,417
Assets:			
Rental Services	\$ 454,216	\$ 453,802	\$ 8,034
International Drilling	235,020	185,677	
Directional Drilling	82,532	28,585	20,960
Tubular Services	88,014	74,372	45,351
Underbalanced Drilling	72,401	54,288	46,045
Production Services	56,353	57,954	12,282
General corporate	65,049	53,648	4,683
Total assets	\$ 1,053,585	\$ 908,326	\$ 137,355

	Years Ended December 31,		
	2007	2006	2005
Revenues:			
United States	\$ 339,476	\$ 231,852	\$ 101,261
International	231,491	79,112	6,761
Total revenues	\$ 570,967	\$ 310,964	\$ 108,022

	As of December 31,		
	2007	2006	2005
Long Lived Assets:			
United States	\$ 655,513	\$ 574,302	\$ 97,390

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International	180,178	153,262	4,313
Total long lived assets	\$ 835,691	\$ 727,564	\$ 101,703

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Table of Contents**ALLIS-CHALMERS ENERGY INC.****Notes to Consolidated Financial Statements (Continued)****NOTE 15 SUPPLEMENTAL CASH FLOWS INFORMATION (in thousands)**

	Years Ended December 31,		
	2007	2006	2005
Interest paid	\$ 40,363	\$ 8,571	\$ 3,924
Income taxes paid	\$ 17,272	\$ 5,796	\$ 676
<u>Other non-cash investing and financing transactions:</u>			
Insurance premiums financed	4,434	2,871	
Purchase of equipment financed through assumption of debt or accounts payable			592
<u>Non-cash investing and financing transactions in connection with acquisitions:</u>			
Fair value of Property and equipment	\$ 4,345	\$ 109,632	\$ 1,750
Fair value of goodwill and other intangibles	350	4,010	
	\$ 4,695	\$ 113,642	\$ 1,750
Value of common stock, issued	\$	\$ 94,980	\$ 1,750
Seller financed note	1,600	750	
Deferred tax liability	3,095	17,662	
Accrued expenses		250	
	\$ 4,695	\$ 113,642	\$ 1,750

NOTE 16 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 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 17 SUBSEQUENT EVENTS

On January 23, 2008, we entered into an Agreement and Plan of Merger with Bronco Drilling Company, Inc., or Bronco, whereby Bronco will become a wholly-owned subsidiary of Allis-Chalmers. The merger agreement, which was approved by our Board of Directors and the Board of Directors of Bronco, provides that the Bronco stockholders

will receive aggregate merger consideration with a value of approximately \$437.8 million, consisting of (a) \$280.0 million in cash and (b) shares of our common stock, par value \$0.01 per share, having an aggregate value of approximately \$157.8 million. The number of shares of our common stock to be issued will be based on the average closing price of our common stock for the ten-trading day period ending two days prior to the closing. Completion of the merger is conditioned upon, among other things, adoption of the merger agreement by Bronco's stockholders and approval by our stockholders of the issuance of shares of our common stock to be used as merger consideration.

In order to finance some or all of the cash component of the merger consideration, the repayment of outstanding Bronco debt and transaction expenses, we expect to incur debt of up to \$350.0 million. We intend to obtain up to \$350.0 million from either (1) a permanent debt financing of up to \$350.0 million or (2) if the permanent debt financing cannot be consummated prior to the closing date of the merger, the draw down under a senior unsecured bridge loan facility in an aggregate principal amount of up to \$350.0 million to be arranged by RBC Capital Markets Corporation and Goldman Sachs Credit Partners L.P., acting as joint lead arrangers and joint bookrunners. We executed a commitment letter, dated January 28, 2008, with Royal Bank of Canada and Goldman Sachs who have

Table of Contents**ALLIS-CHALMERS ENERGY INC.****Notes to Consolidated Financial Statements (Continued)**

each, subject to certain conditions, severally committed to provide 50% of the loans under the senior unsecured bridge facility to us. This commitment for the bridge loan facility will terminate on July 31, 2008, if we have not drawn the bridge facility by such date and the merger is not consummated by such date. The commitment may also terminate prior to July 31, 2008, if the merger is abandoned or a material condition to the merger is not satisfied or we breach our obligations under the commitment letter. We may use the proceeds of the bridge facility to finance the cash component of the merger consideration, repay outstanding Bronco debt and pay transaction expenses.

On January 29, 2008, Burt A. Adams resigned as our President and Chief Operating Officer, effective February 28, 2008. Mr. Adams will remain as a member of our Board of Directors. On January 29, 2008, Mark C. Patterson was elected our Senior Vice-President Rental Services. On January 29, 2008, Terrence P. Keane was elected our Senior Vice-President Oilfield Services.

On January 31, 2008, we entered into an agreement with BCH Ltd., or BCH, to invest \$40.0 million in cash in BCH in the form of a 15% Convertible Subordinated Secured debenture. The debenture is convertible, at any time, at our option into 49% of the common equity of BCH. At the end of two years, we have the option to acquire the remaining 51% of BCH from its parent, BrazAlta Resources Corp., or BrazAlta, based on an independent valuation from a mutually acceptable investment bank. BCH is a Canadian-based oilfield services company engaged in contract drilling operations exclusively in Brazil.

On February 15, 2008, through our DLS subsidiary in Argentina, we entered into a \$25.0 million import finance facility with a bank. Borrowings under this facility will be used to fund a portion of the purchase price of the new drilling and service rigs ordered for our international drilling operation. The facility is available for borrowings until December 31, 2008. Each drawdown shall be repaid over four years in equal semi-annual instalments beginning one year after each disbursement with the final principal payment due not later than March 15, 2013. Interest is payable every six months. The import finance facility is unsecured and contains customary events of default and financial covenants and limits DLS ability to incur additional indebtedness, make capital expenditures, create liens and sell assets.

NOTE 18 SUMMARIZED QUARTERLY FINANCIAL DATA (UNAUDITED) (in thousands, except per share amounts)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Year 2007				
Revenues	\$ 135,900	\$ 143,362	\$ 147,881	\$ 143,824
Operating income	31,470	41,474	31,148	20,690
Net income	\$ 12,165	\$ 19,504	\$ 12,987	\$ 5,784
Income per common share:				
Basic	\$ 0.38	\$ 0.56	\$ 0.37	\$ 0.17
Diluted	\$ 0.37	\$ 0.55	\$ 0.37	\$ 0.16

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Year 2006				
Revenues	\$ 47,911	\$ 61,383	\$ 86,772	\$ 114,898
Operating income	8,856	16,108	19,336	23,430
Net income	\$ 4,423	\$ 9,594	\$ 11,253	\$ 10,356
Income per common share:				
Basic	\$ 0.26	\$ 0.53	\$ 0.52	\$ 0.41
Diluted	\$ 0.23	\$ 0.50	\$ 0.50	\$ 0.40

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ITEM 11. EXECUTIVE COMPENSATION

Compensation Discussion and Analysis

The following is a discussion of the principles and policies underlying our executive compensation program as well as the manner and context in which we award compensation for each of the named executives identified in the Summary Compensation Table below.

Executive Compensation Philosophy and Objectives

It is critical to our long-term success and growth that our business is managed by highly capable leaders with the experience and dedication to oversee a growing and changing organization. To achieve this objective, our compensation philosophy is to recruit, retain and motivate talented and effective employees. We focus on traditional compensation principles that are geared to both our short-term and long-term performance. We adhere to the following compensation principles which influence the design and administration of our executive compensation program:

Compensation decisions should reflect our strategy We have experienced rapid growth in recent years. As we have grown, we have made compensation decisions that reflect our size and growth.

Total compensation should reflect performance Our compensation program provides incentives that reward executives for achieving short-term as well as long-term financial and operational goals. Our total compensation program is managed so that a significant amount of executive compensation is considered at risk, and conditioned on performance.

Compensation levels must be competitive Demand for qualified executive talent in our industry is high, while the supply for this talent is limited. The level of base salaries, short-term incentive opportunities, and long-term incentive opportunities established for our named executive officers are intended to provide a total target compensation opportunity in the range of the market median for executives in comparable positions and markets in which we compete for talent.

Executive interests should be aligned with those of our stockholders The value of our executive compensation programs should generally vary as our stockholders experience increase or decrease in value. Through the use of performance related annual incentives, stock option grants, and restricted stock grants, we attempt to align the long-term interests of our executives with those of our stockholders by linking a portion of executive compensation to our long-term financial performance.

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Compensation programs should motivate executives to stay with us over the long-term In addition to providing compensation that is competitive with the market, we attempt to provide incentive for our executives to stay with the company. We use time vested option and restricted stock awards in our compensation program, providing retention incentives for our executives to stay with us. In the last year, we entered into an employment agreement with each of our named executive officers. Each of these high performing executives have been retained for three year terms. The Compensation Committee believes that retaining each of these individuals will play a critical role in our future success.

Role of Compensation Committee

Executive officer compensation is administered by the Compensation Committee of our board of directors, which is composed of two non-employee directors who satisfy the independence requirements of the New York Stock Exchange. Our board of directors appoints the members of the Compensation Committee, and delegates to the Compensation Committee the responsibility for, among other matters:

evaluating and approving our overall compensation programs;

annually reviewing the performance of and setting the compensation (i.e., salary, incentive awards, and all other elements) for our chief executive officer;

annually reviewing the performance of and recommending the compensation for the other executive officers; and

reviewing and approving annual goals and mechanics along with administering our annual incentive and equity compensation plans and programs.

