OMNI ENERGY SERVICES CORP
Form 10-Q
November 07, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the Quarterly period ended September 30, 2008

or

¨ **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period ______ to ______

COMMISSION FILE NUMBER 0-23383

OMNI ENERGY SERVICES CORP.

(Exact name of registrant as specified in its charter)

LOUISIANA	**72-1395273**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**
4500 N.E. EVANGELINE THRUWAY	
CARENCRO, LOUISIANA	**70520**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (337) 896-6664

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

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 definition of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨	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 x

As of November 5, 2008 there were 20,647,496 shares of the Registrant s common stock, $0.01 par value per share, outstanding.

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OMNI ENERGY SERVICES CORP

FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2008

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

OMNI ENERGY SERVICES CORP.

CONSOLIDATED BALANCE SHEETS

	December 31, 2007	September 30, 2008
	(Dollars in thousands)	
		(unaudited)
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 13,431	$ 2,181
Restricted cash	1,114	1,130
Trade receivables, net	26,566	33,082
Other receivables	627	562
Due from related party	262	262
Parts and supplies inventory	5,950	7,990
Prepaid expenses and other current assets	7,587	5,901
Deferred income taxes	5,818	2,505
Total current assets	61,355	53,613
PROPERTY, PLANT AND EQUIPMENT, net	61,037	82,902
OTHER ASSETS:		
Goodwill	15,038	23,303
Customer intangible assets, net	13,780	14,203
Licenses, permits and other intangible assets, net	9,082	13,320
Loan closing costs, net	4,359	5,252
Other assets	343	326
	42,602	56,404
TOTAL ASSETS	$ 164,994	$ 192,919
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 15,706	$ 15,142
Accrued expenses	4,645	7,988
Current maturities of long-term debt	14,456	19,578
Insurance notes payable	4,808	2,552
Line of credit	17,349	9,260
Total current liabilities	56,964	54,520
LONG-TERM LIABILITIES:		
Long-term debt, less current maturities	34,827	47,876
Other long-term liabilities	1,060	610
Deferred income taxes	11,984	19,081

Total long-term liabilities	47,871	67,567
Total liabilities	104,835	122,087
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS EQUITY:		
Convertible preferred stock, no par value, 5,000,000 shares authorized; 29 shares of Series B issued and outstanding at December 31, 2007 and September 30, 2008 and 5,484 and 5,396 shares of Series C issued and outstanding at December 31, 2007 and September 30, 2008, respectively, liquidation preference of $1,000 per share	1,162	1,074
Common stock, $0.01 par value, 45,000,000 shares authorized; 18,727,615 and 20,692,496 issued and 18,682,615 and 20,647,496 outstanding at December 31, 2007 and September 30, 2008, respectively	187	207
Preferred stock dividends declared	3	3
Additional paid-in capital	93,997	99,658
Accumulated deficit	(35,190)	(30,110)
Total stockholders equity	60,159	70,832
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 164,994	$ 192,919

The accompanying notes are an integral part of these consolidated financial statements.

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OMNI ENERGY SERVICES CORP.

CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

	Three Months Ended September 30, 2007	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2008
	(in thousands, except per share amounts)			
Operating revenue:				
Services	$ 35,731	$ 40,676	$ 107,519	$ 111,496
Rentals	8,406	12,608	23,628	31,669
Total operating revenue	44,137	53,284	131,147	143,165
Operating expenses:				
Direct costs (exclusive of depreciation and amortization shown separately below)				
Services	24,806	27,856	72,849	79,524
Rentals	3,970	6,392	10,674	15,945
Depreciation and amortization	2,749	3,620	7,736	9,776
General and administrative expenses (exclusive of depreciation and amortization shown separately above) (includes litigation settlement of $2,400 in the first quarter of 2008)	5,434	7,282	16,311	23,417
Total operating expenses	36,959	45,150	107,570	128,662
Operating income	7,178	8,134	23,577	14,503
Interest expense	(1,568)	(1,518)	(4,897)	(5,231)
Loss on debt extinguishment			(1,004)	
Other income (expense), net	234	65	299	(137)
Income before income tax expense	5,844	6,681	17,975	9,135
Provision for income tax expense	(1,656)	(2,572)	(6,343)	(3,688)
Net income	4,188	4,109	11,632	5,447
Dividends and accretion of preferred stock	(124)	(123)	(378)	(367)
Non-cash charge attributable to beneficial conversion feature of preferred stock			(255)	
Net income available to common stockholders	$ 4,064	$ 3,986	$ 10,999	$ 5,080
Basic income per share:				
Net income available to common stockholders	$ 0.22	$ 0.20	$ 0.62	$ 0.26
Diluted income per share:				
Net income available to common stockholders	$ 0.16	$ 0.15	$ 0.45	$ 0.21
Weighted average common shares outstanding:				
Basic	18,509	19,919	17,881	19,460
Diluted	26,359	27,480	26,067	26,384

