

Navios Maritime Acquisition CORP
Form 6-K
September 15, 2010

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 6-K

REPORT OF FOREIGN PRIVATE ISSUER
PURSUANT TO RULE 13a-16 OR 15d-16 OF THE
SECURITIES EXCHANGE ACT OF 1934

Dated: September 15, 2010

Commission File No. 001-34104

NAVIOS MARITIME ACQUISITION CORPORATION

85 Akti Miaouli Street, Piraeus, Greece 185 38

(Address of Principal Executive Offices)

Indicate by check mark whether the registrant files or will file annual reports under cover Form 20-F or Form 40-F:
Form 20-F Form 40-F

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by
Regulation S-T Rule 101(b)(1):

Yes No

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by
Regulation S-T Rule 101(b)(7):

Yes No

Indicate by check mark whether the registrant by furnishing the information contained in this Form
is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under
the Securities Exchange Act of 1934.

Yes No

If Yes is marked, indicate below the file number assigned to the registrant in connection with
Rule 12g3-2(b):

N/A

This Report on Form 6-K is hereby incorporated by reference into the Navios Maritime Acquisition Corporation Registration Statement on Form F-3, File No. 333-151707.

Acquisition of VLCC Tanker Vessels

On September 10, 2010, Navios Maritime Acquisition Corporation (referred to herein as we, us or Navios Acquisition) consummated its previously announced acquisition of a fleet of seven very large crude carrier (VLCC) tankers for an aggregate purchase price of \$587.0 million, pursuant to a Securities Purchase Agreement, dated as of July 19, 2010, by and between Navios Acquisition and Vanship Holdings Limited (the Seller), by and between Navios Acquisition and Seller (as amended, the Purchase Agreement). The Purchase Agreement contemplated the purchase of the seven vessel owning subsidiaries (Vessel Owning Subsidiaries) that own each of the vessels.

The \$587.0 million consideration was financed as follows: (a) \$411.0 million of bank debt, incurred at closing; (b) \$113.8 million of cash paid at closing (\$133.8 million cash payment net of \$20.0 million working capital adjustments); (c) \$11.0 million through the issuance of 1,894,918 Navios Acquisition shares of common stock at closing; and (d) \$51.2 million due to shipyard in 2011 for the new build scheduled for delivery in June 2011 (of which \$36.3 million will be drawn down from existing debt facilities entered into in connection with the acquisition).

Of the 1,894,918 shares of our common stock issued at closing, 1,378,122 shares of common stock, having an aggregate value of approximately \$8.0 million, were deposited into a one-year escrow to provide for indemnity or other claims under the Purchase Agreement, and the balance of 516,796 shares of common stock, having an aggregate value of approximately \$3.0 million, were delivered to the Seller. The \$411.0 million of debt consists of six credit facilities with a consortium of banks and has a weighted average margin of 2.94%. The cash portion of the consideration paid at closing was financed with: (i) \$32.2 million cash from the balance sheet of the Vessel Owning Subsidiaries; (ii) \$40.0 million in short term financing from Navios Maritime Holdings Inc. (Navios Holdings); and (iii) existing cash resources of Navios Acquisition. The \$40.0 million facility with Navios Holdings has a margin of LIBOR plus 300 bps and a term of 18 months, maturing on April 1, 2012.

The terms of the Purchase Agreement were previously disclosed in a Report on Form 6-K filed with the Securities and Exchange Commission (SEC) on July 26, 2010 (Acquisition 6-K), which is incorporated herein by reference.

After giving effect to the acquisition of the VLCC tankers, Navios Acquisition's consolidated fleet consists of the following:

Vessel	Type	DWT	Built/ Delivery Date	Net Charter Rate (\$ per day)	Expiration Date	Profit Share
Owned Vessels						
Colin Jacob	LR 1	74,671	2007	17,000	June 2013	50% above \$17,000
Ariadne Jacob	LR 1	74,671	2007	17,000	July 2013	50% above \$17,000
Shinyo Splendor	VLCC	306,474	1993	38,019	5/18/2014	None
Shinyo Navigator	VLCC	300,549	1996	42,705	12/18/2016	None
C. Dream	VLCC	298,570	2000	29,625(1)	3/15/2019	50% above \$30,000 40% above \$40,000
Shinyo Ocean	VLCC	281,395	2001	38,400	1/10/2017	50% above \$43,500
Shinyo Kannika	VLCC	281,474	2001	38,025	2/17/2017	50% above \$44,000
Shinyo Saowalak	VLCC	298,000	2010	48,153	6/15/2025	35% above \$54,388 40% above \$59,388 50% above \$69,388
Vessels to be delivered						
Nave Cosmos	Chemical Tanker	25,000	Q4 2010			
TBN	Chemical Tanker	25,000	Q4 2010			
Shinyo Kieran	VLCC	298,000	Q2 2011	48,153	6/15/2026	35% above \$54,388

40% above \$59,388
50% above \$69,388

TBN	LR 1	75,000	Q4 2011
TBN	LR 1	75,000	Q4 2011

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Vessel	Type	DWT	Built/ Delivery Date	Net Charter Rate (\$ per day)	Expiration Date	Profit Share
TBN	MR 2	50,000	Q1 2012			
TBN	MR 2	50,000	Q2 2012			
TBN	MR 2	50,000	Q3 2012			
TBN	MR 2	50,000	Q3 2012			
TBN	MR 2	50,000	Q4 2012			
TBN	MR 2	50,000	Q4 2012			
TBN	MR 2	50,000	Q4 2012			