Compensation Governance

Each year the compensation paid to our chief executive officer is reviewed and approved by the Compensation Committee. The compensation awarded to our other named executive officers is proposed by the CEO, reviewed by the Compensation Committee and then recommended to the Board of Directors for final approval.

Our Board of Directors generally approves the compensation plans which govern our various direct compensation programs and elements. The table below outlines the governance of those programs.

	Compensation Element	Plan/Governance	Reviewed and Recommended By:	Approved By:
CEO	Base Salary	Employment Agreement	Compensation Committee	Compensation Committee
	Annual Bonus	Employment Agreement		
	Long-Term Incentives	2006 Incentive Plan		
NEOs	Base Salary	Employment Agreements	CEO & Compensation Committee	Board of Directors
	Annual Bonus	Employment Agreements		
	Long-Term Incentives	2006 Incentive Plan		

Role of Compensation Consultants

Pursuant to its charter, the Compensation Committee is authorized to retain any compensation consultants or other advisors as it deems appropriate to assist in compensation matters. Since 2007, the Compensation Committee has periodically engaged Cogent Compensation Partners, Inc., or Cogent, to serve as an independent compensation consultant to the Compensation Committee on executive compensation matters. Cogent performs work at the direction and under the supervision of the Compensation Committee and provides advice, research and analytical services on a variety of compensation related subjects.

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Role of Our Executive Officers in Establishing Compensation

Mr. Hidayatallah, our chief executive officer, is actively involved in the compensation process and provides recommendations to the Compensation Committee in its evaluation and administration of compensation programs for our executive officers, including the recommendation of individual compensation levels for executive officers, other than himself. In developing compensation recommendations, Mr. Hidayatallah has relied on his many years of experience serving as an executive officer in the oilfield service industry as well as publicly available information for comparable compensation guidance. No other executive officer assumes an active role in the evaluation, design or administration of our executive officer compensation programs. Mr. Hidayatallah participates in Compensation Committee meetings relating to the compensation of our other executive officers. Mr. Hidayatallah does not attend Compensation Committee meetings that pertain to him.

Benchmarking

We compare our compensation practices with other comparable companies when making determinations about compensation. Our current peer group of companies was established in 2006. The companies chosen as our peers were selected as representative of the sector in which we operate and of our relative size in terms of market capitalization and revenue. With the assistance of Cogent, our compensation consultant, we reviewed the compensation of our executive officers relative to that paid to executives in our peer group. We use this type of benchmarking as a source of information which complements our own analysis, and not as an independent source for making compensation related decisions. Competitive compensation information provided to us by Cogent represents only part of our decision making process and serves to help us better understand the competitive environment for executive pay.

Our peer group consists of the following companies:

Core Laboratories

Gulfmark Offshore Inc.

NATCO Group Inc.

Newpark Resources

Oil States Intl. Inc.

RPC Inc.

Superior Energy Services Inc.

Superior Well Services Inc.

Tesco Corp.

Tetra Technologies Inc.

W-H Energy Services Inc.

Cogent used compensation information from the peer companies and combined it with published compensation surveys specific to the energy industry to analyze the base salaries and total compensation of each of our named executive officers. The primary energy industry survey used was the 2007 Mercer Energy Compensation Survey in which 217 energy industry companies participated. Our analysis for 2007 compensation showed our named executive officers positioned near the market median of these companies for base salaries and total cash compensation.

Components of Executive Compensation

Our executive compensation program consists of the following components: base salary, annual bonus, long-term incentives, perquisites and benefits.

Base Salary

Competitive base salaries are designed to attract and retain employees by providing them with a stable source of income. In addition, base salaries for our executive officers are designed to compensate the executive for the

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experience, education, personal qualities and other qualifications of that individual that are essential for the specific role of such executive, while remaining competitive with the market. This market consists of both the oilfield services industry and other service-based industries. We have historically set pay at levels that reflect the qualifications of the individuals and their competing opportunities in the market. Our annual incentive compensation is expressed as a percentage of base salary.

Base salaries are generally reviewed on an annual basis. In addition to benchmarking, as noted above, our chief executive officer considers various factors when recommending base salaries, including:

the executive's individual performance;

the performance of the executive's business unit within Allis-Chalmers;

company-wide performance;

the executive's experience and expertise;

the executive's position and job responsibilities;

the executive's years of service with us; and

the competitive pay levels for similar positions.

No specific weight is assigned to any of these factors and our chief executive officer exercises subjective judgment when making salary recommendations with respect to our executive officers.

Annual Incentive Compensation

A significant portion of each executive's total compensation is variable and dependent upon the achievement of one or more goals. Annual incentive compensation primarily consists of cash bonuses. When determining these bonuses, we rely on performance criteria such as the achievement of certain earnings per share or earnings before interest, taxes, depreciation and amortization, or EBITDA, the successful completion of specific job responsibilities or the achievement of other items integral to our success. For 2007, the primary performance criteria used for our corporate executives was meeting specified earnings guidance and successfully completing individual goals pertaining to specified job responsibilities. For our chief financial officer, these goals included managing our financial reporting function, maintaining Sarbanes-Oxley compliance, obtaining financing for acquisitions and receiving an unqualified audit opinion. For our general counsel, these goals included performance related to acquisitions, the timely filing of regulatory reports and successfully managing our legal issues. These performance criteria are generally set forth in each executive's employment agreement. For our division heads, their performance goals are generally tied to the achievement of established EBITDA goals for each such division. For each executive, our chief executive officer evaluates performance in light of the specified performance criteria for each executive and recommends to the Compensation Committee the amount of the annual incentive payment to be awarded. An annual cash bonus may be more than, less than or equal to the target cash bonus amount set for each executive.

Long-Term Incentive Compensation

We award long-term incentive compensation to focus our executives on our long-term growth and stockholder return, as well as to encourage our executives to remain with us for the long-term. Prior to 2006, we primarily granted long-term incentives in the form of stock options pursuant to our Amended and Restated 2003 Stock Option Plan. We selected this form because of the favorable accounting and tax treatment and the expectation of key employees in our industry that they would receive stock options. In 2006, we reassessed our form of award and the Committee adopted the 2006 Incentive Plan, or the 2006 Plan, in order to provide us with a mix of long-term incentive vehicles to complement our stock option awards, namely restricted stock. We do not have pre-established target award amounts for long-term incentive grants. Instead, our chief executive officer recommends the number of awards to grant to each executive.

Stock Options. Stock options are an important aspect of our long-term compensation program. Stock options are granted with an exercise price equal to the fair market value of the option on the date of grant. In 2007, we granted stock options to our chief executive officer and chief financial officer as a means of motivating them to increase stockholder value by aligning their interests with those of our stockholders.

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Restricted Stock. Our use of restricted stock is intended to maintain consistency in management by encouraging our executives to stay with us for the long-term. Restricted stock awards provide some value to an employee during periods of stock market volatility, whereas stock options may have limited perceived value and may do little to retain and motivate employees when the current value of our stock is less than the option price. Further, restricted stock is a meaningful mechanism to align the interests of executives with those of our stockholders, without fostering an environment of undue risks.

In determining long-term incentive awards for the executives, the Compensation Committee relies on recommendations from our chief executive officer. Our chief executive officer considers several factors, including our performance, the individual performance of the executives, the share usage and associated accounting expense when determining restricted stock awards. In 2007, we granted restricted stock to our all of our named executive officers in connection with their renewed employment agreements.

Perquisites

Our named executive officers received certain perquisites in 2007 which consisted of health benefits paid for by us, payment of life insurance premiums and a monthly car allowance. We provide these benefits to our named executive officers as part of a competitive compensation package. In addition, we provide Mr. Hidayatallah with access to a company car and driver because we believe that this allows him to devote optimal time to our business and increases his efficiency.

In addition to the benefits named above, we reimburse Mr. Hidayatallah for maintaining an apartment in Houston, Texas in close proximity to our corporate office because Mr. Hidayatallah resides in California. We also reimburse Mr. Hidayatallah for expenses for traveling between Texas and California. Mr. Hidayatallah's reimbursements for his travel expenses and his apartment in Houston are provided for in his employment agreement.

We did not provide tax gross-ups related to these perquisites in 2007.

Employee Benefits

We offer our named executive officers standard employee benefits to provide for them in time of disability and to allow us to remain competitive in the market in order to attract and retain key employees. Our primary benefits, which are available to all employees, include participation in our employee health, dental and vision plans, disability and life insurance plans and our 401(k) savings plan. We currently match 50% of the employees' pre-tax contributions up to 6% of the employee's salary (including bonus), subject to contribution limits. We also pay the cost of health insurance premiums for each of our named executive officers.

Compensation of the Named Executive Officers

Chairman & Chief Executive Officer

We entered into a new employment agreement with Mr. Hidayatallah effective April 2007. The terms of the agreement were proposed by Mr. Hidayatallah and the Compensation Committee retained the services of Cogent to assist in negotiating the terms of the agreement. Pursuant to his agreement, Mr. Hidayatallah's salary was increased from \$400,000 to \$500,000, which represented a 25% increase in his annual salary. The salary was set just below the market median as reported by Cogent. The Compensation Committee also felt this increase was reasonable given the competitiveness of the salary in the market, and the significant strides we have made in terms of growth under the direction and leadership of Mr. Hidayatallah. The agreement also provides Mr. Hidayatallah the opportunity to earn an annual incentive bonus equal to 100% of his base salary, which makes him eligible to receive up to \$1 million in annual total cash compensation. The resulting total cash compensation would position Mr. Hidayatallah's pay near the market median if the annual incentive bonus was achieved. For 2007, Mr. Hidayatallah's annual incentive bonus was based on Allis-Chalmers meeting specified earnings guidance of not less than \$1.70 per share. Although Mr. Hidayatallah did not receive his target annual incentive bonus for 2007 because we did not meet our specified earnings guidance for the year (actual earnings were \$1.46 per share), he did receive a discretionary \$100,000 bonus for the first quarter of 2007 for growing Allis-Chalmers' operations both domestically and internationally.

