

TODCO
Form 10-Q
August 04, 2005

Table of Contents

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2005

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 1-31983

TODCO

(Exact name of registrant as specified in its charter)

Delaware

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

76-0544217

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

**2000 W. Sam Houston Parkway South, Suite 800
Houston, Texas 77042-3615**

(Address of registrant's principal executive offices)

(713) 278-6000

(Registrant's telephone number, including area code)

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

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

As of July 31, 2005, 61,021,760 shares of Class A common stock were outstanding and no shares of Class B common stock were outstanding.

TABLE OF CONTENTS

**Page
Number**

PART I FINANCIAL INFORMATION

Item 1. Condensed Consolidated Balance Sheets at June 30, 2005 and December 31, 2004 2
Condensed Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2005 and 2004 3

<u>Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2005 and 2004</u>	4
<u>Notes to Condensed Consolidated Financial Statements</u>	5
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	18
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	32
<u>Item 4. Controls and Procedures</u>	32
<u>PART II OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	33
<u>Item 4. Submission of Matters to a Vote of Security Holders</u>	33
<u>Item 6. Exhibits</u>	34
<u>Rule 13a-14a/15d-14a Certification of CEO</u>	
<u>Rule 13a-14a/15d-14a Certification of CFO</u>	
<u>Section 1350 Certification of CEO and CFO</u>	

Table of Contents**PART I****Item 1. Financial Statements (Unaudited)****TODCO AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS**

	June 30, 2005 (Unaudited)	December 31, 2004
	(In millions, except share data)	
ASSETS		
Cash and cash equivalents	\$ 106.6	\$ 65.1
Accounts receivable		
Trade	94.1	67.2
Related party	10.1	11.5
Other	5.6	3.8
Supplies	4.0	4.3
Deferred income taxes	3.5	3.5
Other current assets	2.4	2.5
Total current assets	226.3	157.9
Property and equipment	918.6	920.8
Less accumulated depreciation	395.8	353.6
Property and equipment, net	522.8	567.2
Other assets	31.6	36.3
Total assets	\$ 780.7	\$ 761.4
LIABILITIES AND STOCKHOLDERS EQUITY		
Trade accounts payable	\$ 26.4	\$ 20.6
Accrued income taxes	11.3	10.6
Accrued income taxes related party	14.5	8.4
Debt due within one year	2.1	8.2
Debt due within one year related party	3.0	3.0
Interest payable related party	0.1	0.2
Other current liabilities	46.0	45.5
Current liabilities related to discontinued operations	0.2	0.2
Total current liabilities	103.6	96.7
Long-term debt	17.7	17.2
Deferred income taxes	155.4	163.6
Other long-term liabilities	4.4	3.3

Total long-term liabilities	177.5	184.1
Commitments and contingencies		
Preferred stock, \$0.01 par value, 50,000,000 shares authorized and no shares issued and outstanding		
Common stock, Class A, \$0.01 par value, 500,000,000 shares authorized, 60,752,667 shares and 60,300,746 shares issued and outstanding at June 30, 2005 and December 31, 2004, respectively	0.6	0.6
Common stock, Class B, \$0.01 par value, 260,000,000 shares authorized and no shares issued and outstanding		
Additional paid-in capital	6,511.5	6,510.0
Retained deficit	(6,008.4)	(6,027.5)
Unearned compensation	(4.1)	(2.5)
Total stockholders' equity	499.6	480.6
Total liabilities and stockholders' equity	\$ 780.7	\$ 761.4

See accompanying notes.