1. Vessel sub-chartered at \$34,843/day over the next two years.

Navios Acquisition has previously filed the audited combined financial statement of the Vessel Owning Subsidiaries for the years ended December 31, 2009, 2008 and 2007 in the Acquisition 6-K and the unaudited combined financial statements for the three month periods ended March 31, 2010 and 2009 in a Report on Form 6-K filed with the SEC on August 6, 2010. This Report on Form 6-K contains the unaudited combined financial statements for the six month periods ended June 30, 2010 and 2009 of the Vessel Owning Subsidiaries. In addition, this Report contains the unaudited condensed combined pro forma financial statements of Navios Acquisition as of and for the six month period ended June 30, 2010 to give effect to the acquisition of the Vessel Owning Subsidiaries. Such financial statements may not be indicative of the future operations or post-closing financial position of such companies.

With respect to the historical financial statements, the revenues of the Vessel Owning Subsidiaries for the first six month period ended June 30, 2010 was approximately \$3.3 million higher than for the comparable 2009 period. However, net income for the first six months was down from approximately \$14.3 million in 2009 to approximately \$2.7 million in 2010. Based on information from the Seller, such decrease was due mainly to a loss of \$4.9 million in 2010 compared to a gain of \$10.7 million in 2009 on the mark-to-market value of certain interest rate swap agreements and a write-off of deferred loan costs of approximately \$1.2 million, partially offset by lower interest expense. Such derivative financial instruments were extinguished in connection with the closing of the acquisition, and the Purchase Agreement required the Seller to take a number of other actions that will impact the post-closing financial statements including, but not limited to, extinguishing the shareholders loans, settlement of accrued tax liabilities, prepayment in full of the loan facility dated August 20, 2008 on the Shinyo Kieran and the related interest rate swap agreements. Accordingly, the unaudited condensed combined balance sheet, statements of income and cash flows contained herein may not be indicative of the continued operations of the Vessel Owning Subsidiaries following their acquisition.

This Report contains forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward looking statements are based on Navios Acquisition's current expectations and observations. Actual results may differ materially from those expressed or implied by such forward-looking statements. Factors that could cause actual results to differ materially include, but are not limited to changes in the demand for product and chemical tankers, fluctuation of charter rates, competitive factors in the market in which Navios Acquisition operates; risks associated with operations outside the United States; and other factors listed from time to time in the Navios Acquisition's filings with the SEC.

INDEX TO UNAUDITED CONDENSED COMBINED FINANCIAL STATEMENTS

Unaudited Condensed Combined Financial Statements of the Vessel Owning

Subsidiaries:

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Vessel Owning Subsidiaries
 Unaudited Condensed Combined Balance Sheets
 as of December 31, 2009 and June 30, 2010
 (expressed in US\$)

	Note	December 31, 2009	June 30, 2010
Assets			
<i>Current assets</i>			
Cash		18,217,569	13,619,655
Restricted cash		2,639,807	2,497,163
Trade accounts receivable			858,807
Prepayments and other receivables		2,104,359	1,861,504
Amounts due from related parties	9(b)	883,654	1,112,422
Supplies		416,205	1,414,120
Total current assets		24,261,594	21,363,671
Restricted cash		6,500,000	14,500,000
Loan to a related party	9(b)	8,882,533	8,882,533
Deferred loan costs		3,200,992	2,216,573
Vessels, net	4	359,334,424	490,727,007
Vessels under construction	5	174,901,072	89,543,922
Total assets		577,080,615	627,233,706
Liabilities			
<i>Current liabilities</i>			
Current portion of long-term bank loans	6	51,979,567	40,223,988
Amounts due to related parties	9(b)	13,788,975	16,584,296
Accrued liabilities and other payables		10,358,065	8,257,729
Total current liabilities		76,126,607	65,066,013
Long-term bank loans	6	344,910,681	376,850,067
Loans from a related party	9(b)	131,459,170	156,385,888
Derivative financial instruments	7	9,729,403	11,354,087
Total liabilities		562,225,861	609,656,055
Commitments and contingencies	10		
Shareholder's equity			
Paid-in capital		15	15
Retained earnings		14,854,739	17,577,636

Total shareholder s equity	14,854,754	17,577,651
Total liabilities and shareholder s equity	577,080,615	627,233,706

See accompanying notes to the unaudited condensed combined financial statements.

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Vessel Owning Subsidiaries

Unaudited Condensed Combined Statements of Income
for the six month periods ended June 30, 2009 and 2010

(expressed in US\$)

	Note	2009	2010
Operating revenue			
Revenue	8	31,825,564	35,173,743
Operating expense ^(a)			
Vessel operating expenses		8,679,973	8,514,394
Depreciation expenses		10,938,752	11,465,923
Management fee	9(a)	300,000	330,050
Commission		621,237	728,265
Administrative expenses		76,019	178,898
Total operating expense		20,615,981	21,217,530
Operating income		11,209,583	13,956,213
Other income/(expense) ^(a)			
Interest income		207,624	153,558
Interest expense		(7,843,283)	(5,100,899)
Write off of deferred loan costs	6(f)		(1,206,915)
Changes in fair value of derivative financial instruments	7	10,777,913	(4,899,212)
Others, net		(12,490)	(179,848)
Total other income/(expense)		3,129,764	(11,233,316)
Income before income taxes		14,339,347	2,722,897
Income taxes			
Net income		14,339,347	2,722,897

(a) Includes the following income/expenses resulting from transactions with related parties (see note 9(a)):