In connection with his employment agreement, Mr. Hidayatallah was awarded 685,000 shares of performance-based restricted stock and 200,000 stock options. The annualized present value of the award is approximately \$4.66

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million, which is equivalent to 5.8 times the annualized long-term incentive value awarded at the 75th percentile of our peer group. The Compensation Committee granted these awards in order to recognize the dedication and leadership of Mr. Hidayatallah as well as to further retain and motivate Mr. Hidayatallah to continue to focus on the growth of Allis-Chalmers. While this award's value falls within the top quartile of the market, which is generally outside our normal compensation strategy, the Compensation Committee considered the significant growth of Allis-Chalmers since inception under the direction of Mr. Hidayatallah. Particularly, the Compensation Committee noted that in 2003 we had revenues of \$33 million with net income of \$2.3 million and in 2007 our revenues increased to \$571 million with net income of \$50.4 million. In addition, our market capitalization increased from approximately \$12 million in 2003 to approximately \$512 million in 2007. The Compensation Committee also felt the restricted stock award was appropriate because it is performance-based, making it both tax deductible and stockholder friendly since the performance measure of the restricted stock award is based upon an increase each year in total stockholder return.

Chief Financial Officer

We entered into a new employment agreement with Mr. Perez effective April 2007. Pursuant to his new agreement, Mr. Perez's salary was increased from \$260,000 to \$286,000, which represented approximately a 10% increase in his annual salary. In considering the competitiveness of the increase, the Compensation Committee was provided with market data which showed the increase would position his base salary just above the market median. The agreement also provides Mr. Perez the opportunity to earn an annual incentive bonus equal to 50% of his base salary. The total cash compensation that Mr. Perez is eligible to receive is between the market 25th percentile and the median, according to information provided to the Compensation Committee by Cogent. For 2007, Mr. Perez's annual incentive bonus was based on him meeting individual performance goals of managing our financial reporting function, maintaining Sarbanes-Oxley compliance, obtaining financing for acquisitions and receiving an unqualified audit opinion from our independent public accountants. In addition, Mr. Perez's annual incentive bonus was based on Allis-Chalmers meeting specified earnings guidance of not less than \$1.70 per share. Although Mr. Perez met his individual performance goals, we did not meet our earnings guidance for the year (actual earnings were \$1.46 per share). Therefore, Mr. Perez did not receive an annual incentive bonus for 2007.

In connection with his employment agreement, Mr. Perez was awarded 15,000 stock options and 25,000 shares of performance-based restricted stock. The annual present value of the equity on the date of grant positioned Mr. Perez total direct compensation around the market 75th percentile, according to a report provided to us by Cogent. In making these grants, the Compensation Committee considered such factors as his role in obtaining financing for our acquisitions, his oversight in the successful implementation of our financial controls systems, his receipt of three consecutive clean audit opinions and his overall leadership in the accounting and finance function.

General Counsel & Secretary

We entered into a new employment agreement with Mr. Pound in December 2007. Pursuant to his new agreement, Mr. Pound's salary was increased from \$240,000 to \$250,000, which represented approximately a 4% increase and positioned his base salary at the market median. The agreement also provides Mr. Pound the opportunity to earn an annual incentive bonus equal to 50% of his base salary. The total cash compensation that Mr. Pound is eligible to receive is between the market 25th percentile and the median, based on information provided by Cogent. For 2007, Mr. Pound's annual incentive bonus was based on him meeting individual performance goals of successfully completed acquisitions, timely filing of regulatory reports and successful management of our legal issues. In addition, Mr. Pound's annual incentive bonus was based on Allis-Chalmers meeting specified earnings guidance of not less than \$1.70 per share. Although Mr. Pound met his individual performance goals, we did not meet our earnings guidance for the year (actual earnings were \$1.46 per share). Therefore, Mr. Pound did not receive an annual incentive bonus for 2007.

In connection with his employment agreement, Mr. Pound was awarded 15,000 shares of restricted stock. This equity grant was awarded to Mr. Pound for the high level of responsibility he assumed in successfully overseeing our acquisitions and other important compliance responsibilities. In addition, these equity awards were made to retain and motivate Mr. Pound to focus on the long-term growth of Allis-Chalmers.

President and CEO of Strata Directional Technology LLC

We entered into a new employment agreement with Mr. Bryan in July 2007. Mr. Bryan's salary was maintained at \$250,000 as his base salary was already positioned between the market median and the 75th percentile. The agreement also provides Mr. Bryan the opportunity to earn an annual incentive bonus equal to 100% of his base salary. The total cash compensation that Mr. Bryan is eligible to receive is above the market's 75th percentile, according to information

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provided to the Compensation Committee by Cogent. For 2007, Mr. Bryan's annual incentive bonus was based on Strata Directional Technology LLC, or Strata, meeting financial goals of EBITDA of \$21.9 million for the year. Mr. Bryan received an annual incentive bonus of \$231,250 for meeting such financial goals.

In connection with his employment agreement, Mr. Bryan was awarded 112,500 shares of restricted stock for 2007. This equity grant was awarded to Mr. Bryan for being the highest performing named executive officer in 2007. Despite losing 19 directional drillers in 2007, his division maintained EBITDA and revenue targets and had the highest return on capital employed. In addition, the Compensation Committee considered the high performance of Strata, over the past five years. In 2003 Strata had revenues of \$16.0 million and EBITDA of \$1.4 million. Under the leadership of Mr. Bryan, in 2007 Strata had increased its revenues to \$96 million with EBITDA of \$21.9 million. Strata also has the highest return on capital employed among all of our business segments. The size of Mr. Bryan's equity award in comparison to those made to other named executive officers for 2007, other than the chief executive officer, is a reflection of Mr. Bryan's exceptional performance during 2007.

Senior Vice President Oilfield Services

We entered into a new employment agreement with Mr. Keane in July 2007 and increased his salary from \$175,000 to \$225,000, which represented a 29% increase in his annual base salary. Mr. Keane's 2007 compensation is based upon his service as President of AirComp LLC. In January 2008, Mr. Keane was promoted to Senior Vice President Oilfield Services and his salary was increased to \$250,000. The increase positioned Mr. Keane's salary between the market median and the 75th percentile. In April 2008, Mr. Keane's employment agreement was amended to reflect his new position and his salary was increased to \$275,000.

The agreement also provides Mr. Keane the opportunity to earn an annual incentive bonus equal to 100% of his base salary. The total cash compensation that Mr. Keane is eligible to receive is above the market's 75th percentile according to information provided to the Compensation Committee by Cogent. For 2007, Mr. Keane's annual incentive bonus was based on AirComp LLC meeting financial goals of EBITDA of \$16.1 million for the year. Mr. Keane received an annual incentive bonus of \$156,250 for meeting such financial goals.

In connection with his employment agreement, Mr. Keane was awarded 45,000 shares of restricted stock in 2007. This award was made in part as consideration for his role in the revenue growth of his division over the past 5 years. In 2003 AirComp LLC had revenues of \$6.7 million and EBITDA of \$1.2 million. Under the leadership of Mr. Keane, in 2007 AirComp LLC had revenues of \$51 million and EBITDA of \$16.8 million. In addition, the equity award was made to further retain and motivate Mr. Keane to continue in our successful growth.

*Executive Compensation Policies and Processes**Equity Award Grant Practices*

We award all stock options to purchase our common stock to executive officers and all other employees at the market price of our common stock on the grant date. Employees are not allowed to select the effective date of stock option grants and neither we nor the Compensation Committee has ever back-dated any option awards. Although the Compensation Committee does not set specific dates in which it makes equity awards, the Compensation Committee does not time its approval of equity awards around the release of any material non-public information.

Policy Regarding Section 162(m) of the Internal Revenue Code

Section 162(m) of the Internal Revenue Code generally limits our ability to take a federal income tax deduction for compensation paid to our named executive officers in excess of \$1 million. The stock options we grant have been structured to qualify as performance-based so they are not subject to this deduction limitation. Although the Compensation Committee will seek to utilize deductible forms of compensation to the extent practicable, it believes it is important to preserve flexibility in administering compensation programs. Accordingly, we have not adopted a policy that all compensation must qualify as deductible under Section 162(m).

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For 2007, our executive compensation had the following implications under Section 162(m) of the Internal Revenue Code:

Base salaries for all named executive officers were fully deductible in 2007 as each of those salaries were under \$1 million.

Stock options awards were granted under the stockholder approved 2006 Incentive Plan and are deductible as performance-based compensation under Section 162(m).

The restricted shares granted to our CEO in connection with his employment agreement were granted under the stockholder approved 2006 Incentive Plan and are deductible as performance-based compensation because they vest only upon the achievement of certain performance goals.

Executive Stock Ownership Guidelines

We do not currently have any policy or guidelines that require a specified ownership of our common stock by our directors or executive officers or stock retention guidelines applicable to equity-based awards granted to directors and executive officers. However, the Compensation Committee has committed itself to working with Cogent Compensation Partners, Inc. to develop and establish stock ownership requirements. The Compensation Committee believes that establishing ownership guidelines will more closely align our key executives' interests with those of our stockholders. The Compensation Committee will establish target ownership requirements by conducting a study into the market levels of required ownership.