2

Table of Contents

TODCO AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2005	2004	2005	2004
	(In millions, except per share data)			
Operating revenues	\$ 130.5	\$ 80.8	\$ 242.4	\$ 154.6
Costs and expenses				
Operating and maintenance	86.5	61.1	155.4	128.0
Depreciation	23.9	24.0	47.9	48.2
General and administrative	9.9	7.2	18.3	19.6
Gain on disposal of assets, net	(5.6)	(1.9)	(6.7)	(4.6)
	114.7	90.4	214.9	191.2
Operating income (loss)	15.8	(9.6)	27.5	(36.6)
Other income (expense), net				
Interest income	0.8		1.3	0.1
Interest expense	(0.9)	(1.0)	(1.9)	(2.0)
Interest expense related party			(0.1)	(3.2)
Loss on retirement of debt				(1.9)
Other, net	1.0	0.1	1.5	0.6
	0.9	(0.9)	0.8	(6.4)
Income (loss) before income taxes	16.7	(10.5)	28.3	(43.0)
Income tax expense (benefit)	5.7	(3.1)	9.2	(13.3)
Net income (loss)	\$ 11.0	\$ (7.4)	\$ 19.1	\$ (29.7)
Net income (loss) per common share:				
Basic	\$ 0.18	\$(0.12)	\$ 0.32	\$ (0.58)
Diluted	\$ 0.18	\$(0.12)	\$ 0.31	\$ (0.58)
Weighted average common shares outstanding:				
Basic	60.3	60.0	60.2	51.1
Diluted	61.2	60.0	61.0	51.1

See accompanying notes.

Table of Contents

TODCO AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Months Ended	
	June 30,	
	2005	2004
	(In millions)	
Cash Flows from Operating Activities		
Net income (loss)	\$ 19.1	\$(29.7)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation	47.9	48.2
Deferred income taxes	(17.2)	(13.6)
Stock-based compensation expense	4.3	9.4
Net gain on disposal of assets	(6.7)	(4.6)
Amortization of debt issue costs	0.4	(0.2)
Deferred income, net	(5.2)	(6.7)
Deferred expenses, net	4.4	3.3
Loss on retirement of debt		1.9
Changes in operating assets and liabilities, net of effect of distributions to related parties		
Accounts receivable, net	(28.7)	(2.1)
Accounts payable and other current liabilities	15.9	(6.2)
Accounts receivable/payable to related party, net	1.3	5.4
Income taxes receivable/payable, net	6.7	(0.4)
Other, net	(0.1)	0.2
Net cash provided by operating activities	42.1	4.9
Cash Flows from Investing Activities		
Capital expenditures	(9.1)	(4.8)
Proceeds from disposal of assets, net	10.3	9.7
Net cash provided by investing activities	1.2	4.9
Cash Flows from Financing Activities		
Payments on short-term debt	(1.1)	
Proceeds from short-term debt	2.1	
Repayments on 6.75% senior notes	(7.7)	
Issuance of common stock under long-term incentive plans	3.7	
Other, net	1.2	(1.9)
Net cash used in financing activities	(1.8)	(1.9)
Net increase in cash and cash equivalents	41.5	7.9

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Cash and cash equivalents at beginning of period	65.1	20.0
Cash and cash equivalents at end of period	\$106.6	\$ 27.9

See accompanying notes.

4

Table of Contents

TODCO AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1 Nature of Business

TODCO (together with its subsidiaries and predecessors, unless the context requires otherwise, the Company, we or our), is a leading provider of contract oil and gas drilling services, primarily in the United States (U.S.) Gulf of Mexico shallow water and inland marine region, an area referred to as the U.S. Gulf Coast. The Company owns and operates 64 drilling rigs, consisting of 24 jackup rigs, 27 barge rigs, three submersible rigs, one platform rig and nine land rigs. The Company contracts its drilling rigs, related equipment and work crews primarily on a dayrate basis to drill oil and natural gas wells.

In January 2001, the Company was acquired by Transocean Inc. (the Transocean Merger). In July 2002, Transocean Inc. (Transocean) announced plans to divest its Gulf of Mexico shallow and inland water (Shallow Water) business through an initial public offering of the Company. During 2003, the Company completed the transfer to Transocean of all assets not related to its Shallow Water business (Transocean Assets), including the transfer of all revenue-producing assets. In February 2004, the Company completed its initial public offering and secondary stock offerings were completed in September 2004, December 2004 and May 2005. As of June 30, 2005, Transocean has sold all of its remaining shares of the Company s common stock. See Note 3.

Note 2 Summary of Significant Accounting Policies and Basis of Consolidation

Basis of Consolidation These condensed financial statements have been prepared in accordance with the rules of the Securities and Exchange Commission for interim financial statements and do not include all annual disclosures required by accounting principles generally accepted in the United States. These financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company s Form 10-K for the fiscal year ended December 31, 2004. The condensed financial information as of June 30, 2005 and for the three and six months ended June 30, 2005 and 2004 is unaudited, but includes all adjustments that management considers necessary for a fair presentation of the Company s consolidated results of operations, financial position and cash flows. Results for the three and six months ended June 30, 2005 are not necessarily indicative of results to be expected for the full fiscal year 2005 or any other future periods.