	2009	2010
Vessel operating expenses		
Agency fee	600,000	600,000
Management fee	300,000	330,050
Interest income	184,912	126,046
Interest expense, net of amounts capitalized	1,537,400	1,579,552

See accompanying notes to the unaudited condensed combined financial statements.
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Vessel Owning Subsidiaries

Unaudited Condensed Combined Statements of Shareholders Equity
for the six month periods ended June 30, 2009 and 2010
(expressed in US\$)

	Paid-in capital	Retained earnings	Total shareholders equity
Balance as of January 1, 2009	15	(3,820,639)	(3,820,624)
Net income		14,339,347	14,339,347
Dividend paid		(4,000,000)	(4,000,000)
Balance as of June 30, 2009	15	6,518,708	6,518,723
Balance as of January 1, 2010	15	14,854,739	14,854,754
Net income		2,722,897	2,722,897
Balance as of June 30, 2010	15	17,577,636	17,577,651

See accompanying notes to the unaudited condensed combined financial statements.

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Vessel Owning Subsidiaries

Unaudited Condensed Combined Statements of Cash Flows
for the six month periods ended June 30, 2009 and 2010

(expressed in US\$)

	2009	2010
<i>Cash flows from operating activities</i>		
Net income	14,339,347	2,722,897
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expenses	10,938,752	11,465,923
Amortization of deferred loan costs	148,436	112,445
Amortization of loan premium	(36,993)	(36,993)
Expenditure relating to drydocking	(5,001,428)	
Amortization of deferred revenue	(1,232,948)	
Write off of deferred loan costs		1,206,915
Change in fair value of derivative financial instruments (net of cash settlement payment of \$3,274,528 in 2010)	(10,777,913)	1,624,684
Changes in operating assets and liabilities:		
Trade accounts receivable	869,424	(858,807)
Prepayments and other receivables	(2,648,978)	242,855
Amounts due from related parties	1,267,853	(228,768)
Supplies	(81,988)	(997,915)
Accrued liabilities and other payables	3,411,514	(2,100,336)
Amounts due to related parties	4,528,035	2,795,321
Net cash provided by operating activities	15,723,113	15,948,221
<i>Cash flows from investing activities:</i>		
Capital expenditure on vessels under construction	(4,729,758)	(57,501,356)
Increase in restricted cash	(554,136)	(7,857,356)
Net cash used in investing activities	(5,283,894)	(65,358,712)
<i>Cash flows from financing activities:</i>		
Proceeds from long-term bank loans		90,000,000
Repayment of long-term bank loans	(18,625,000)	(69,779,200)
Proceeds from loans from a related party	3,835,714	24,926,718
Dividend paid	(4,000,000)	
Payment of loan costs	(189,068)	(334,941)
Net cash (used in)/provided by financing activities	(18,987,354)	44,812,577
Net decrease in cash	(8,539,135)	(4,597,914)

An excess supply of jackups and other mobile offshore drilling units currently exists in the U.S. Gulf Coast. If industry conditions improve, inactive rigs that are not currently being marketed could be reactivated to meet an increase in demand for drilling rigs. Improved market

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conditions, particularly relative to other drilling market segments, could also lead to jackups and other mobile offshore drilling units being moved into the U.S. Gulf Coast or could lead to increased rig construction and rig upgrade programs by our competitors. Some of our competitors have already announced plans to upgrade existing equipment or build additional jackups with higher specifications than our jackups. A significant increase in the supply of jackup rigs or other mobile offshore drilling units could adversely affect both utilization and dayrates.

Our ability to move our rigs to other regions is limited.

Most jackup and submersible rigs can be moved from one region to another, and in this sense the marine contract drilling market is a global market. The demand/supply balance for jackup and submersible rigs may

vary somewhat from region to region, because the cost of a rig move is significant, there is limited availability of rig moving vessels and some rigs are designed to work in specific regions. However, significant variations between regions tend not to exist on a long-term basis due to the ability to move rigs. Because many of our rigs were designed for drilling in the U.S. Gulf Coast, our ability to move our rigs to other regions in response to changes in market conditions is limited. In addition, in the master separation agreement, we agree not to compete with Transocean in specified geographic locations. See *Certain Relationships and Related Party Transactions Relationship Between Us and Transocean Master Separation Agreement Noncompetition and Other Covenants*.

Our jackup rigs are at a relative disadvantage to higher specification rigs.

Many of our competitors have jackup fleets with generally higher specification rigs than those in our jackup fleet. Particularly during market downturns when there is decreased rig demand, higher specification jackups and other rigs may be more likely to obtain contracts than lower specification jackups. As a result, our lower specification jackups have in the past been stacked earlier in the cycle of decreased rig demand than most of our competitors' jackups and have been reactivated later in the cycle. This pattern has adversely impacted our business and could be repeated. In addition, higher specification rigs have greater flexibility to move to areas of demand in response to changes in market conditions. Furthermore, in recent years, an increasing amount of exploration and production expenditures have been concentrated in deep water drilling programs and deeper formations, including deep gas prospects, requiring higher specification jackups, semisubmersible drilling rigs or drillships. This trend is expected to continue and could result in a decline in demand for lower specification jackup rigs like ours.

Our business involves numerous operating hazards, and we are not fully insured against all of them.