Compensation Committee Report

The Compensation Committee has reviewed and discussed the Compensation Discussion and Analysis required by Item 402(b) of Regulation S-K with management and, based on such review and discussions, the Compensation Committee recommended to the board of directors that the Compensation Discussion and Analysis be included in this Annual Report on Form 10-K/A for the year ended December 31, 2007.

The Compensation Committee of the Board
of Directors

Ali H. M. Afdhal
Zane Tankel

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Table of Contents**Summary Compensation Table**

The following table provides a summary of the cash and non-cash compensation for the year ended December 31, 2007 and 2006 for each of (1) the Chief Executive Officer and the Chief Financial Officer and (2) each of our three most highly compensated executive officers during 2007 other than the Chief Executive Officer or Chief Financial Officer. We refer to these executives collectively as the named executive officers.

Name and Principal Position	Year	Salary (\$)	Bonus (\$)	Stock Awards(1) (\$)	Option Awards(2) (\$)	Non-Equity	All	Total (\$)
						Incentive Plan Compensation (\$)(3)	Other Compensation (\$)(5)	
Munawar H. Hidayatallah Chairman & Chief Executive Officer	2007	475,000	100,000	2,013,444	547,115		139,034	3,274,593
	2006	400,000			845,694	400,000	88,240	1,733,934
Victor M. Perez Chief Financial Officer	2007	270,833		63,608	81,912		43,000	459,353
	2006	248,833	100,000		212,551	120,000	21,801	703,185
Theodore F. Pound General Counsel and Secretary	2007	240,833		6,346	65,852		29,751	342,782
	2006	205,500	100,000		230,142	90,000	15,923	641,565
David K. Bryan President and Chief Executive Officer of Strata Directional Technology LLC	2007	250,000		309,877	5,284	231,250	21,148	817,559
	2006	187,000			33,038	174,996	12,941	407,975
Terrence P. Keane(4) Senior Vice President Oilfield Services	2007	202,404		287,653	38,399	156,250	40,393	725,099
	2006	172,038			128,957	87,500	16,062	404,557

(1) The amounts indicated represent the aggregate dollar amount of compensation expense, excluding the reduction for risk of forfeiture, related to restricted stock awards recognized in our financial statements during fiscal year 2007. The expense was determined in accordance with FAS 123(R) as disclosed in

Notes 1 and 10 to our financial statements included in our annual report on Form 10-K for the year ended December 31, 2007.

- (2) The amounts indicated represent the aggregate dollar amount of compensation expense, excluding the reduction for risk of forfeiture, related to stock option awards recognized in our financial statements during fiscal year 2007 and includes amounts from awards granted prior to 2007. The expense was determined in accordance with FAS 123(R) as disclosed in Notes 1 and 10 to our financial statements included in our annual report on Form 10-K for the year ended December 31, 2007.
- (3) The amounts indicated represent annual incentive compensation paid pursuant to

each executives
employment
agreement.

- (4) Mr. Keane's promotion to Senior Vice President Oilfield Services was effective January 29, 2008. During 2007, Mr. Keane served as President and Chief Executive Officer of AirComp LLC.
- (5) The following table provides a summary of the All Other Compensation column and includes all perquisites:

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Name	Year	401(k)	Allis-Chalmers		Other	Total	
		plan	Car	Provided	Personal		
		Health	Matching	Car	Provided	Other	Total
		Benefits	Contributions	Allowance	Car (2)	Benefits (3)	Total
		(1)	(1)	(1)	(1)	(1)	(1)
		(\$)	(\$)	(\$)	(\$)	(\$)	(\$)
Munawar H. Hidayatallah	2007	62,788	7,500		12,302	56,444	139,034
	2006	27,832	3,750		7,023	49,635	88,240
Victor M. Perez	2007	23,513	7,488	12,000			43,001
	2006	10,723	4,578	6,500			21,801
Theodore F. Pound	2007	10,001	7,750	12,000			29,751
	2006	9,623	4,800	1,500			15,923
David K. Bryan	2007	10,801	4,347	6,000			21,148
	2006	6,941		6,000			12,941
Terrence P. Keane	2007	22,418	5,975	12,000			40,393
	2006	5,751	2,311	8,000			16,062

- (1) The amounts indicated represent actual health benefit premiums and expenses paid by Allis-Chalmers.
- (2) We provide a company car and driver to Mr. Hidayatallah for business reasons and for commuting to and from the office. The cost of the driver was determined by allocating a portion of the total actual employment costs of the administrative employee based on amount of driving time per employee. The cost of the company car was determined by allocating a portion

of the car purchase price (total cost divided by three for the expected usage of the car in years), annual cost of insurance, maintenance and other costs based on mileage incurred for commuting and personal use by each employee.

- (3) Other personal benefits for Mr. Hidayatallah include \$23,415 in Allis-Chalmers-paid airline flights and \$33,029 in apartment and utility costs for the corporate apartment in Houston, Texas for the fiscal year 2007.

Table of Contents**Grant of Plan-Based Awards**

The following table sets forth the grants of plan-based awards for 2007 as a dollar amount for each of the named executive officers. All equity-based awards were granted under our 2006 Incentive Plan.

Name	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards (1)			Estimated Future Payouts Under Equity Incentive Plan Awards (2)			All other stock awards: Number of shares of stock or Units # (3)	All other option awards: Number of Securities Underlying Options # (4)	Exercise or Base Price of Option Awards \$/sh	Grant Date Fair Value of Stock and Option Awards \$ (5)
		Threshold	Target	Maximum	Threshold	Target	Maximum				
Munawar H. Hidayatallah	8/3/2007		475,000								
	9/17/2007				685,000	685,000			200,000	21.95	2,607,824
Victor M. Perez	8/3/2007		139,750		15,000	15,000				21.95	165,056
	8/3/2007				25,000	25,000					462,946
Theodore F. Pound	12/3/2007		120,000				15,000				231,150
David K. Bryan	6/14/2007		218,500				37,500				830,250
	10/14/2007						75,000				1,440,750
Terrence P. Keane	6/14/2007		212,500				45,000				996,300

(1) Reflects each named executive officer's target amount of the annual cash incentive bonus under our non-equity incentive compensation plan for 2007. The amounts of

the performance bonus awards made to the named executive officers pursuant to the incentive compensation plan for 2007 are set forth in the Non-Equity Incentive Plan Compensation column of the Summary Compensation Table above.

- (2) The amounts indicated represent performance based restricted stock awards and options granted during fiscal year 2007. The vesting schedules, upon satisfying performance criteria, for the awards granted during the fiscal year 2007 are disclosed in footnotes 2, 6 and 7 in the following Outstanding Equity Awards table.
- (3) The amounts indicated represent restricted stock awards granted during fiscal year 2007. The

vesting
schedules for
restricted stock
awards granted
during the fiscal
year 2007 are
disclosed in the
footnotes in the
following
Outstanding
Equity Awards
table.

- (4) The amounts indicated represent options granted during fiscal year 2007. The vesting schedules for option awards granted during the fiscal year 2007 are disclosed in the footnotes in the following Outstanding Equity Awards table.
- (5) The valuation of restricted stock awards and stock options were determined in accordance with FAS 123(R) as disclosed in Notes 1 and 10 to our financial statements included in our annual report on Form 10-K for the year ended December 31, 2007.

Table of Contents**Outstanding Equity Awards at Fiscal Year-End 2007**

The following table sets forth information regarding outstanding equity awards for each of our named executive officers for 2007.

Name	Options Awards					Stock Awards			Equity Incentive Plan Awards:
	Number of Securities Underlying Unexercised Options #	Number of Securities Underlying Unexercised Options #	Equity Incentive Plan Awards: Number of Securities Unexercised Options #	Exercise Price \$	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested #	Market Value of Shares or Units of Stock That Have Not Vested \$(1)	Number of Unearned Shares, Units or Other Rights That Have Not Vested #	Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested \$(1)
Munawar H. Hidayatallah	200,000	83,333	200,000	3.86	2/2/2015				
				10.85	12/15/2015				
				21.95	8/3/2017			685,000(6)	10,103,750
Victor M. Perez	25,000	45,000	15,000(2)	4.85	11/13/2014				
				10.85	12/15/2015				
				21.95	8/3/2017			25,000(7)	368,750
Theodore F. Pound III	40,000	50,000		4.85	11/13/2014				
				10.85	12/15/2015	15,000(3)	221,250		
David K. Bryan	20,000			4.87	5/24/2015				
						37,500(4)	553,125		
						75,000(5)	1,106,250		
Terrence P. Keane	15,000			4.87	5/24/2015				

25,000

10.85 12/15/2015

45,000(4) 663,750

- (1) The values represented have been calculated by multiplying \$14.75, the closing price of our common stock on December 31, 2007, by the number of shares of restricted stock.
- (2) The performance-based stock options were granted on August 3, 2007 and vest 20% on August 3, 2008, 20% on August 3, 2009 and 60% on August 3, 2010. Alternatively, the award vests 100% on August 3, 2010 if certain performance goals are met. Vesting is also contingent on continued employment.
- (3) The restricted stock awards were granted on December 3, 2007 and vest 20% on December 3, 2008, 20% on December 3, 2009 and 60% on December 3, 2010.
- (4) The restricted stock awards were granted on June 14, 2007 and vest 20% on June 14, 2008, 20% on June 14,

2009 and 60% on
June 14, 2010.