Intercompany transactions and accounts have been eliminated. For investments in joint ventures that either do not meet the criteria of being a variable interest entity or where the Company is not deemed to be the primary beneficiary for accounting purposes, the equity method of accounting is used where the Company s ownership in the joint venture is between 20 percent and 50 percent and for investments in joint ventures where more than 50 percent is owned and the Company does not have control of the joint venture. The cost method of accounting is used for investments in joint ventures where the Company s ownership is less than 20 percent and the Company does not have significant influence over the joint venture. For investments in joint ventures that meet the criteria of a variable interest entity and where the Company is deemed to be the primary beneficiary for accounting purposes, such entities are consolidated. See Note 4.

Accounting Estimates The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and disclosure of contingent assets and liabilities. The Company evaluates its estimates on an ongoing basis, including those related to bad debts, supplies obsolescence, investments, property and equipment and other long-lived assets, income taxes, personal injury claim liabilities, employment benefits and contingent liabilities. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from such estimates.

Cash and Cash Equivalents Cash equivalents are stated at cost plus accrued interest, which approximates fair value. Cash equivalents are highly liquid investments with an original maturity of three months or less. As of June

Table of Contents

30, 2005, and December 31, 2004, the Company had \$12.0 million and \$11.9 million, respectively, of restricted cash to support three performance bonds issued in connection with our contracts with PEMEX in Mexico. This restricted cash is included in other assets on the condensed consolidated balance sheet.

Accounts Receivable and Allowance for Doubtful Accounts Accounts receivable trade are stated at the historical carrying amount net of write-offs and allowance for doubtful accounts receivable. Interest receivable on delinquent accounts receivable is included in the accounts receivable trade balance and recognized as interest income when collectibility is reasonably assured. Uncollectible accounts receivable trade are written off when a settlement is reached for an amount that is less than the outstanding historical balance. The Company establishes an allowance for doubtful accounts receivable on a case-by-case basis when it believes the collection of specific amounts owed is unlikely to occur. This allowance was \$0.3 million and \$0.2 million at June 30, 2005, and December 31, 2004, respectively.

Supplies Supplies are carried at the lower of average cost or market value less an allowance for obsolescence. This allowance was \$0.3 million at June 30, 2005 and December 31, 2004.

Stock-Based Compensation Effective January 1, 2003, the Company adopted the fair value method of accounting for stock-based compensation using the prospective method of transition under Statement of Financial Accounting Standards (SFAS) 123, *Accounting for Stock-based Compensation* (SFAS 123). Under the prospective method and in accordance with the provisions of SFAS 148, *Accounting for Stock-Based Compensation Transition and Disclosure* (SFAS 148), the recognition provisions are applied to all employee awards granted, modified or settled after January 1, 2003.

New Accounting Pronouncements In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004) (SFAS 123(R)), *Share-Based Payment*, which is a revision of SFAS 123. SFAS 123(R) supersedes Accounting Principles Board (APB) Opinion No. 25 (APB 25) and amends SFAS 95, *Statement of Cash Flows*. Generally, the approach to accounting for share-based payments in SFAS 123(R) is similar to the approach described in SFAS 123. However, SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values (i.e., pro forma disclosure is no longer an alternative to financial statement recognition). SFAS 123(R) is effective for the Company beginning January 1, 2006. As the Company has already adopted SFAS 123, the Company's adoption of SFAS 123(R) is not expected to have a material impact on the Company's consolidated results of operations, financial position or cash flows.

In December 2004, the FASB issued SFAS 153, *Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29* (SFAS 153). This Statement amends APB Opinion No. 29 to permit the exchange of nonmonetary assets to be recorded on a carry over basis when the nonmonetary assets do not have commercial substance. This is an exception to the basic measurement principal of measuring a nonmonetary asset exchange at fair value. A nonmonetary asset exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS 153 is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The Company adopted SFAS 153 effective April 1, 2005 and the adoption did not have a material effect on its financial condition or results of operations.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections* (SFAS 154). SFAS 154 is a replacement of APB Opinion No. 20, *Accounting Changes*, and FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*. SFAS 154 applies to all voluntary changes in accounting principle and changes the accounting for and reporting of a change in accounting principle. SFAS 154 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle unless it is impracticable. Previously, most voluntary changes in accounting principle were required to be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company does not anticipate the adoption of SFAS 154 to have a material effect on its financial condition or results of operations.