The accompanying notes are an integral part of these consolidated financial statements.

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OMNI ENERGY SERVICES CORP.

CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2008

(unaudited)

	Preferred Stock Shares	Preferred Stock Amount	Common Stock Shares	Common Stock Amount
	(in thousands, except share amounts)			
BALANCE, December 31, 2007	5,513	$ 1,162	18,727,615	$ 187
Stock based compensation				
Stock options and warrants exercised and other			1,057,766	11
Restricted stock awards, net of forfeitures			462,500	5
Tax benefit associated with exercise of non-qualified stock options				
Common stock issued in legal settlement			400,000	4
Preferred stock dividends declared				
Preferred stock conversion	(88)	(88)	44,615	
Net income				
BALANCE, September 30, 2008	5,425	$ 1,074	20,692,496	$ 207

	Preferred Stock Dividends Declared	Additional Paid-In Capital	Accumulated Deficit	Total
	(in thousands)			
BALANCE, December 31, 2007	$ 3	$ 93,997	$ (35,190)	$ 60,159
Stock based compensation		990		990
Stock options and warrants exercised and other		2,512		2,523
Restricted stock awards, net of forfeitures		1,218		1,223
Tax benefit associated with exercise of non-qualified stock options		857		857
Common stock issued in legal settlement		(4)		
Preferred stock dividends declared			(367)	(367)
Preferred stock conversion		88		
Net income			5,447	5,447
BALANCE, September 30, 2008	$ 3	$ 99,658	$ (30,110)	$ 70,832

The accompanying notes are an integral part of these consolidated financial statements.

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OMNI ENERGY SERVICES CORP.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

	Nine Months Ended September 30, 2007	2008
	(in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 11,632	$ 5,447
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,736	9,776
Amortization of deferred loan issuance costs	759	860
(Gain) loss on fixed asset disposition	(163)	311
Provision for doubtful accounts		275
Stock based compensation expense	743	990
Accretion of discount on convertible notes	448	116
Loss on debt extinguishment	1,004	
Deferred income taxes	6,343	2,637
Changes in operating assets and liabilities:		
Trade receivables	(7,195)	(3,711)
Other receivables	(492)	101
Parts and supplies inventory	(1,444)	(200)
Prepaid expenses and other current assets	2,794	4,753
Other assets	90	(132)
Accounts payable and accrued expenses	2,724	688
Net cash provided by operating activities	24,979	21,911
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property, plant and equipment	(11,884)	(9,686)
Proceeds from disposal of property, plant and equipment	1,302	424
Acquisitions, net of cash received	(23,673)	(20,836)
Proceeds from collection of other receivable	184	
Tax benefit associated with exercise of non-qualified stock options		857
Return of restricted cash		489
Investment in restricted cash		(1,130)
Net cash used in investing activities	(34,071)	(29,882)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from the issuance of long-term debt	14,934	19,232
Proceeds from issuance of common stock for cash and exercise of stock options and warrants	8,399	2,648
Preferred stock dividends	(129)	(491)
Principal payments on long-term debt	(19,773)	(14,827)
Loan closing costs	(2,299)	(1,752)
Borrowings (payments) on line of credit, net	8,856	(8,089)
Net cash provided by (used in) financing activities	9,988	(3,279)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	896	(11,250)
Cash and cash equivalents, at beginning of period	12,576	13,431

Cash and cash equivalents, at end of period	$ 13,472	$ 2,181

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OMNI ENERGY SERVICES CORP.

CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

(unaudited)

	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2008
	(in thousands)	
SUPPLEMENTAL CASH FLOW DISCLOSURES:		
Cash paid for interest	$ 4,172	$ 4,262
Cash paid for taxes	$	$ 205
NON-CASH TRANSACTIONS:		
Application of restricted cash to capital lease payable and other	$	$ 625
Equipment financed through capital lease	$ 58	$
Equipment note paid off under sale/leaseback	$ 201	$
Preferred stock issued as dividends paid-in-kind	$ 256	$
Beneficial conversion feature of preferred stock	$ 255	$
Conversion of preferred stock to common	$ 377	$ 88
Premiums financed with insurance carrier	$ 5,256	$ 3,109
Notes payable issued to former owners of acquired entities	$ 8,500	$ 8,000
Equipment transferred in satisfaction of settlement of accrued liability	$	$ 750

The accompanying notes are an integral part of these consolidated financial statements.

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OMNI ENERGY SERVICES CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

The financial statements included herein, which have not been audited pursuant to the rules and regulations of the Securities and Exchange Commission (SEC), reflect all adjustments which, in the opinion of management, are necessary for a fair presentation of our financial position, results of operations and cash flows for the interim periods on a basis consistent with the annual audited statements. All such adjustments are of a normal recurring nature. The results of operations for interim periods are not necessarily indicative of the results that may be expected for any other interim period of a full year. Certain information, accounting policies and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been omitted pursuant to such rules and regulations, although we believe that the disclosures are adequate to make the information presented not misleading. These financial statements should be read in conjunction with our audited financial statements included in our Annual Report on Form 10-K, for the year ended December 31, 2007 filed with the Securities and Exchange Commission on March 17, 2008.

IMPAIRMENT OF LONG-LIVED ASSETS

We review our long lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable in accordance with Statement of Financial Accounting Standards (SFAS) No. 144 *Accounting for the Impairment and Disposal of Long-Lived Assets*. If the carrying amount of the asset, including any intangible assets associated with that asset, exceeds its estimated undiscounted net cash flow, before interest, we will recognize an impairment loss equal to the difference between its carrying amount and its estimated fair value.

CASH AND CASH EQUIVALENTS

We consider highly liquid investments with an original maturity of 90 days or less to be cash equivalents. The $1.1 million included in restricted cash at December 31, 2007 represented cash held in escrow related to the purchase of an aircraft which was released from restriction during the first quarter of 2008. The proceeds were used to settle the outstanding balance of a capital lease payable with the remaining proceeds remitted to us. The $1.1 million included in restricted cash at September 30, 2008 represents cash deposited into an irrevocable trust as part of a legal settlement to be paid to the trust beneficiary in October 2008 and January 2009.

STOCK BASED COMPENSATION

We follow the provisions of SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS No. 123R) which requires that compensation cost relating to share-based payment transactions be recognized in the financial statements. The cost is measured at the grant date, based on the calculated fair value of the award, and is recognized as an expense over the employee s requisite service period (generally the vesting period of the equity award).

ACCOUNTING PRONOUNCEMENTS RECENTLY ADOPTED

In September 2006, the Financial Accounting Standards Board (the FASB) issued SFAS No. 157, *Fair Value Measurements* (SFAS No. 157). This statement defines fair value, establishes a framework for measuring fair value under U.S. generally accepted accounting principles and requires enhanced disclosures about fair value measurements. It does not require any new fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. Our financial statements have not been impacted by the adoption of SFAS No. 157.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115* (SFAS No. 159). This Statement permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS No. 159 does not affect any existing accounting literature that requires certain assets and liabilities to be carried at fair value. The Statement is effective for fiscal years beginning after November 15, 2007. At January 1, 2008, we did not elect the fair value option under the SFAS No. 159 and, therefore, there was no impact to our consolidated financial statements.