(5) The restricted stock awards were granted on October 4, 2007 and vest 20% on October 4, 2008, 20% on October 4, 2009 and 60% on October 4, 2010.

(6) The performance-based restricted stock awards were granted on September 17, 2007 and vest one-third each on April 1, 2008, 2009 and 2010 if certain performance goals are met. Alternatively, the award vests 100% on April 1, 2010 if certain performance goals are met. Vesting is also contingent on continued employment, except in the case of death or disability.

(7) The performance-based restricted stock awards were granted on August 3, 2007 and vest 20% on August 3, 2008, 20% on August 3, 2009 and 60% on August 3, 2010. Alternatively, the award vests 100%

on the third anniversary date if certain performance goals are met. Vesting is also contingent on continued employment.

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Table of Contents**Option Exercises and Stock Vested During Fiscal Year 2007**

The following table sets forth information concerning each exercise of stock options and each vesting of stock, including restricted stock and similar instruments, during 2007 for each of our named executive officers on an aggregated basis.

Name	Option Awards	
	Number of Shares Acquired on Exercise (#)	Value Realized on Exercise (\$)
Munawar H. Hidayatallah		
Victor M. Perez	18,000	\$ 271,616
Theodore F. Pound III	10,000	\$ 161,538
David K. Bryan	35,000	\$ 536,099
Terrence P. Keane	10,000	\$ 146,315

Director Compensation for Fiscal Year 2007

Our current policy is to pay each of our non-management directors (currently all directors other than Messrs. Adams, Hidayatallah and Toboroff) a retainer of \$10,000 each quarter. Each non-management director serving on a committee of the board of directors will receive an additional \$1,500 each quarter for service on such committee, and each non-management director serving as chairman or co-chairman of a committee of the board of directors will receive an additional \$1,500 each quarter for acting as chairman or co-chairman of such committee. In addition, our audit committee financial expert will receive an additional \$12,500 on a quarterly basis. For the first three quarters of 2007, each non-management director received a retainer of \$8,750 each quarter. Each non-management director serving on a committee of the board of directors received an additional \$1,250 each quarter for service on such committee, and each non-management director serving as chairman or co-chairman of a committee of the board of directors received an additional \$2,500 each quarter for acting as chairman or co-chairman of such committee. In addition, our audit committee financial expert receive an additional \$7,500 on a quarterly basis. Directors are also compensated for out-of-pocket travel expenses.

The following table sets forth information concerning the compensation of each of our directors during 2007.

Name	Fees Earned or Paid in Cash				Total (\$)
	Paid in Cash (\$)	Stock Awards(1) (\$)	Option Awards (\$)	All Other Compensation (\$)	
Burt A. Adams(2)					
Ali H.M. Afdhal	50,000	63,104(4)			113,104
Alejandro Bulgheroni	35,000	63,104(4)			98,104
Carlos Bulgheroni	35,000	63,104(4)			98,104
Victor F. Germack	90,000	63,104(4)			153,104
James M. Hennessy	26,250	37,655(5)			63,905
Munawar H. Hidayatallah(2)					

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Name	Fees Earned or Paid in Cash (\$)	Stock Awards(1) (\$)	Option Awards (\$)	All Other Compensation (\$)	Total (\$)
John E. McConaughy Jr.	50,000	63,104(4)			113,104
Robert E. Nederlander	55,000	63,104(4)			118,104
Zane Tankel	38,913	46,888(6)			85,801
Leonard Toboroff(2)	156,250(3)	64,934(4)		23,683(7)	244,867

(1) The amounts indicated represent the aggregate dollar amount of compensation expense, excluding the reduction for risk of forfeiture, related to restricted stock awards recognized in our financial statements during fiscal year 2007 and includes amounts from awards granted prior to 2007. The expense was determined in accordance with FAS 123(R) as disclosed in Notes 1 and 10 to our financial statements included in our annual report on Form 10-K for the year ended December 31, 2007. As of December 31, 2007, each of

our directors,
except for
Messrs. Adams
and
Hidayatallah,
owned 4,000
shares of
restricted stock
that vests on
October 4, 2008.

- (2) Employee directors do not receive any additional compensation for serving on the board of directors.
- (3) This amount includes consulting fees paid to Mr. Toboroff of \$12,500 per month from January 2007 through September 2007 and \$15,000 per month beginning October 2007, pursuant to an oral consulting agreement with Mr. Toboroff.
- (4) Directors were granted 4,000 restricted stock awards on October 4, 2007 with a grant date fair value of \$76,840. The valuation of restricted stock awards were determined in accordance with

FAS 123(R) as disclosed in Notes 1 and 10 to our financial statements included in our annual report on Form 10-K for the year ended December 31, 2007.

- (5) Mr. Hennessy was granted 4,000 shares of restricted stock on October 4, 2007 with a grant date fair value of \$76,840 and 1,200 shares of restricted stock on December 20, 2007 with a grant date fair value of \$18,468. The valuation of restricted stock awards were determined in accordance with FAS 123(R) as disclosed in Notes 1 and 10 to our financial statements included in our annual report on Form 10-K for the year ended December 31, 2007.
- (6) Mr. Tankel was granted 4,000 shares of restricted stock on October 4, 2007 with a

grant date fair value of \$76,840 and 1,800 shares of restricted stock on December 20, 2007 with a grant date fair value of \$27,702. The valuation of restricted stock awards were determined in accordance with FAS 123(R) as disclosed in Notes 1 and 10 to our financial statements included in our annual report on Form 10-K for the year ended December 31, 2007.

- (7) This amount includes actual health benefit premiums paid by Allis-Chalmers.

Employment Agreements and Change-in-Control Arrangements with Management

The following is a description of the employment agreements and change-in-control arrangements that are currently in effect with respect to each named executive officer. The amount of compensation payable to each named executive officer upon termination with or without cause, termination due to death or disability, and various change-in-control scenarios is shown below. The amounts shown assume that such termination was effective as of December 31, 2007, and thus includes amounts earned through such time and are estimates of the amounts which would be paid out to the executives upon their termination. The actual amounts to be paid out can only be determined at the time of such executive's separation from us.

Employment Agreements

Munawar H. Hidayatallah serves as our Chairman and Chief Executive Officer pursuant to the terms of a three-year employment agreement effective as of April 1, 2007. Under the terms of his employment agreement, Mr. Hidayatallah receives an annual base salary of \$500,000 subject to an annual increase. In addition, Mr. Hidayatallah is entitled to receive a bonus in an amount equal to 100% of his base salary if he meets certain strategic objectives specified in the agreement. Mr. Hidayatallah is also entitled to four weeks vacation per year and is eligible to participate in all employee incentive compensation plans and to receive all of the fringe benefits provided to all employees. Pursuant to the agreement, Mr. Hidayatallah was permitted to assume ownership on his life insurance policy that was held by Allis-Chalmers. The agreement also provides for (a) tax gross-up payments for taxes incurred under Section 4999 of the Internal Revenue Code, (b) reimbursement of legal fees incurred in connection

with the negotiation of his employment agreement and (c) reimbursements for travel and lodging related to Mr. Hidayatallah's travel from his principal residence to our headquarters in Houston, Texas. Mr. Hidayatallah is also subject to customary non-compete provisions for a period of two years after termination of his agreement. Information with respect to compensation upon termination with or without cause, termination due to death or disability, and upon a change-in-control is set forth below under Severance and Change in Control Arrangements.

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Victor M. Perez serves as our Chief Financial Officer pursuant to the terms of a three-year employment agreement effective as of April 3, 2007. Under the terms of the employment agreement, Mr. Perez receives an annual base salary of \$286,000 subject to an annual increase in the discretion of the board of directors. In addition, Mr. Perez is entitled to receive a bonus in an amount equal to up to 50% of his base salary if he meets certain strategic objectives specified in his employment agreement. Mr. Perez is also entitled to four weeks vacation per year, a \$1,000 monthly car allowance and is eligible to participate in all employee incentive compensation plans and to receive all of the fringe benefits provided to all employees. Mr. Perez is subject to customary non-compete and non-solicitation provisions for the term of his agreement. Information with respect to compensation upon termination with or without cause, termination due to death or disability, or upon a change-in-control is set forth below under *Severance and Change in Control Arrangements*.

Theodore F. Pound III serves as our General Counsel and Secretary pursuant to the terms of a three-year employment agreement dated as of December 3, 2007. Under the terms of the employment agreement, Mr. Pound receives an annual base salary of \$250,000 subject to an annual increase in the discretion of the board of directors. In addition, Mr. Pound is entitled to receive a bonus in an amount equal to up to 50% of his base salary if he meets certain strategic objectives specified in his employment agreement. Mr. Pound is also entitled to four weeks vacation per year, a \$1,000 monthly car allowance and is eligible to participate in all employee incentive compensation plans and to receive all of the fringe benefits provided to all employees. Mr. Pound is subject to customary non-compete and non-solicitation provisions for the term of his agreement. Information with respect to compensation upon termination with or without cause, termination due to death or disability, or upon a change-in-control is set forth below under *Severance and Change in Control Arrangements*.

David K. Bryan, President and Chief Executive Officer of our subsidiary Strata Directional Technology LLC, or Strata, is employed pursuant to a three-year employment agreement effective July 1, 2007. Under the terms of the employment agreement, Mr. Bryan receives an annual base salary of \$250,000 subject to an annual increase in the discretion of the board of directors. In addition, Mr. Bryan is entitled to receive a bonus based on budgeted EBITDA provided that Strata meets designated minimum earnings targets and provided further that such bonus shall not exceed 100% of Mr. Bryan's base salary. The bonus calculation is subject to adjustment in subsequent years. Mr. Bryan is also entitled to four weeks vacation per year, a \$1,000 monthly car allowance, and is eligible to participate in all employee incentive compensation plans and to receive all of the fringe benefits provided to all employees. Mr. Bryan is also subject to customary non-compete and non-solicitation provisions for the term of his agreement. Information with respect to compensation upon termination with or without cause, termination due to death or disability, or upon a change-in-control is set forth below under *Severance and Change in Control Arrangements*.