Reclassifications Certain reclassifications have been made to prior period amounts to conform to the current period's presentation.

Table of Contents**Note 3 Capital Stock and Related Transactions**

Capital Structure In February 2004, the Company amended its certificate of incorporation to, among other things, create two classes of common stock, Class A and Class B, increase its authorized capital stock and to convert any issued and outstanding shares of the Company's common stock into Class B common stock. As amended, the Company's authorized capital stock consists of (i) 500,000,000 shares of Class A common stock, par value \$.01 per share, and 260,000,000 shares of Class B common stock, par value \$.01 per share, and (ii) 50,000,000 shares of preferred stock, par value \$.01 per share.

Capital Stock Transactions and Retirement of Related Party Debt In February 2004, prior to the Company's IPO, the Company exchanged \$45.8 million in principal amount of its outstanding 7.375% Senior Notes held by Transocean Holdings Inc. (a wholly owned subsidiary of Transocean, Transocean Holdings), plus accrued interest thereon, for 359,638 shares of the Company's Class B common stock (4,367,714 shares of Class B common stock after giving effect to a stock dividend). Immediately following this exchange, the Company exchanged \$152.5 million and \$289.8 million principal amount of its outstanding 6.75% and 9.5% Senior Notes, respectively, held by Transocean, plus accrued interest thereon, for 3,580,768 shares of the Company's Class B common stock (43,487,535 shares of Class B common stock after giving effect to a stock dividend). The determination of the number of shares issued in the exchange transactions was based on a method that took into account the IPO price of \$12.00 per share. The net effect of these transactions was to decrease notes payable and interest payable to a related party by \$528.9 million with an offsetting increase in common stock of \$0.5 million and additional paid-in capital of \$528.4 million. Additionally, the Company expensed the remaining balance of deferred consent fees associated with these notes and recognized a \$1.9 million loss on retirement of debt.

Also in connection with the closing of the IPO, Transocean made additional equity contributions totaling \$2.8 million, including \$1.0 million in intercompany payable balances owed by the Company to Transocean as of the IPO date.

Initial Public Offering and Related Events In February 2004, the Company completed the IPO of 13,800,000 shares of its Class A common stock at \$12.00 per share. The Company did not receive any proceeds from the initial sale of Class A common stock.

Upon completion of the IPO, the Company entered into various agreements to complete the separation from Transocean, including an employee matters agreement, a master separation agreement and a tax sharing agreement. The master separation agreement provides for, among other things, the assumption by the Company of liabilities relating to the Shallow Water business and the assumption by Transocean of liabilities unrelated to the Shallow Water business, including the indemnification of losses that may occur as a result of certain of the Company's ongoing legal proceedings. See Note 9.

In February 2004, the Company recorded an equity transaction related to net liabilities related to Transocean's business of \$0.4 million for which legal title had not been transferred to Transocean as of the IPO date in accordance with the business indemnity between the Company and Transocean. The net liabilities related to Transocean's business totaled \$0.2 million at June 30, 2005 and December 31, 2004. The indemnification by Transocean was recorded as a credit to additional paid-in capital with a corresponding offset to a related party receivable from Transocean.

In conjunction with the IPO, the Company entered into a tax sharing agreement with Transocean. See Note 8.

Secondary Stock Offerings Secondary stock offerings were completed in September 2004, December 2004 and May 2005 in which Transocean sold an additional 17,940,000 shares, 14,950,000 shares and 13,310,000 shares, respectively, of the Company's Class A common stock. At the closing of the December 2004 secondary stock offering, Transocean converted all of its unsold shares of Class B common stock into an equal number of Class A common stock shares, resulting in there being no shares of Class B common stock outstanding. The Company received no proceeds from the secondary stock offerings. As of June 30, 2005, Transocean has sold all of its remaining shares of the Company's common stock.