Our operations are subject to the usual hazards inherent in the drilling of oil and gas wells, such as blowouts, reservoir damage, loss of production, loss of well control, punchthroughs, craterings, fires and pollution. The occurrence of these events could result in the suspension of drilling operations, claims by the operator, damage to or destruction of the equipment involved and injury or death to rig personnel. We may also be subject to personal injury and other claims of rig personnel as a result of our drilling operations. Operations also may be suspended because of machinery breakdowns, abnormal drilling conditions, failure of subcontractors to perform or supply goods or services and personnel shortages. In addition, offshore and inland marine drilling operators are subject to perils peculiar to marine operations, including capsizing, grounding, collision and loss or damage from severe weather. Damage to the environment could also result from our operations, particularly through oil spillage or extensive uncontrolled fires. We may also be subject to property, environmental and other damage claims by oil and gas companies. Our insurance policies and contractual rights to indemnity may not adequately cover losses, and we may not have insurance coverage or rights to indemnity for all risks. Moreover, pollution and environmental risks generally are not totally insurable.

Following the terrorist attacks on September 11, 2001, insurance underwriters increased insurance premiums for many of the coverages historically maintained and issued general notices of cancellation to their customers for war risk, terrorism and political risk insurance in respect of a wide variety of insurance coverages, including liability and aviation coverages. Insurance markets are volatile and the cost of insurance has generally increased significantly for most companies in 2003 compared to prior years. We increased our insurance deductibles in 2003 to mitigate these rising costs. Insurance premiums and/or deductibles could be increased further or coverages may be unavailable in the future.

If a significant accident or other event, including terrorist acts, war, civil disturbances, pollution or environmental damage, occurs and is not fully covered by insurance or a recoverable indemnity from a customer, it could adversely affect our financial position or results of operations. Moreover, we may not be able to maintain adequate insurance in the future at rates we consider reasonable or be able to obtain insurance against certain risks.

We are subject to litigation.

We are also from time to time involved in a number of litigation matters, including, among other things, contract disputes, personal injury, environmental, asbestos and other toxic tort, employment, tax and securities litigation, and other litigation that arises in the ordinary course of our business. Litigation may have an adverse effect on us because of potential adverse outcomes, the costs associated with defending the lawsuits, the diversion of our management's resources and other factors.

Failure to retain key personnel could hurt our operations.

We require highly skilled personnel to operate and provide technical services and support for our drilling rigs. To the extent that demand for drilling services and the number of operating rigs increases, shortages of qualified personnel could arise, creating upward pressure on wages and difficulty in staffing rigs.

Loss of key management could hurt our operations.

Our success is to a considerable degree dependent on the services of our key management, including Jan Rask, our President and Chief Executive Officer. The loss of any member of our key management could adversely affect our results of operations.

Unionization efforts could increase our costs or limit our flexibility.

A small percentage of our employees worldwide work under collective bargaining agreements, all of whom work in Venezuela and Trinidad. Efforts have been made from time to time to unionize other portions of our workforce, including workers in the Gulf of Mexico. Any such unionization could increase our costs or limit our flexibility.

Governmental laws and regulations may add to our costs or limit drilling activity.

Our operations are affected in varying degrees by governmental laws and regulations. The drilling industry is dependent on demand for services from the oil and gas industry and, accordingly, is also affected by changing tax and other laws relating to the energy business generally. We may be required to make significant capital expenditures to comply with laws and regulations. It is also possible that these laws and regulations may in the future add significantly to operating costs or may limit drilling activity.

Compliance with or a breach of environmental laws can be costly and could limit our operations.

Our operations are subject to regulations that require us to obtain and maintain specified permits or other governmental approvals, control the discharge of materials into the environment, require the removal and cleanup of materials that may harm the environment or otherwise relate to the protection of the environment. For example, as an operator of mobile offshore drilling units in navigable U.S. waters and some offshore areas, we may be liable for damages and costs incurred in connection with oil spills or other unauthorized discharges of chemicals or wastes resulting from those operations. Laws and regulations protecting the environment have become more stringent in recent years, and may in some cases impose strict liability, rendering a person liable for environmental damage without regard to negligence or fault on the part of such person. Some of these laws and regulations may expose us to liability for the conduct of or conditions caused by others or for acts that were in compliance with all applicable laws at the time they were performed. The application of these requirements or the adoption of new requirements could have a material adverse effect on our financial position or results of operations.

Our non-U.S. operations involve additional risks not associated with our U.S. operations.

We operate in regions that may expose us to political and other uncertainties, including risks of:

terrorist acts, war and civil disturbances,

expropriation or nationalization of equipment, and

the inability to repatriate income or capital.

Our insurance policies and indemnity provisions in our drilling contracts generally do not protect us from loss of revenue. If a significant accident or other event occurs and is not fully covered by insurance or a recoverable indemnity from a customer, it could adversely affect our financial position or results of operations.

Many governments favor or effectively require the awarding of drilling contracts to local contractors or require foreign contractors to employ citizens of, or purchase supplies from, a particular jurisdiction. These practices may adversely affect our ability to compete.

Our non-U.S. contract drilling operations are subject to various laws and regulations in countries in which we operate, including laws and regulations relating to the equipment and operation of drilling units, currency conversions and repatriation, oil and gas exploration and development, taxation of offshore earnings and earnings of expatriate personnel, the use of local employees and suppliers by foreign contractors and duties on the importation and exportation of drilling units and other equipment. Governments in some foreign countries have become increasingly active in regulating and controlling the ownership of concessions and companies holding concessions, the exploration for oil and gas and other aspects of the oil and gas industries in their countries. In some areas of the world, this governmental activity has adversely affected the amount of exploration and development work done by major oil and gas companies and may continue to do so. Operations in less developed countries can be subject to legal systems which are not as mature or predictable as those in more developed countries, which can lead to greater uncertainty in legal matters and proceedings.