Terrence P. Keane was promoted to Senior Vice President Oilfield Services in January 2008 and his base salary was increased to \$250,000. Prior to his promotion, Mr. Keane served as President of Aircomp LLC. In connection with such promotion, we amended Mr. Keane's previous employment agreement in April 2008. Pursuant to the amended agreement, Mr. Keane is entitled to a base salary of \$275,000, subject to an annual increase in the discretion of the board of directors. For 2008, Mr. Keane is entitled to receive (1) a bonus of up to 50% of his base salary based upon AirComp LLC meeting budgeted EBITDA targets established by management for the first six months of 2008 and (2) a bonus of up to 50% based upon our Oilfield Services segment meeting budgeted EBITDA targets established by our management for the last six months of 2008. For the remaining term of his agreement, Mr. Keane is entitled to receive a bonus of up to 100% of his base salary based upon our Oilfield Services segment meeting budgeted EBITDA targets established by management. Mr. Keane is also entitled to six weeks vacation per year and is eligible to participate in all employee incentive compensation plans and to receive all of the fringe benefits provided to all employees. In addition, Mr. Keane is entitled to a \$1,000 monthly car allowance. The employment agreement also contains customary non-compete and non-solicitation provisions. Information with respect to compensation upon termination with or without cause, termination due to death or disability, or upon a change-in-control is set forth below under *Severance and Change in Control Arrangements*.

Severance and Change in Control Arrangements

The following severance and change in control arrangements apply to each of the named executive officers, who are referred to as an executive for purposes of this discussion.

Each executive's employment agreement provides that if his employment is terminated by us upon his death, disability or for cause, we will pay him his earned but unpaid salary as of the date of termination, any unpaid expense

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reimbursements, compensation for accrued, unused vacation as of the date of termination and any further compensation that may be provided by the terms of any benefit plans in which he participates and the terms of any outstanding equity grants. Termination for Cause for Messrs. Hidayatallah, Perez and Pound shall occur immediately if the executive commits (1) a criminal act involving dishonesty or moral turpitude or (2) a material breach of any of the terms and provisions of his employment agreement or fails to obey written directions by our President or Chief Executive Officer (or, in the case of Mr. Hidayatallah, our board of directors) which are not inconsistent with his employment agreement. Messrs. Bryan and Keane's employment agreements defines Cause to mean:

the commission of any act of dishonesty, fraud, misrepresentation, misappropriation, or embezzlement involving Allis-Chalmers;

the unauthorized use or disclosure of any confidential information or trade secrets of Allis-Chalmers;

any violation of a law or regulation applicable to our business, which violation does or is reasonably like to cause material injury to Allis-Chalmers;

executive's conviction of, or plea of *nolo contendere* or guilty to (a) a felony or (b) any other crime which involves moral turpitude;

executive's continued failure, in the sole discretion of the board, to perform the principal duties, functions and responsibilities of his position (other than any such failure resulting from executive's disability) or to follow the directives of the board after written notice from Allis-Chalmers identifying the deficiencies in performance and a reasonable cure period of not less than thirty (30) days of any breach capable of cure;

gross negligence or willful misconduct in the performance of executive's duties; or

a material and willful breach of executive's fiduciary duties to Allis-Chalmers.

Each executive's employment agreement provides that if his employment is terminated by us without cause or if the executive resigns within a six month period of being constructively terminated (as defined below), we will pay him his earned but unpaid salary, unearned salary for the lesser of one year following termination of employment or the remainder of the employment agreement (except for Messrs. Bryan and Keane who will receive payments through the end of their employment agreement and Mr. Hidayatallah who will receive payments equal to three times his then current annual salary) in semi-monthly payments, any unpaid expense reimbursements, compensation for accrued, unused vacation as of the date of termination and any further compensation that may be provided by the terms of any benefit plans in which he participates and the terms of any outstanding equity grants. In general, a constructive termination would occur if we:

demote the executive to a lesser position, either in title or responsibility,;

decrease the executive's salary or benefits below the highest level in effect at anytime during his employment,;

require the executive to relocate to a principal place of business more than 50 miles from our current principal place of business, with certain exceptions,;

are subject to a change in control (as defined below), unless executive accepts employment with the successor; or

breach any other material term of the employment agreement which is not cured within 30 days after receiving notice of such breach.

A change in control as defined in the employment agreements includes:

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the acquisition by any individual, entity or group, or person of ownership of more than 50% of either (1) the then outstanding shares of common stock or (2) the combined voting power of our then outstanding voting securities entitled to vote, with certain exceptions;

individuals who currently constitute the board of directors cease for any reason to constitute at least a majority of the board, with several exceptions;

a complete liquidation or dissolution of Allis-Chalmers; or

(a) the consummation of a reorganization, merger or consolidation or (b) the sale or other disposition of all or substantially all of our assets unless, in each case, immediately following the event

Our stockholders immediately before the event own, directly or indirectly, at least 50% of the combined voting power of our then outstanding voting securities in substantially the same proportion as their ownership of us, or

At least a majority of the members of the board of directors of the entity resulting from the transaction were members of the incumbent board at the time of the execution of the agreement providing for the transaction.

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The following table sets forth the estimated payments and benefits that would be provided to each named executive officer, other than Mr. Hidayatallah, if such officer's employment had been terminated on December 31, 2007 by us without cause or upon a change of control:

Name	Salary Continuation	Value of Unvested Equity Awards if Change of Control(1)	Value of Unvested Equity Awards if Terminated Without Cause	Total if Change of Control	Total if Terminated Without Cause
Victor M. Perez, Chief Financial Officer	\$286,000	\$ 368,750		\$ 654,750	\$ 286,000
Theodore F. Pound III, General Counsel and Secretary	\$250,000	\$ 221,250(2)		\$ 471,250	\$ 250,000
David Bryan, President and Chief Executive Officer of Strata Directional Technology LLC	\$625,000	\$ 1,659,375(2)		\$2,284,375	\$ 625,000
Terrence P. Keane, Senior Vice President Oilfield Services	\$562,500	\$ 663,750(2)		\$1,226,250	\$ 562,500

(1) The amounts in this column represent unvested restricted stock that have been valued by multiplying \$14.75, the closing price of a share of our common stock on December 31, 2007, by the number of shares of restricted stock held by each named

executive
officer that
would vest.

- (2) The equity awards represented by this column would vest only if there was a change of control of Allis-Chalmers and the successor company refused to assume or continue the agreement covering these shares.

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The following table sets for the estimated payments and benefits that would be provided to Mr. Hidayatallah if his employment had been terminated on December 31, 2007 by us due to his death or disability, with or without cause or upon a change of control:

Event	Salary Continuation	Value of Unvested Equity Awards (1)	Total
Death		\$ 10,103,750	\$ 10,103,750
Disability		\$ 10,103,750	\$ 10,103,750
For Cause			
Without Cause	\$ 1,500,000	\$ 10,103,750	\$ 11,603,750
Change of Control	\$ 1,500,000	\$ 10,103,750	\$ 11,603,750

(1) This amount represents 685,000 shares of performance-based restricted stock multiplied by \$14.75, the closing price of a share of our common stock on December 31, 2007.

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

The Compensation Committee of our board of directors currently consists of Messrs. Afdhal and Tankel. Mr. Freedman resigned as a member of our board of directors and as a member of our Compensation Committee, effective April 17, 2007. Mr. Freedman served as our Executive Vice President during 2002 and currently serves as our Vice President Investor Relations. No current executive officer has ever served as a member of the board of directors or compensation committee of any other entity (other than our subsidiaries) that has or has had one or more executive officers serving as a member of our board or our Compensation Committee.

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PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) (1) Financial Statements

None.

(2) Financial Statement Schedules

None.

(3) Exhibits

The exhibits listed on the accompanying Exhibit Index are filed as part of this annual report on Form 10-K/A or incorporated by reference.

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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 July 9, 2008.

/s/ Munawar H. Hidayatallah
Munawar H. Hidayatallah
Chief Executive Officer and Chairman

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, this report has been signed on the date indicated by the following persons on behalf of the registrant and in the capacities indicated.