Table of Contents**Note 4 Delta Towing**

The Company owns a 25 percent equity interest in Delta Towing LLC (Delta Towing), a joint venture formed to own and operate the Company's U.S. marine support vessel business, consisting primarily of shallow water tugs, crewboats and utility barges. The Company previously contributed its support vessel business to the joint venture in return for a 25 percent ownership interest and certain secured notes receivable from Delta Towing with a face value of \$144.0 million. The Company valued these notes at \$80.0 million and no value was assigned to the ownership interest in Delta Towing. Delta Towing's property and equipment, with a net book value of \$36.8 million at June 30, 2005, are collateral for the Company's notes receivable. The remaining 75 percent ownership interest is held by Beta Marine LLC (Beta Marine), which also loaned Delta Towing \$3.0 million. See Note 5.

Under FASB Interpretation No. 46, *Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51* (FIN 46), Delta Towing is considered a variable interest entity because its equity is not sufficient to absorb the joint venture's expected future losses. The Company is deemed to be the primary beneficiary of Delta Towing for accounting purposes because it has the largest percentage of investment at risk through the secured notes held by the Company and would thereby absorb the majority of the expected losses of Delta Towing. The Company adopted FIN 46 and, accordingly, consolidated Delta Towing effective December 31, 2003. As of June 30, 2005 and December 31, 2004 all intercompany accounts have been eliminated in consolidation as a result of the adoption of FIN 46, as well as all intercompany transactions during the three and six months ended June 30, 2005 and 2004.

The creditors of Delta Towing have no recourse to the general credit of the Company.

Note 5 Debt and Capital Lease Obligations

Debt and capital lease obligations, net of unamortized discounts, premiums, and fair value adjustments, were comprised of the following (in millions):

	Third Party		Related Party	
	June 30, 2005	December 31, 2004	June 30, 2005	December 31, 2004
6.75% Senior Notes, due April 2005	\$	\$ 7.8	\$	\$
6.95% Senior Notes, due April 2008	2.2	2.2		
7.375% Senior Notes, due April 2018	3.5	3.5		
9.5% Senior Notes, due December 2008	11.1	11.2		
Other Debt	1.0		3.0	3.0
Capital Lease Obligations	2.0	0.7		
Total	19.8	25.4	3.0	3.0
Less debt due within one year	2.1	8.2	3.0	3.0
Total long-term debt	\$17.7	\$ 17.2	\$	\$

Third Party Debt ¾ Revolving Credit Facility ¼ In December 2003, the Company entered into a two-year, \$75 million floating-rate secured revolving credit facility that declined to \$60 million in December 2004. The facility is secured by most of the Company's drilling rigs, receivables, and the stock of most of its U.S. subsidiaries and is guaranteed by some of its subsidiaries. Borrowings under the facility bear interest at our option at either (1) the higher of (A) the prime rate and (B) the federal funds rate plus 0.5 percent, plus a margin in either case of 2.50 percent or (2) the Eurodollar rate plus a margin of 3.50 percent. Commitment fees on the unused portion of the facility are 1.5 percent of the average daily balance and are payable quarterly. Borrowings and letters of credit issued under the facility are limited by a borrowing base equal to the lesser of (A) 20 percent of the orderly liquidated value of the drilling rigs securing the facility, as determined from time to time by a third party selected by the agent under the facility, and (B) the sum of 10 percent of the orderly liquidated value of the drilling rigs securing the facility plus

80 percent of the U.S. accounts receivable outstanding less than 90 days, net of any provision for bad debt associated with such U.S. accounts receivable.

Financial covenants include maintenance of certain financial ratios and other ratios, including working capital, liquidity, and debt-to-total capitalization ratios, and a minimum tangible net worth by the Company.

Table of Contents

The revolving credit facility provides, among other things, for the issuance of letters of credit that the Company may utilize to guarantee its performance under some drilling contracts, as well as insurance, tax and other obligations in various jurisdictions. The facility also provides for customary fees and expense reimbursements and includes other covenants (including limitations on the incurrence of debt, mergers and other fundamental changes, asset sales and dividends) and events of default (including a change of control) that are customary for similar secured non-investment grade facilities.