In December 2007, the SEC issued Staff Accounting Bulletin No. 110 (SAB No. 110). SAB No. 110 expresses the views of the SEC staff regarding the use of a simplified method, as discussed in SAB No. 107, in developing an estimate of expected term of plain vanilla share options in accordance with SFAS No. 123R. The SEC staff indicated in SAB No. 107 that it would accept a company s election to use the simplified method, regardless of whether the company has sufficient information to make more refined estimates of expected term, for options granted prior to December 31, 2007. In SAB No. 110, the SEC staff states that it will continue to accept, under certain circumstances, the use of the simplified method beyond December 31, 2007. We are currently utilizing the simplified method in our estimate of the expected term of share options.

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ACCOUNTING PRONOUNCEMENTS NOT YET ADOPTED

In December 2007, the FASB issued SFAS No. 141 (revised), *Business Combinations* (SFAS No. 141R). This Statement changes the accounting for business combinations, including the measurement of acquirer shares issued in consideration for a business combination, the recognition of contingent consideration, the accounting for preacquisition gain and loss contingencies, the recognition of capitalized in-process research and development costs, the accounting for acquisition-related restructuring cost accruals, the treatment of acquisition related transaction costs and the recognition of changes in the acquirer s income tax valuation allowance. SFAS No. 141R is effective for fiscal years beginning after December 15, 2008, with early adoption prohibited.

In December 2007, the FASB issued SFAS No. 160 *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51* (SFAS No. 160). This Statement changes the accounting for noncontrolling (minority) interests in consolidated financial statements, including the requirements to classify noncontrolling interests as a component of consolidated stockholders equity, and the elimination of minority interest accounting in results of operations with earnings attributable to noncontrolling interests reported as part of consolidated earnings. Additionally, SFAS No. 160 revises the accounting for both increases and decreases in a parent s controlling ownership interest. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008, with early adoption prohibited. At this time we have no minority interest therefore we expect no impact from the adoption of this statement.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* (SFAS No. 161). SFAS No. 161 is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity s financial position, financial performance, and cash flows. SFAS No. 161 is effective for fiscal years beginning on or after November 15, 2008. We are currently evaluating the impact, if any, that the adoption of SFAS No. 161 will have on our results of operations and financial position.

In May 2008, the FASB issued its Staff Position APB No. 14-1 (FSP APB No. 14-1) *Accounting for Convertible Debt Instruments That May Be Settled Upon Conversion (Including Partial Cash Settlement).* FSP APB No. 14-1 requires the proceeds from the issuance of exchangeable debt instruments to be allocated between a liability component (issued at a discount) and an equity component. The resulting debt discount will be amortized over the period the convertible debt is expected to be outstanding as additional non-cash interest expense. The provisions of FSP APB No. 14-1 are effective for fiscal years beginning after December 15, 2008 and will require retrospective application. We are currently evaluating the impact the adoption of FSP APB No. 14-1 will have on its results of operations and financial position.

NOTE 2. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment, net, consists of the following at December 31, 2007 and September 30, 2008, respectively:

	December 31, 2007	**September 30, 2008**
	(In thousands)	
Land	$ 793	$ 782
Construction in progress	734	801
Building and improvements	8,200	9,187
Drilling, field and support equipment	79,382	103,903
Shop equipment	1,153	719
Office equipment	2,261	2,335
Aircraft	1,438	1,438
Vehicles	4,291	4,919
	98,252	124,084
Less: accumulated depreciation	(37,215)	(41,182)
Total property, plant and equipment, net	$ 61,037	$ 82,902

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NOTE 3. LONG-TERM DEBT AND LINE OF CREDIT

At December 31, 2007 and September 30, 2008, long-term debt consists of the following:

	December 31, 2007	September 30, 2008
	(In thousands)	
Notes payable to a bank with interest payable at prime plus 1.50% (9.25% at December 31, 2007 and 6.50 % at September 30, 2008) maturing July 31, 2023, secured by real estate	$ 1,288	$ 1,255
Notes payable to a finance company with interest at 8%, maturing February 10, 2013, secured by real estate	152	134
Promissory notes payable to certain former owners of acquired companies with interest at 5%, maturing at various dates through April 2011	8,500	7,000
Convertible promissory notes payable to certain former stockholders of acquired companies with interest at 5%, maturing at various dates through April 2011, net of beneficial conversion of $71 at December 31, 2007 and $7 at September 30, 2008	4,929	12,492
Promissory notes payable to finance companies secured by vehicles and equipment	642	531
Capital leases payable to finance companies secured by an aircraft and equipment	549	42
Subordinated promissory note to a former debenture holder with a fixed interest rate of 8%, unsecured, paid in full	197	
Term Loan payable to a bank, variable interest rate at LIBOR plus 2.75% (7.01% at September 30, 2008), secured by various equipment, maturing April 23, 2013		46,000
Term and Capex Loans payable to a bank, variable interest rate at LIBOR plus 2% (ranging from 6.63% to 6.93% at December 31, 2007), secured by various equipment, paid in full	33,026	
Total	$ 49,283	$ 67,454
Less: current maturities	(14,456)	(19,578)
Long-term debt, less current maturities	$ 34,827	$ 47,876

SENIOR CREDIT FACILITY

Effective April 24, 2008, we increased our credit facility to $90.0 million (New Senior Credit Facility), including a $50.0 million term loan (the Term Loan), a $25.0 million working capital revolving line of credit (the Revolver), and a $15.0 million delayed draw term loan available to fund future acquisitions. The Revolver replaced our previous line of credit (the Line). Availability under the Revolver is the lower of: (i) $25.0 million or (ii) the sum of eligible accounts receivable and inventory, as defined under the agreement governing the Revolver. The Revolver accrues interest at the 30-day LIBOR plus 2.25% (6.46% at September 30, 2008) and matures in April 2013. The Revolver is collateralized by accounts receivable and inventory. As of September 30, 2008, we had $9.3 million outstanding under the Revolver. Due to the lock-box arrangement and the subjective acceleration clause in the agreements governing the Revolver and the Line, the debt under the Line and the Revolver have been classified as a current liability as of December 31, 2007 and September 30, 2008, as required by Emerging Issues Task Force (EITF) No. 95-22, *Balance Sheet Classification of Borrowings Outstanding under Revolving Credit Agreements that include both a Subjective Acceleration Clause and a Lock-box Arrangement.*

On August 28, 2008, the New Senior Credit Facility was amended to remove the $15.0 million delayed draw term loan. As an accommodation to our lender, we agreed to remove the delayed draw portion of the facility in order to make syndication of the loan more manageable.

Under the terms of the Term Loan, the funding limits are limited to the lesser of $50.0 million and 80% of the orderly liquidation value of our equipment. In addition, the Term Loan matures in February 2012 and will be repaid quarterly in equal payments of $2.0 million, with interest paid monthly in arrears and accruing at the annual interest rate of LIBOR plus 2.75% (7.01% at September 30, 2008). The Term Loan contains customary financial covenants and limitations on capital expenditures. With the proceeds from the New Senior Credit Facility, we (i) repaid approximately $28.7 million of outstanding principal balance under our previous term loan; (ii) repaid approximately $2.1 million of outstanding principal balance under our previous capital expenditure loan; (iii) repaid the balance on the Line; and (iv) closed the acquisition of Industrial Lift Truck and Equipment Co., Inc. (ILT). The balance of the proceeds available under the New Senior Credit Facility was used to pay fees and expenses of the aforementioned transaction and to provide additional working capital. As of September 30, 2008, we had $46.0 million outstanding under the Term Loan.

CAPITAL LEASES

In December 2006, we acquired a corporate-configured helicopter under capital lease for internal use. The capital lease was paid off in the first quarter of 2008. In March 2007, we acquired equipment under a capital lease maturing in 2012.