Name	Title	Date
/s/ Munawar H. Hidayatallah Munawar H. Hidayatallah	Chairman and Chief Executive Officer (Principle Executive Officer)	July 9, 2008
/s/ Victor M. Perez Victor M. Perez	Chief Financial Officer (Principal Financial Officer)	July 9, 2008
/s/ Bruce Sauers Bruce Sauers	Chief Accounting Officer (Principal Accounting Officer)	July 9, 2008
/s/ Ali H. M. Afdhal Ali H. M. Afdhal	Director	July 9, 2008
Alejandro P. Bulgheroni	Director	
Carlos A. Bulgheroni	Director	
/s/ Victor F. Germack Victor F. Germack	Director	July 9, 2008
/s/ James M. Hennessy James M. Hennessy	Director	July 9, 2008
/s/ John E. McConnaughy, Jr. John E. McConnaughy, Jr.	Director	July 9, 2008
/s/ Robert E. Nederlander Robert E. Nederlander	Director	July 9, 2008
/s/ Zane Tankel Zane Tankel	Director	July 9, 2008

/s/ Leonard Toboroff
Leonard Toboroff

Director

July 9, 2008

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EXHIBIT INDEX

Exhibit	Description
2.1	First Amended Disclosure Statement pursuant to Section 1125 of the Bankruptcy Code, dated September 14, 1988, which includes the First Amended and Restated Joint Plan of Reorganization dated September 14, 1988 (incorporated by reference to Registrant's Current Report on Form 8-K dated December 1, 1988).
2.2	Reorganization Trust Agreement dated September 14, 1988 by and between Registrant and John T. Grigsby, Jr., Trustee (incorporated by reference to Exhibit D of the First Amended and Restated Joint Plan of Reorganization dated September 14, 1988 included in Registrant's Current Report on Form 8-K dated December 1, 1988).
2.3	Agreement and Plan of Merger dated as of May 9, 2001 by and among Registrant, Allis-Chalmers Acquisition Corp. and Oil Quip Rentals, Inc. (incorporated by reference to Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed May 15, 2001).
2.4	Stock Purchase Agreement dated February 1, 2002 by and between Registrant and Jens H. Mortensen, Jr. (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed February 21, 2002).
2.5	Stock Purchase Agreement dated February 1, 2002 by and among Registrant, Energy Spectrum Partners LP, and Strata Directional Technology, Inc. (incorporated by reference to Exhibit 2.10 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2001).
2.6	Stock Purchase Agreement dated August 10, 2004 by and among Allis-Chalmers Corporation and the investors named thereto (incorporated by reference to Exhibit 10.37 to the Registration Statement on Form S-1 (Registration No. 118916) filed on September 10, 2004).
2.7	Amendment to Stock Purchase Agreement dated August 10, 2004 (incorporated by reference to Exhibit 10.38 to the Registration Statement on Form S-1 (Registration No. 118916) filed on September 10, 2004).
2.8	Addendum to Stock Purchase Agreement dated September 24, 2004 (incorporated by reference to Exhibit 10.55 to Registrant's Current Report on Form 8-K filed on September 30, 2004).
2.9	Asset Purchase Agreement dated November 10, 2004 by and among AirComp LLC, a Delaware limited liability company, Diamond Air Drilling Services, Inc., a Texas corporation, and Marquis Bit Co., L.L.C., a New Mexico limited liability company, Greg Hawley and Tammy Hawley, residents of Texas and Clay Wilson and Linda Wilson, residents of New Mexico (incorporated by reference to the Current Report on Form 8-K filed on November 15, 2004).
2.10	Purchase Agreement and related Agreements by and among Allis-Chalmers Corporation, Chevron USA, Inc., Dale Redman and others dated December 10, 2004 (incorporated by reference to Exhibit 10.63 to the Registrant's Current Report on Form 8-K filed on December 16, 2004).
2.11	Stock Purchase Agreement dated April 1, 2005, by and among Allis-Chalmers Energy Inc., Thomas Whittington, Sr., Werlyn R. Bourgeois and SAM and D, LLC. (incorporated by reference to

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Exhibit 10.51 to the Registrant's Current Report on Form 8-K filed on April 5, 2005).

- 2.12 Stock Purchase Agreement effective May 1, 2005, by and among Allis-Chalmers Energy Inc., Wesley J. Mahone, Mike T. Wilhite, Andrew D. Mills and Tim Williams (incorporated by reference to Exhibit 10.51 to the Registrant's Current Report on Form 8-K filed on May 6, 2005).
- 2.13 Purchase Agreement dated July 11, 2005 among Allis-Chalmers Energy Inc., Mountain Compressed Air, Inc. and M-I, L.L.C. (incorporated by reference to Exhibit 10.42 to the Registrant's Current Report on Form 8-K filed on July 15, 2005).
- 2.14 Asset Purchase Agreement dated July 11, 2005 between AirComp LLC, W.T. Enterprises, Inc. and William M. Watts (incorporated by reference to Exhibit 10.43 to the Registrant's Current Report on Form 8-K filed on July 15, 2005).
- 2.15 Asset Purchase Agreement by and between Patterson Services, Inc. and Allis-Chalmers Tubular Services, Inc. (incorporated by reference to Exhibit 10.44 to the Registrant's Current Report on Form 8-K filed on September 8, 2005).

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Exhibit	Description
2.16	Stock Purchase Agreement dated as of December 20, 2005 between the Registrant and Joe Van Matre (incorporated by reference to Exhibit 10.33 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2005).
2.17	Stock Purchase Agreement, dated as of April 27, 2006, by and among Bridas International Holdings Ltd., Bridas Central Company Ltd., Associated Petroleum Investors Limited, and the Registrant. (incorporated by reference to Exhibit 2.3 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2006)
2.18	Stock Purchase Agreement, dated as of October 17, 2006, by and between Allis-Chalmers Production Services, Inc. and Randolph J. Hebert (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on October 19, 2006).
2.19	Asset Purchase Agreement, dated as of October 25, 2006, by and between Allis-Chalmers Energy Inc. and Oil & Gas Rental Services, Inc. (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on October 26, 2006).
2.20	Agreement and Plan of Merger by and among the Registrant, Bronco Drilling Company, Inc. and Elway Merger Sub, Inc., dated as of January 23, 2008 (incorporated by reference to Exhibit 2.1 to the Registrant's Form 8-K filed on January 24, 2008).
3.1	Amended and Restated Certificate of Incorporation of Registrant (incorporated by reference to Exhibit 3.1 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2001).
3.2	Certificate of Designation, Preferences and Rights of the <i>Series A 10% Cumulative Convertible Preferred Stock</i> (\$.01 Par Value) of Registrant (incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed February 21, 2002).
3.3	Amended and Restated By-laws of Registrant (incorporated by reference to Exhibit 3.3. to the Registrant's Annual Report of Form 10-K for the year ended December 31, 2001).
3.4	Certificate of Amendment of Certificate of Incorporation filed with the Delaware Secretary of State on June 9, 2004 (incorporated by reference to Exhibit 3.3 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2004).
3.5	Certificate of Amendment of Certificate of Incorporation filed with the Delaware Secretary of State on January 5, 2005 (incorporated by reference to Exhibit 3.5 to the Registrant's Current Report on Form 8-K filed January 11, 2005).
3.6	Certificate of Amendment of Certificate of Incorporation filed with the Delaware Secretary of State on August 16, 2005 (incorporated by reference to Exhibit 3.5 to the Registrant's Current Report on Form 8-K filed August 17, 2005).
4.1	Specimen Stock Certificate of Common Stock of Registrant (incorporated by reference to Exhibit 4.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2004).

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- 4.2 Registration Rights Agreement dated as of March 31, 1999, by and between Allis-Chalmers Corporation and the Pension Benefit Guaranty Corporation (incorporated by reference to Exhibit 10.3 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 1999).
- 4.3 Registration Rights Agreement dated April 2, 2004 by and between Registrant and the Stockholder signatories thereto (incorporated by reference to Exhibit 10.43 to Amendment No. 1 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2003).
- 4.4 Registration Rights Agreement dated as of January 29, 2007 by and among Allis-Chalmers Energy Inc., the Guarantors named therein and the Initial Purchasers named therein (incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on January 29, 2007).
- 4.5 Registration Rights Agreement dated as of January 18, 2006 by and among Allis-Chalmers Energy Inc., the Guarantors named therein and the Initial Purchasers named therein (incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on January 24, 2006).

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Exhibit	Description
4.6	Registration Rights Agreement dated as of August 14, 2006 by and among the Registrant, the guarantors listed on Schedule A thereto and RBC Capital Markets Corporation (incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K filed on August 14, 2006).
4.7	Indenture dated as of January 18, 2006 by and among the Registrant, the Guarantors named therein and Wells Fargo Bank, N.A., as trustee (incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed on January 24, 2006).
4.8	First Supplemental Indenture dated as of August 11, 2006 by and among Allis-Chalmers GP, LLC, Allis-Chalmers LP, LLC, Allis-Chalmers Management, LP, Rogers Oil Tool Services, Inc., the Registrant, the other Guarantors (as defined in the Indenture referred to therein) and Wells Fargo Bank, N.A (incorporated by reference to Exhibit 4.2 to the Registrant's Form 8-K filed on August 14, 2006).
4.9	Second Supplemental Indenture dated as of January 23, 2007 by and among Petro-Rentals, Incorporated, the Registrant, the other Guarantor parties thereto and Wells Fargo Bank, N.A., as trustee (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on January 24, 2007).
4.10	Indenture, dated as of January 29, 2007, by and among the Registrant, the Guarantors named therein and Wells Fargo Bank, N.A. (incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed on January 29, 2007).
4.11	Form of 9.0% Senior Note due 2014 (incorporated by reference to Exhibit A to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed on January 24, 2006).
4.12	Form of 8.5% Senior Note due 2017 (incorporated by reference to Exhibit A to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed on January 29, 2007).
10.1	Amended and Restated Retiree Health Trust Agreement dated September 14, 1988 by and between Registrant and Wells Fargo Bank (incorporated by reference to Exhibit C-1 of the First Amended and Restated Joint Plan of Reorganization dated September 14, 1988 included in Registrant's Current Report on Form 8-K dated December 1, 1988).
10.2	Amended and Restated Retiree Health Trust Agreement dated September 18, 1988 by and between Registrant and Firststar Trust Company (incorporated by reference to Exhibit C-2 of the First Amended and Restated Joint Plan of Reorganization dated September 14, 1988 included in Registrant's Current Report on Form 8-K dated December 1, 1988).
10.3	Product Liability Trust Agreement dated September 14, 1988 by and between Registrant and Bruce W. Strausberg, Trustee (incorporated by reference to Exhibit E of the First Amended and Restated Joint Plan of Reorganization dated September 14, 1988 included in Registrant's Current Report on Form 8-K dated December 1, 1988).
10.4*	Allis-Chalmers Savings Plan (incorporated by reference to Registrant's Annual Report on Form 10-K for the year ended December 31, 1988).