During the three and six months ended June 30, 2005, the Company recognized \$0.2 million and \$0.4 million, respectively, in interest expense related to commitment fees on the unused portion of the facility and recognized \$0.3 million and \$0.6 million, respectively, for the corresponding periods ending June 30, 2004. During the three and six months ended June 30, 2005 and June 30, 2004, the company amortized \$0.3 million, \$0.6 million, \$0.3 million and \$0.6 million, respectively, in deferred financing costs as a component of interest expense. At June 30, 2005 and December 31, 2004, the Company had no borrowings outstanding under this facility.

Senior Notes and Exchange Offer In 2002, Transocean and the Company completed exchange offers and consent solicitations for the Company's 6.5%, 6.75%, 6.95%, 7.375%, 9.125%, and 9.5% Senior Notes (the Exchange Offer). As a result of the Exchange Offer, the Company's outstanding 6.5%, 6.75%, 6.95%, 7.375%, 9.125%, and 9.5% Senior Notes were exchanged by Transocean for newly issued Transocean notes having the same principal amount, interest rate, redemption terms and payment and maturity dates (the Exchanged Notes). Both the Exchanged Notes and the notes not exchanged remained the obligation of the Company.

In February 2004, prior to the Company's IPO, the Company exchanged \$488.1 million in principal amount of the then outstanding Exchanged Notes, plus accrued interest thereon, for 3,940,406 shares of the Company's Class B common stock (47,855,249 shares of Class B common stock after giving effect to a stock dividend). In connection with the exchange, the Company recognized \$3.1 million in interest expense related to the Exchanged Notes in 2004. There are no Exchanged Notes payables to Transocean outstanding as a result of the above transaction at June 30, 2005 or December 31, 2004.

In connection with the Exchange Offer, the Company had made an aggregate of \$8.3 million in consent payments to holders of the notes that were exchanged. The consent payments were amortized as an increase to interest expense over the remaining terms of the Exchanged Notes using the interest method. No amounts were amortized to interest expense in 2004. In connection with the retirement of the Exchanged Notes prior to the completion of the IPO, the Company expensed the remaining balance of these deferred consent fees of approximately \$1.9 million in February 2004, which has been reflected as a loss on retirement of debt in the Company's consolidated statement of operations.

In April 2005, the Company repaid the outstanding balance of \$7.7 million related to the 6.75% Senior Notes. As a result, at June 30, 2005, approximately, \$2.2 million, \$3.5 million, and \$10.2 million principal amount of the 6.95%, 7.375%, and 9.5% Senior Notes, respectively, due to third parties were outstanding. The fair value of these notes at June 30, 2005, was approximately \$2.2 million, \$3.2 million, and \$10.9 million, respectively, based on the estimated yield to maturity which takes into account TODCO's credit worthiness as a separate entity. The Company recognized \$0.3 million, \$0.7 million, \$0.5 million, and \$0.9 million in interest expense related to these notes for the three and six months ended June 30, 2005 and 2004, respectively.

Other Debt - Third Party ^{3/4} The Company entered into an unsecured line of credit with a bank in Venezuela in the third quarter of 2004 to provide a maximum of 4.5 billion Venezuela Bolivars (\$2.1 million U.S. dollars at the current exchange rate at June 30, 2005) in order to manage local currency liquidity. Each draw on the line of credit is denominated in Venezuela Bolivars and is evidenced by a 30-day promissory note that bears interest at the then market rate as designated by the bank. The promissory notes are pre-payable at any time at the Company's option. However, if not repaid within 30 days, the promissory notes may be renewed at mutually agreeable terms for an additional 30-day period at the then designated interest rate. There are no commitment fees payable on the unused portion of the line of credit, and the facility is reviewed annually by the bank's board of directors.

Table of Contents

At June 30, 2005, the Company had \$1.0 million (2.1 billion Venezuela Bolivars) in borrowings outstanding with respect to the line of credit which bears interest at 17% per annum. This amount is reported as short-term debt in the Company's condensed consolidated balance sheet at June 30, 2005. The Company recognized \$0.1 million in interest expense related to the line of credit for the three and six months ended June 30, 2005.