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Total cost and accumulated depreciation of assets held under capital lease is as follows:

	December 31, 2007	September 30, 2008
	(In thousands)	
Aircraft	$ 1,437	$
Equipment	58	58
Less: Accumulated depreciation	(101)	(9)
Capitalized cost, net	$ 1,394	$ 49

Depreciation expense for the three and nine months ended September 30, 2008 and 2007 was $0.00 million and $0.00 million and $0.03 million and $0.08 million, respectively, for all assets held under capital lease.

SUBORDINATED PROMISSORY NOTES

In May 2005, we issued approximately $4.3 million of unsecured, subordinated promissory notes (Subordinated Promissory Notes). The Subordinated Promissory Notes were scheduled to be paid quarterly, with interest in arrears, over 36 months in level payments with interest accruing at the rate of 8% per annum. The Subordinated Promissory Notes were paid off in May 2008. At December 31, 2007 and September 30, 2008, the Subordinated Promissory Notes had a balance of approximately $0.2 million and $0.0 million, respectively.

PREHEAT NOTES

In connection with the purchase of all of the issued and outstanding stock of Preheat, Inc. (Preheat) in February 2006, we issued $4.0 million in 5% promissory notes payable to certain Preheat stockholders (Preheat Notes). The Preheat Notes consist of three separate notes with $2.7 million maturing in February 2008 and $1.3 million maturing in February 2009. At December 31, 2007 and September 30, 2008, the Preheat Notes had a balance of $4.0 million. In February 2008, we terminated the employment of one of the Preheat stockholders for cause. The terms of the Preheat Notes provide that a termination of either of the Preheat stockholders employment for cause results in the cancellation of the Preheat Notes. The Preheat stockholders are contesting our assertion and have filed a lawsuit against the Company (see Note 4). Consequently, the Preheat Notes remain recorded as a liability in the financial statements pending resolution of the matter.

RIG TOOLS NOTES

In connection with the purchase of all of the issued and outstanding stock of Rig Tools, Inc. (Rig Tools) in November 2006, we issued $4.0 million in 5% convertible promissory notes payable to certain Rig Tools stockholders (Rig Tools Notes). The Rig Tools Notes consist of three separate notes with $3.0 million maturing in November 2007 and $1.0 million maturing in November 2008. The Rig Tools Notes can be prepaid at any time and are convertible into shares of our common stock at a price of $8.00 per share. We initially recorded a beneficial conversion feature of $0.7 million related to the stock valuation at closing which was recorded as a debt discount and is being amortized over the life of the Rig Tools Notes. At December 31, 2007 and September 30, 2008, the Rig Tools Notes had a balance of $1.0 million. The beneficial conversion feature had an unamortized balance of $0.1 million and $0.0 million at December 31, 2007 and September 30, 2008, respectively.

CHARLES HOLSTON NOTES

In connection with the acquisition of BMJ Industrial Investments, L.L.C. and its wholly-owned subsidiary, Charles Holston, Inc. (collectively Holston) in March 2007 (See Note 7), we issued $5.0 million in 5% promissory notes payable to certain Holston owners (Holston Notes). The Holston Notes consist of three separate notes with $1.0 million maturing in February 2008, $2.0 million maturing in February 2009 and $2.0 million maturing in February 2010. The Holston Notes maturing in 2009 and 2010 are convertible into shares of our common stock at a price of $9.24 per share. Based upon the stock valuation at the time of issuance, no beneficial conversion feature existed. At December 31, 2007 and September 30, 2008, the Holston Notes had a balance of $5.0 million and $4.0 million, respectively.

CYPRESS NOTES

In connection with the acquisition of certain assets of Cypress Consulting Services, Inc. d/b/a Cypress Energy Services (Cypress) in February 2007, we issued a $3.0 million promissory note accruing interest at an annual rate of 5% payable to a Cypress stockholder (the Cypress Note). The Cypress Note is payable over three years with $1.0 million maturing in February 2008, $1.0 million maturing in February 2009 and $1.0 million maturing in February 2010. At December 31, 2007 and September 30, 2008, the Cypress Note had a balance of $3.0 million and $2.0 million, respectively.