- 10.5* Allis-Chalmers Consolidated Pension Plan (incorporated by reference to Registrant's Annual Report on Form 10-K for the year ended December 31, 1988).
- 10.6 Agreement dated as of March 31, 1999 by and between Registrant and the Pension Benefit Guaranty Corporation (incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 1999).

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Exhibit	Description
10.7	Letter Agreement dated May 9, 2001 by and between Registrant and the Pension Benefit Guarantee Corporation (incorporated by reference to Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2002).
10.8	Termination Agreement dated May 9, 2001 by and between Registrant, the Pension Benefit Guarantee Corporation and others (incorporated by reference to Registrant's Current Report on Form 8-K filed on May 15, 2002).
10.9*	Executive Employment Agreement, dated April 1, 2007, by and between the Registrant and Munawar H. Hidayatallah (incorporated by reference to Exhibit 10.3 to the Registrant's Form 8-K filed on November 6, 2007).
10.10*	Executive Employment Agreement, effective April 3, 2007, by and between the Registrant and Victor M. Perez (incorporated by reference to Exhibit 10.4 to the Registrant's Form 8-K filed on November 6, 2007).
10.11*	Executive Employment Agreement, effective July 1, 2007, by and between the Registrant and Terrence P. Keane (incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K filed on July 24, 2007).
10.12*	Executive Employment Agreement, dated December 3, 2007, by and between the Registrant and Theodore F. Pound III (incorporated by reference to Exhibit 10.2 to the Registrant's Form 8-K filed on December 6, 2007).
10.13*	Executive Employment Agreement, effective July 1, 2007, by and between the Registrant and David K. Bryan (incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K filed on July 13, 2007).
10.14*	Employment Agreement, dated December 18, 2006, by and between the Registrant and Burt A. Adams (incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed on December 19, 2006).
10.15	Executive Employment Agreement, effective January 1, 2008, by and between the Registrant and Mark C. Patterson (incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K filed on February 25, 2008).
10.16	Purchase Agreement dated as of January 12, 2006 by and among Allis-Chalmers Energy Inc, the Guarantors named therein and the Initial Purchasers named therein (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on January 24, 2006).
10.17	Purchase Agreement dated as of August 8, 2006 by and between the Registrant, the guarantors listed on Schedule B thereto and RBC Capital Markets Corporation (incorporated by reference to Exhibit 10.4 to the Registrant's Form 8-K filed on August 14, 2006).
10.18	Purchase Agreement dated as of January 24, 2007 by and among Allis-Chalmers Energy Inc., the Guarantors named therein and the Initial Purchasers named therein (incorporated by reference to

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Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on January 29, 2007).

- 10.19 Amended and Restated Credit Agreement dated as of January 18, 2006 by and among Allis-Chalmers Energy Inc., as borrower, Royal bank of Canada, as administrative agent and Collateral Agent, RBC Capital Markets, as lead arranger and sole bookrunner, and the lenders party thereto (incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed on January 24, 2006).
- 10.20 First Amendment to Amended and Restated Credit Agreement dated as of August 8, 2006, by and among the Registrant, the guarantors named thereto and Royal Bank of Canada (incorporated by reference to Exhibit 10.3 to the Registrant's Form 8-K filed on August 14, 2006).
- 10.21 Senior Unsecured Bridge Loan Agreement, dated December 18, 2006, by and among the Registrant, Royal Bank of Canada, as administrative agent, RBC Capital Markets Corporation, as exclusive lead arranger and sole bookrunner, and the guarantors and institutional lenders named thereto (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on December 19, 2006).
- 10.22 Strategic Agreement dated July 1, 2003 between Pan American Energy LLC Sucursal Argentina and DLS Argentina Limited Sucursal Argentina (incorporated by reference to Exhibit 10.13 to the Registrant's Quarterly Report on Form 10-Q filed on December 29, 2006).

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Exhibit	Description
10.23	Amendment No. 1 dated May 18, 2005 to Strategic Agreement between Pan American Energy LLC Sucursal Argentina and DLS Argentina Limited Sucursal Argentina (incorporated by reference to Exhibit 10.14 to the Registrant's Quarterly Report on Form 10-Q filed on December 29, 2006).
10.24	Amendment No. 2 dated January 1, 2006 between Pan American Energy LLC Sucursal Argentina and DLS Argentina Limited Sucursal Argentina (incorporated by reference to Exhibit 10.15 to the Registrant's Quarterly Report on Form 10-Q filed on December 29, 2006).
10.25	Investor Rights Agreement, dated December 18, 2006, by and between the Registrant and Oil & Gas Rental Services, Inc. (incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on December 19, 2006).
10.26	Investors Rights Agreement dated as of August 18, 2006 by and among the Registrant and the investors named on Exhibit A thereto (incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K filed on August 14, 2006).
10.27*	2003 Incentive Stock Plan (incorporated by reference to Exhibit 4.12 to the Registrant's Current Report on Form 8-K filed August 17, 2005).
10.28*	Form of Option Certificate issued pursuant to 2003 Incentive Stock Plan (incorporated by reference to Exhibit 10.41 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2003).
10.29*	2006 Incentive Plan (incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K filed on September 18, 2006).
10.30*	Form of Employee Restricted Stock Agreement pursuant to the Registrant's 2006 Incentive Plan (incorporated by reference to Exhibit 10.2 to the Registrant's Form 8-K filed on September 18, 2006).
10.31*	Form of Employee Nonqualified Stock Option Agreement pursuant to the Registrant's 2006 Incentive Plan (incorporated by reference to Exhibit 10.3 to the Registrant's Form 8-K filed on September 18, 2006).
10.32*	Form of Employee Incentive Stock Option Agreement pursuant to the Registrant's 2006 Incentive Plan (incorporated by reference to Exhibit 10.4 to the Registrant's Form 8-K filed on September 18, 2006).
10.33	Form of Non-Employee Director Restricted Stock Agreement pursuant to the Registrant's 2006 Incentive Plan (incorporated by reference to Exhibit 10.5 to the Registrant's Form 8-K filed on September 18, 2006).
10.34*	Form of Non-Employee Director Nonqualified Stock Option Agreement pursuant to the Registrant's 2006 Incentive Plan (incorporated by reference to Exhibit 10.6 to the Registrant's Form 8-K filed on September 18, 2006).

- 10.35 Form of Performance Award Agreement pursuant to the Registrants' 2006 Incentive Plan (incorporated by reference to Exhibit 10.5 to the Registrant's Form 8-K filed on November 6, 2007).
- 10.36 Second Amended and Restated Credit Agreement, dated as of April 26, 2007, by and among the Registrant, as borrower, Royal Bank of Canada, as administrative agent and collateral agent, RBC Capital Markets, as lead arranger and sole bookrunner, and the lenders party thereto (incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K filed on May 10, 2007).
- 10.37 First Amendment to Second Amended and Restated Credit Agreement, dated as of December 3, 2007, by and among the Registrant, the guarantors named thereto, Royal Bank of Canada and the lenders named thereto (incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K filed on December 6, 2007).
- 10.38 Amended and Restated Guaranty, dated April 26, 2007, by each of the guarantors named thereto in favor of Royal Bank of Canada, as administrative agent and collateral agent (incorporated by reference to Exhibit 10.2 to the Registrant's Form 8-K filed on May 10, 2007).
- 10.39 Amended and Restated Pledge and Security Agreement, dated April 26, 2007, by the Registrant in favor of Royal Bank of Canada, as administrative agent and collateral agent (incorporated by reference to Exhibit 10.3 to the Registrant's Form 8-K filed on May 10, 2007).

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Exhibit	Description
10.40	Credit Agreement, dated January 31, 2008, among the Registrant, as lender, BCH Ltd., as borrower, and BCH Energy do Brasil Servicos de Petroleo Ltda., as guarantor (incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K filed on February 6, 2008).
10.41	Option to Purchase and Governance Agreement, dated January 31, 2008, among the Registrant, BrazAlta Resources Corp. and BCH Ltd. (incorporated by reference to Exhibit 10.2 to the Registrant's Form 8-K filed on February 6, 2008).
10.42	Subordination Agreement, dated January 31, 2008, among the Registrant, Standard Bank PLC, BCH Ltd., BCH Energy do Brasil Servicos de Petroleo Ltda. and BrazAlta Resources Corp. (incorporated by reference to Exhibit 10.3 to the Registrant's Form 8-K filed on February 6, 2008).
10.43	Form of Convertible Subordinated Secured Debenture (incorporated by reference to Schedule E to Exhibit 10.1 to the Registrant's Form 8-K filed on February 6, 2008).
10.44	Agreement, dated April 1, 2007, by and between the Registrant and David Wilde (incorporated by reference to Exhibit 99.1 to the Registrant's Form 8-K filed on April 3, 2007).
21.1	Subsidiaries of Registrant (filed as Exhibit 21.1 to the Registrant's Form 10-K filed on March 7, 2008).
23.1	Consent of UHY LLP.
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.
* Compensation Plan or Agreement	