Another risk inherent in our operations is the possibility of currency exchange losses where revenues are received and expenses are paid in foreign currencies. We may also incur losses as a result of an inability to collect revenues because of a shortage of convertible currency available to the country of operation.

Our Venezuela operations are subject to adverse political and economic conditions, and our Venezuelan lake barges would require substantial refurbishment to return to service.

A portion of our operations is conducted in the Republic of Venezuela, which has been experiencing political and economic turmoil, including labor strikes and demonstrations. The implications and results of the political, economic and social instability in Venezuela are uncertain at this time, but the instability could have an adverse effect on our business. Depending on future developments, we could decide to cease operations in Venezuela. Venezuela also imposes foreign exchange controls that limit our ability to convert local currency into U.S. dollars and transfer excess funds out of Venezuela. Although our current drilling contracts in Venezuela call for a significant portion of our dayrates to be paid in U.S. dollars, changes in existing regulation or the interpretation or enforcement of those regulations could further restrict our ability to receive U.S. dollar payments. The exchange controls could also result in an artificially high value being placed on the local currency. None of our lake barges in Venezuela have operated since January 2000. If or when those barges will return to work is uncertain, and all of these barges would require substantial refurbishment to be ready for service.

Risks Related to Our Principal Stockholder Transocean

Transfers of our common stock by Transocean could adversely affect your rights as a stockholder and cause our stock price to decline and could affect our ability to engage in major acquisitions, mergers or other growth opportunities.

Transocean will be permitted to transfer a controlling interest in us without allowing you to participate or realize a premium for your shares of common stock. For a description of Transocean's current plans with respect to our common stock that it will continue to own after the closing of this offering, see [Shares Eligible for Future Sale](#). A sale of a controlling interest to a third party may adversely affect the market price of our common stock and our business and results of operations because the change in control may result in a change of management decisions and business policy.

We have agreed to use our best efforts to register shares of our common stock held by Transocean for public sale under the Securities Act. See Certain Relationships and Related Party Transactions Relationship Between Us and Transocean Registration Rights Agreement. Disclosure requirements in connection with the registration of such shares could affect our ability to engage in major acquisitions, mergers or other growth opportunities.

We will be controlled by Transocean as long as it owns a majority of the voting power of our outstanding common stock, and other stockholders will be unable to affect the outcome of stockholder voting during that time.

As long as Transocean owns, directly or indirectly, a majority of the voting power of our outstanding common stock, Transocean will be able to exert significant control over us, including the ability to elect or remove and replace our entire board of directors and take other actions without calling a special meeting. Other stockholders, by themselves, will not be able to affect the outcome of any stockholder vote. As a result, Transocean, subject to any fiduciary duty owed to our minority stockholders under Delaware law, will be able to control all matters affecting us, including:

the composition of our board of directors and, through it, any determination with respect to our business direction and policies, including the appointment and removal of officers,

the determination of incentive compensation, which may affect our ability to retain key employees,

the allocation of business opportunities between Transocean and us,

any determinations with respect to mergers or other business combinations,

our acquisition or disposition of assets,

our financing decisions and our capital raising activities,

the payment of dividends on our common stock,

amendments to our amended and restated certificate of incorporation or bylaws, and

determinations with respect to our tax returns.

In addition, Transocean may enter into credit agreements, indentures or other contracts that limit our activities and the activities of Transocean's other subsidiaries. Transocean's representatives on our board could direct our business so as not to breach any of these agreements.

Transocean is generally not prohibited from selling a controlling interest in us to a third party. Because of exemptions granted under our rights agreement and because we have elected not to be subject to Section 203 of the General Corporation Law of the State of Delaware, Transocean, as a controlling stockholder, may find it easier to sell its controlling interest to a third party than if we had not taken such actions. See Description of Capital Stock Delaware Business Combination Statute for a description of Section 203 and the potential positive and negative consequences, depending on the circumstances, of electing not to be subject to it.

Our interests may conflict with those of Transocean with respect to our past and ongoing business relationships, and because of Transocean's controlling ownership, we may not be able to resolve these conflicts on terms commensurate with those possible in arms-length transactions.

Our interests may conflict with those of Transocean in a number of areas relating to our past and ongoing relationships, including:

the solicitation and hiring of employees from each other,

the timing and manner of any sales or distributions by Transocean of all or any portion of its ownership interest in us,

agreements with Transocean and its affiliates relating to corporate services that may be material to our business,

business opportunities that may be presented to Transocean and to our officers and directors associated with Transocean, competition between Transocean and us within the same lines of business, and our dividend policy.

We may not be able to resolve any potential conflicts with Transocean, and even if we do, the resolution may be less favorable than if we were dealing with an unaffiliated party. Our certificate of incorporation provides that Transocean has no duty to refrain from engaging in activities or lines of business similar to ours and that Transocean and its officers and directors will not be liable to us or our stockholders for failing to present specified corporate opportunities to us. See Description of Capital Stock Transactions and Corporate Opportunities. In addition, in the master separation agreement, we agree not to compete with Transocean in specified lines of business. See Certain Relationships and Related Party Transactions Relationship Between Us and Transocean Master Separation Agreement and Noncompetition and Other Covenants.

The terms of our separation from Transocean, the related agreements and other transactions with Transocean were determined in the context of a parent-subsidiary relationship and thus may be less favorable to us than the terms we could have obtained from an unaffiliated third party.