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BAILEY NOTE

In connection with the acquisition of certain assets of Bailey Operating, Inc. (BOI) in June 2007, we issued a $0.5 million promissory note accruing interest at an annual rate of 5% payable to BOI (Bailey Note). The Bailey Note is payable on or before May 31, 2010. At December 31, 2007 and September 30, 2008, the Bailey Note had a balance of $0.5 million.

BEG NOTES

In connection with the acquisition of certain assets of B.E.G. Liquid Mud Services Corp. (BEG) (See Note 7) in January 2008, we issued $4.0 million of 5% promissory notes payable to certain shareholders of BEG (BEG Notes). The BEG Notes are payable over three years with $1.3 million maturing in January 2009, $1.3 million maturing in January 2010 and $1.4 million maturing in January 2011 and are convertible into shares of our common stock at a rate of $3.70 per share under certain circumstances. Based upon the stock valuation at the time of the issuance, no beneficial conversion feature exists. At September 30, 2008, the BEG Notes had a balance of $4.0 million.

ILT NOTES

In connection with the acquisition of ILT (See Note 7), we issued $4.0 million of promissory notes payable to the shareholders of ILT (ILT Notes). The ILT Notes are payable over three years with $2.0 million maturing in April 2009, $1.0 million maturing in April 2010 and $0.5 million maturing in April 2011. The ILT Notes bear interest at a rate of 5% per annum payable in arrears and are convertible into shares of our common stock at a rate of $10.50 per share under certain circumstances. Based upon the stock valuation at the time of the issuance, no beneficial conversion feature exists. An additional note in the amount of $0.5 million, which is non-convertible and non-interest bearing, matures in April 2011. At September 30, 2008, the ILT Notes had a balance of $4.0 million.

INSURANCE NOTES PAYABLE

A portion of our property and casualty insurance premiums are financed through certain short-term installment loan agreements. The insurance notes are payable in monthly installments through June 2009 and accrue interest at 3.97%.

NOTE 4. COMMITMENTS AND CONTINGENCIES

EXECUTIVE COMPENSATION AGREEMENTS

Effective January 5, 2007, we entered into new Restricted Stock and Stock-Based Award Incentive Agreements (collectively RSAs) with James Eckert, our former Chief Executive Officer, and Darcy Klug, our former Executive Vice President. The RSAs provided for the granting of between 400,000 and 500,000 shares of our restricted common stock to each of the executive officers on the terms set forth in the RSAs. The number of shares of restricted stock became fixed and payable in the event of (i) a change in control or the receipt by our Board of Directors of a change of control offer as defined by the RSAs; (ii) termination without cause; or (iii) death or disability. Additionally, at the time of vesting in the restricted shares, each executive officer would have received the right to a cash payment of $1.2 million. The revised RSAs would have terminated on December 31, 2008, and any unvested restricted common stock or stock-based awards would have terminated and lapsed.

The RSA for Mr. Klug was mutually terminated pursuant to a Termination and Mutual Release Agreement effective April 28, 2008, in connection with the termination of his employment and the settlement of litigation between Mr. Klug and us, among others.

On December 31, 2007, we entered into a new Restricted Stock Agreement (NRSA) with Mr. Eckert. Under the NRSA, we awarded Mr. Eckert 400,000 restricted shares of our common stock on January 1, 2008. The restricted shares vested immediately, but the shares will remain subject to transfer restrictions which lapse at a rate of 33,333 quarterly after the initial lapse of transfer restrictions on 100,000 shares on January 1, 2009.

In conjunction with the NRSA, we mutually terminated the RSA with Mr. Eckert and entered into an Amended and Restated Employment Agreement (Amended Agreement) with Mr. Eckert. The Amended Agreement was effective until June 30, 2008 unless we had otherwise terminated it in accordance with the Amended Agreement. Additionally, we entered into a Consulting Agreement (Consulting Agreement) with Mr. Eckert effective December 31, 2007. Under the terms of the Consulting Agreement, upon the termination of the Amended Agreement on June 30, 2008, we have retained Mr. Eckert as an independent contractor to perform consulting services for us for a period of one year.