Other Debt - Related Party ^{3/4} In connection with the acquisition of the U.S. marine support vessel business, Delta Towing entered into a \$3.0 million note agreement with Beta Marine dated January 30, 2001. The note bears interest at 8 percent per annum, payable quarterly. The \$3.0 million note has been classified as a current obligation in the Company's condensed consolidated balance sheet at June 30, 2005 and December 31, 2004 as Delta Towing remains in default on this note payable to a related party. The Company has no obligation to fund this debt on behalf of Delta Towing. Interest expense related to the note agreement with Beta Marine was \$0 million, \$0.1 million, \$0 million and \$0.1 million for each of the three and six months ending June 30, 2005 and 2004, respectively.

Capital Lease Obligations From time to time the Company enters into capital lease agreements for certain drilling equipment. In January 2004 and during 2003, the Company entered into three such capital lease agreements and exercised options to buy-out the remaining terms of these lease agreements for \$2.3 million in the second quarter of 2004. In August 2004, the Company entered into a two-year capital lease agreement for \$0.9 million with a final maturity date in July 2006. The Company exercised its option to buy-out the remaining term of this lease agreement in February 2005 for \$0.7 million. The Company entered into additional capital lease agreements for \$1.1 million each in January 2005 and June 2005. Future lease payments as of June 30, 2005 under these agreements are \$2.2 million, including principal and interest, of which \$1.2 million and \$1.0 million is payable in the twelve month periods ended June 30, 2006 and 2007, respectively. Interest expense, which is not significant, is included in the future lease payments. Depreciation expense on these assets, which is not significant, is included in depreciation expense.

Note 6 Other Current Liabilities

Other current liabilities are comprised of the following (in millions):

	June 30, 2005	December 31, 2004
Accrued self-insurance claims	\$22.3	\$ 21.7
Deferred revenue	3.7	11.4
Accrued payroll and employee benefits	12.3	8.0
Accrued taxes, other than income	7.0	3.2
Other	0.7	1.2
Total other current liabilities	\$46.0	\$ 45.5

Note 7 Supplementary Cash Flow Information

Supplementary cash flow information relating to both continuing and discontinued operations is as follows (in millions):

	Six Months Ended June 30,	
	2005	2004
Non-cash financing activities:		
Debt-for-equity exchange (a)	\$	\$(528.9)
Equity contributions from parent, net of distributions (b)	7.7	162.0

(a) Prior to the closing of the Company's IPO in

February 2004, the Company completed a non-cash exchange of \$528.9 million in long-term related party notes payable to Transocean and related accrued interest payable for shares of the Company's Class B common stock. See Notes 3 and 5.

- (b) In connection with the closing of the IPO, the Company completed certain equity transactions related to the Company's separation from Transocean. In February 2004, the Company recorded business and tax indemnities of the Company by Transocean of \$10.7 million as an increase in accounts receivable-related party and an increase in additional paid-in capital and transferred to Transocean \$1.0 million of intercompany payable balances as of the IPO date as an increase in additional paid-in

capital (see Note 3). Additionally, the Company recorded the book transfer of substantially all pre-IPO income tax benefits to Transocean of \$173.7 million as a decrease in deferred income tax assets and a decrease in additional paid-in capital. In the first quarter of 2005, the Company recorded an additional \$7.7 million in pre-IPO deferred state tax liabilities that existed at the IPO. This recognition resulted in a \$7.7 million reduction in additional paid-in capital, \$0.9 million of deferred state tax benefit and a \$6.8 million increase in deferred tax liabilities. See Note 8.

Table of Contents

Note 8 Income Taxes

Until February 2004, the Company was a member of an affiliated group that included its parent company, Transocean Holdings, and current and deferred taxes were allocated based upon what the Company's tax provision (benefit) would have been had the Company filed a separate tax return.

Income taxes have been provided based upon the tax laws and rates in the countries in which operations are conducted and income is earned. 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 the Company's assets and liabilities using the applicable tax rates in effect. A valuation allowance for deferred tax assets is recorded when it is more likely than not that some or all of the benefit from the deferred tax assets will not be realized.

Tax Sharing Agreement In conjunction with the IPO, the Company entered into a tax sharing agreement with Transocean whereby Transocean will indemnify the Company against substantially all pre-IPO income tax liabilities. However, as part of the tax sharing agreement, the Company must pay Transocean for substantially all pre-IPO income tax benefits utilized or deemed to have been utilized su