Transactions and agreements entered into after our acquisition by Transocean and on or before the closing of the IPO presented conflicts between our interests and those of Transocean. These transactions and agreements included the following:

agreements related to the separation of our business from Transocean that provide for, among other things, the assumption by us of liabilities related to our business, the assumption by Transocean of liabilities unrelated to our business, our respective rights, responsibilities and obligations with respect to taxes and tax benefits and the terms of our various interim and ongoing relationships, as described under Certain Relationships and Related Party Transactions Relationship Between Us and Transocean,

the transfer to Transocean of assets that were not related to our business, as described under Certain Relationships and Related Party Transactions Asset Transfers to Transocean, Relationship Between Us and Transocean Master Separation Agreement TODCO Business, and Transfer of Assets and Assignment of Liabilities, and

charters of drilling units with Transocean, borrowings from Transocean, administrative support services provided by Transocean to us and other transactions with Transocean, as described under Certain Relationships and Related Party Transactions.

Because these transactions and agreements were entered into in the context of a parent-subsidiary relationship, their terms may be less favorable to us than the terms we could have obtained from an unaffiliated third party. In addition, while we are controlled by Transocean, it is possible for Transocean to cause us to amend these agreements on terms that may be less favorable to us than the current terms of the agreements. We may not be able to resolve any potential conflict, and even if we do, the resolution may be less favorable than if we were dealing with an unaffiliated party. See Certain Relationships and Related Party Transactions Relationship Between Us and Transocean.

Some of our executive officers and directors may have potential conflicts of interest because of their ownership of Transocean ordinary shares or their role as directors or executive officers of Transocean.

Some of our executive officers and directors own Transocean ordinary shares or options to purchase Transocean ordinary shares which are of greater value than their ownership of our common stock and options. Ownership of Transocean ordinary shares by our directors and executive officers could create, or appear to create, potential conflicts of interest when directors and executive officers are faced with decisions that could have different implications for Transocean than they do for us.

Several of our directors also serve as directors or executive officers of Transocean. These directors owe fiduciary duties to the shareholders of each company. As a result, in connection with any transaction or other relationship involving both companies, these directors may need to recuse themselves and not participate in any board action relating to these transactions or relationships.

Our tax sharing agreement with Transocean Holdings could require substantial payments by us in the event that a third party becomes the owner of a majority of our voting power or any of our subsidiaries are deconsolidated.

Our tax sharing agreement with Transocean Holdings provides that we must pay Transocean Holdings for substantially all pre-closing tax benefits utilized subsequent to the closing of the IPO. See *Certain Relationships and Related Party Transactions Relationship Between Us and Transocean Tax Sharing Agreement*. As of June 30, 2004, we had approximately \$485 million of estimated pre-closing tax benefits subject to our obligation to reimburse Transocean Holdings. This amount includes approximately \$173 million of the tax benefits reflected in our December 31, 2003 historical financial statements and additional tax benefits that resulted from the closing of the IPO, additional tax benefits we expect to result from specified ownership changes, statutory allocations of the tax benefits among Transocean Holdings consolidated group members and other events. Depending upon certain tax planning strategies executed by Transocean during 2004 and actual Transocean taxable income for 2004, this pre-closing tax benefit amount could change. See Note 10 to our condensed consolidated financial statements for the period ended June 30, 2004 included in this prospectus.

Additionally, the tax sharing agreement provides that if any person other than Transocean or its subsidiaries becomes the beneficial owner of greater than 50% of the total voting power of our outstanding voting stock, we will be deemed to have utilized all of these pre-closing tax benefits, and we will be required to pay Transocean Holdings an amount for the deemed utilization of these tax benefits adjusted by a specified discount factor. If an acquisition of beneficial ownership had occurred on June 30, 2004, the estimated amount that we would have been required to pay to Transocean Holdings would have been approximately \$390 million. We may not have the ability to prevent or influence a transaction requiring this payment, particularly in the case of an acquisition by a third party of a substantial amount of voting stock of Transocean. Our requirement to make this payment could have the effect of delaying or preventing a change of control.

Our tax sharing agreement with Transocean Holdings also provides that if any of our subsidiaries that join with us in the filing of consolidated returns ceases to do so, we will be deemed to have used that portion of any pre-closing tax benefits that will be allocable to the subsidiary following that cessation, and we will generally be required to pay Transocean Holdings the amount of this deemed tax benefit, adjusted by a specified discount factor, at the time the subsidiary ceases to join in the filing of these returns.

Payment of amounts for the deemed utilization of tax benefits by us could require additional financing. The amount of our payments to Transocean Holdings will not be adjusted for any difference between the tax benefits that we are deemed to utilize and the tax benefits that we actually utilize, and the difference between these amounts could be substantial. Among other considerations, applicable tax laws may, as a result of another person becoming the owner of greater than 50% of the total voting power of our outstanding voting stock, significantly limit our use of these tax benefits, and these limitations are not taken into account in determining the amount of the payment to Transocean Holdings. Additionally, Transocean Holdings' right to receive this payment could result in a conflict of interest between us and Transocean and for those of our directors who are officers or directors of Transocean in considering any potential transaction.

Our tax sharing agreement with Transocean Holdings could delay or preclude us from realizing tax benefits created after the closing of the IPO.