On May 1, 2008, the former owners of Preheat, which we acquired in February 2006, filed a lawsuit in federal court in the United States District Court for the Western District of Louisiana in Lafayette, Louisiana, against us, our directors, our current Chief Executive Officer, our current Senior Vice President/Chief Financial Officer, one of our investment advisors, and a principal of the investment advisor. The lawsuit seeks, among other things, (i) a declaratory judgment that the Preheat purchase agreement executed in December 2005 is null because of alleged securities fraud and bad faith breach of the purchase agreement and that one of the former Preheat owner s ERISA rights be clarified, (ii) injunctive relief to halt alleged securities disclosure violations by us and to remove three board members, and (iii) damages resulting from the nullification of the Preheat

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purchase agreement. At this point, we are unable to assess the ultimate impact of this litigation on our financial position, results of operations or cash flows. However, we believe the claims against us are without merit and will vigorously contest any legal action. Accordingly, we have not accrued any amounts related to this litigation.

OTHER

In the normal course of our business, we become involved in various litigation matters including, among other things, claims by third parties for alleged property damages, personal injuries and other matters. While we believe we have meritorious defenses against these claims, management has used estimates in determining our potential exposure and has recorded reserves in our financial statements related thereto where appropriate. It is possible that a change in our estimates of that exposure could occur, but we do not expect such changes in estimated costs will have a material effect on our financial position or results of operations.

NOTE 5. STOCKHOLDERS EQUITY

COMMON STOCK

On November 11, 2005, we entered into a Common Stock Purchase Agreement (the Stock Purchase Agreement) with Fusion Capital Fund II, LLC (Fusion Capital). Under terms of the Stock Purchase Agreement, Fusion Capital has committed to purchase up to $25.0 million of our common stock, at intervals determined by us, at prices determined by a formula set forth in the Stock Purchase Agreement. As of September 30, 2008, 665,429 shares have been issued under this agreement generating proceeds of $6.4 million. No shares were issued during the first or second quarter of 2008. The Stock Purchase Agreement expired in August 2008.

On April 29, 2008, we issued 400,000 shares of our common stock in partial settlement of litigation between Mr. Klug and us (See Note 4).

PREFERRED STOCK

At December 31, 2007 and September 30, 2008, 29 shares of Series B Preferred Stock are outstanding and are convertible into 7,733 shares of our common stock at a conversion rate of $1.25 per share.

On May 17, 2005, we entered into a Securities Purchase Agreement with certain of our affiliates and executive officers to issue up to $5.0 million of Series C Preferred in conjunction with the completion of a senior credit facility. Our Series C Preferred is convertible into shares of our common stock at a conversion price of $1.95 per share and includes detachable warrants to purchase up to 6,550,000 additional shares of our common stock at exercise prices ranging between $1.95 and $3.50 per share. The conversion prices of our Series C Preferred and the warrant exercise prices were supported by a fairness opinion issued by a third party. The proceeds of the issuance were allocated to the warrants and preferred stock based on the relative fair value of each instrument. The value attributed to the warrants was $2.9 million ($2.7 million net of offering costs) and was recorded as additional paid in capital while $0.6 million was the attributed value to the preferred stock. In addition, the conversion terms of the preferred stock result in a beneficial conversion feature valued at approximately $0.7 million. As a result of the terms of conversion, we recorded a one time charge to retained earnings for this amount representing a deemed dividend to the preferred stockholders with the offset recorded in additional paid in capital.

On August 29, 2005, the remainder of the Series C Preferred and warrants were issued generating gross proceeds of $1.5 million. The proceeds of the issuance of the second tranche were allocated to the warrants and preferred stock based on the relative fair value of each instrument. The entire value of $1.5 million was attributed to the fair value of the warrants and was recorded as additional paid in capital. In addition, the conversion terms of the preferred stock issued in the second tranche resulted in no beneficial conversion feature.