Our tax sharing agreement with Transocean Holdings provides that we must pay Transocean Holdings for most pre-closing tax benefits that we utilize on a tax return with respect to a period after the closing of the IPO. If the utilization of a pre-closing tax benefit defers or precludes our utilization of any post-closing tax benefit, our payment obligation with respect to the pre-closing tax benefit generally will be deferred until we

actually utilize that post-closing tax benefit. This payment deferral will not apply with respect to, and we will have to pay currently for the utilization of pre-closing tax benefits to the extent of,

up to 20% of any deferred or precluded post-closing tax benefit arising out of our payment of foreign income taxes, and

100% of any deferred or precluded post-closing tax benefit arising out of a carryback from a subsequent year.

Therefore, we may not realize the full economic value of tax deductions, credits and other tax benefits that arise post-closing until we have utilized all of the pre-closing tax benefits, if ever.

Risks Related to Our Separation from Transocean

We anticipate incurring substantial losses during industry downturns and may need additional financing to withstand industry downturns.

Our net losses from continuing operations before cumulative effect of a change in accounting principle were approximately \$222 million, \$529 million and \$30 million during the years ended December 31, 2003 and 2002 and the six months ended June 30, 2004, respectively, and we anticipate incurring substantial losses during future cyclical downturns in our industry. We will not receive any proceeds from this offering. During cyclical downturns in our industry, we may need additional financing in order to satisfy our cash requirements. If we are not able to obtain financing in sufficient amounts and on acceptable terms, we may be required to reduce our business activities, seek financing on unfavorable terms or pursue a business combination with another company.

We do not have a long history of operating as a stand-alone company, we may encounter difficulties in making the changes necessary to operate as a stand-alone company, and we may incur greater costs as a stand-alone company that may adversely affect our results.

Since our merger with Transocean and prior to our separation, Transocean performed various corporate functions for us, including the following:

information technology and communications,

human resource services such as payroll and benefit plan administration,

legal,

tax,

accounting,

office space and office support,

risk management,

treasury and corporate finance, and

investor services, investor relations and corporate communications.

Since the separation, Transocean has no obligation to provide these functions to us other than certain interim services provided by Transocean, which are described in *Certain Relationships and Related Party Transactions Relationship Between Us and Transocean*. Under the transition services agreement, we are required to use Transocean's accounting and information technology systems for so long as Transocean owns at least 50% of the voting power of our voting stock. However, we expect to replace the computerized accounting system provided by Transocean with our own system by January 1, 2005. We have created, or engaged third parties to provide, our own systems and business functions to replace the other systems and business functions Transocean provided prior to our separation. We may incur difficulties in performing these functions and may also incur higher costs for these functions than the amounts we were allocated by Transocean. If we do not have in place our own systems and business functions to replace those currently

provided by Transocean or if we do not have agreements with other providers of these services once our interim services agreement with Transocean expires, we may operate our business less efficiently and our results may suffer.

Risks Related to this Offering, the Securities Markets and Ownership of Our Class A Common Stock

Substantial sales of our common stock by Transocean or us could cause our stock price to decline and issuances by us may dilute your ownership interest in our company.

We are unable to predict whether significant amounts of our common stock will be sold by Transocean after the offering. Any sales of substantial amounts of our common stock in the public market by Transocean or us, or the perception that these sales might occur, could lower the market price of our common stock. For a description of Transocean's current plans with respect to our common stock that it will continue to own after the closing of this offering, see Prospectus Summary Our Relationship With Transocean. Further, if we issue additional equity securities to raise additional capital, your ownership interest in our company may be diluted and the value of your investment may be reduced. Please read Shares Eligible for Future Sale for information about the number of shares that will be outstanding and could be sold after this offering.

The disparate voting rights of our Class A common stock and Class B common stock may adversely affect the value and liquidity of our Class A common stock.

The differential in the voting rights of the Class A common stock and Class B common stock both prior to and following any spin-off, exchange offer or sale of Class B common stock by Transocean could adversely affect the value of our Class A common stock to the extent that investors or any potential future purchaser of our common stock ascribes value to the superior voting rights of our Class B common stock. The existence of two separate classes of common stock could result in less liquidity for either class of common stock than if there were only one class of common stock. In particular, the consummation of a complete spin-off or exchange offer by Transocean of its Class B common stock could result in decreased liquidity for the Class A common stock as investors may prefer the more liquid Class B common stock. This greater liquidity could also cause the Class B common stock to trade at a higher market price than the Class A common stock.

We have no plans to pay regular dividends on our common stock, so stockholders may not receive funds without selling their common stock.

We have no plans to pay regular dividends on our common stock. We generally intend to invest our future earnings, if any, to fund our growth. Any payment of future dividends will be at the discretion of our board of directors and will depend on, among other things, our earnings, financial condition, capital requirements, level of indebtedness, statutory and contractual restrictions applying to the payment of dividends, and other considerations that our board of directors deems relevant. Our credit facility also includes limitations on our payment of dividends. Accordingly, investors may have to sell some or all of their common stock in order to generate cash flow from their investment. Investors may not receive a gain on their investment when they sell our common stock and may lose the entire amount of the investment.

The price of our Class A common stock may be volatile.

The market price of our Class A common stock could be subject to significant fluctuations after this offering and may decline below the initial public offering price. You may not be able to resell your shares at or above the initial public offering price. Among the factors that could affect our stock price are:

our operating and financial performance and prospects,

quarterly variations in the rate of growth of our financial indicators, such as earnings per share, net income and revenues,

changes in revenue or earnings estimates,

publication of research reports by analysts,

speculation in the press or investment community,

strategic actions by us or our competitors, such as acquisitions or restructurings,

sales of our common stock by stockholders,

actions by institutional investors or by Transocean,

fluctuations in oil and gas prices,

general market conditions, and

U.S. and international economic, legal and regulatory factors unrelated to our performance.

The stock markets in general have experienced extreme volatility that has at times been unrelated to the operating performance of particular companies. These broad market fluctuations may adversely affect the trading price of our common stock.

Our rights agreement, provisions in our charter documents or Delaware law may inhibit a takeover, which could adversely affect the value of our Class A common stock.

Our amended and restated certificate of incorporation, bylaws and rights agreement, as well as Delaware corporate law, contain provisions that could delay or prevent a change of control or changes in our management that a stockholder might consider favorable. Many of these provisions, though not our rights agreement, become effective at the time Transocean ceases to own a majority of the voting power of our outstanding common stock. These provisions apply even if the offer may be considered beneficial by some of our stockholders. If a change of control or change in management is delayed or prevented, the market price of our Class A common stock could decline.

Purchasers in this offering will experience immediate and substantial dilution in net tangible book value per share.

Dilution per share represents the difference between the offering price and the net consolidated book value per share immediately after the offering of our Class A common stock. Purchasers of our common stock in this offering will experience immediate dilution of \$7.71 in net tangible book value per share as of June 30, 2004, based on the offering price of \$15.75 per share.

CAUTIONARY STATEMENT ABOUT FORWARD-LOOKING STATEMENTS

This prospectus contains both historical and forward-looking statements. All statements other than statements of historical fact are, or may be deemed to be, forward-looking statements. Forward-looking statements include information concerning our possible or assumed future financial performance and results of operations, including statements about the following subjects:

our strategy,

improvement in the fundamentals of the oil and gas industry,

the supply and demand imbalance in the oil and gas industry,

the correlation between demand for our rigs and our earnings and customers' expectations of energy prices,

our plans, expectations and any effects of focusing on marine assets and drilling for natural gas along the U.S. Gulf Coast, pursuing efficient, low-cost operations and a disciplined approach to capital spending, maintaining high operating standards and maintaining a conservative capital structure,

the emergence of the drilling industry from a low point in the cycle,

expected revenues, operating income (loss) and net income (loss) from continuing operations for the remainder of 2004,

estimated tax benefits,

expected capital expenditures,

expected general and administrative expense,

refurbishment costs,

our ability to take advantage of opportunities for growth and our ability to respond effectively to market downturns,

sufficiency of funds for required capital expenditures, working capital and debt service,

deep gas drilling opportunities,

operating standards,

payment of dividends,

competition for drilling contracts,

matters relating to derivatives,

matters related to our letters of credit and surety bonds,

future restructurings,

matters relating to our future transactions, agreements and relationship with Transocean,

payments under agreements with Transocean,

interests conflicting with those of Transocean,

effects of Hurricane Ivan,

results and effects of legal proceedings,

future utilization rates,

future dayrates, and

expectations regarding improvements in offshore drilling activity, demand for our drilling rigs, our plan to operate primarily in the U.S. Gulf Coast, operating revenues, operating and maintenance expense, insurance expense and deductibles, interest expense, debt levels and other matters with regard to outlook.

Forward-looking statements in this prospectus are identifiable by use of the following words and other similar expressions:

anticipate,

believe,

budget,

could,

estimate,

expect,

forecast,

intent,

may,

might,

plan,

potential,

predict,

project, and

should.

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The following factors could affect our future results of operations and could cause those results to differ materially from those expressed in the forward-looking statements included in this prospectus:

worldwide demand for oil and gas,

exploration success by producers,

demand for offshore and inland water rigs,

our ability to enter into and the terms of future contracts,

labor relations,

political and other uncertainties inherent in non-U.S. operations (including exchange controls and currency fluctuations),

the impact of governmental laws and regulations,

the adequacy of sources of liquidity,

uncertainties relating to the level of activity in offshore oil and gas exploration and development,

oil and natural gas prices (including U.S. natural gas prices),

competition and market conditions in the contract drilling industry,

work stoppages,

the availability of qualified personnel,

operating hazards,

war, terrorism and cancellation or unavailability of insurance coverage,

compliance with or breach of environmental laws,

the effect of litigation and contingencies,

our inability to achieve our plans or carry out our strategy,

the matters discussed in Risk Factors, and

other factors discussed in this prospectus.

Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those indicated. You should not place undue reliance on forward-looking statements. Each forward-looking statement speaks only as of the date of the particular statement, and we undertake no obligation to publicly update or revise any forward-looking statements.

USE OF PROCEEDS

We will not receive any proceeds from the sale of our Class A common stock by the selling stockholders in this offering.

DIVIDEND POLICY

We do not intend to declare or pay regular dividends on our common stock in the foreseeable future. Instead, we generally intend to invest any future earnings in our business. Subject to Delaware law, our board of directors will determine the payment of future dividends on our common stock, if any, and the amount of any dividends in light of:

any applicable contractual restrictions limiting our ability to pay dividends,

our earnings and cash flows,

our capital requirements,

our financial condition, and

other factors our board of directors deems relevant.

Our credit facility includes limitations on our payment of dividends. We have not paid any dividends since the completion of our IPO in February 2004.

MARKET INFORMATION

Our Class A common stock is listed on the New York Stock Exchange under the symbol THE. As of September 1, 2004, there were approximately 2,123 holders of our Class A common stock. We have presented in the table below, for the periods indicated, the reported high and low sales prices for our Class A common stock on the New York Stock Exchange.

Calendar Period	Price Per Share of Our Class A Common Stock	
	High	Low
2004		
First Quarter (starting February 5)	\$ 16.45	\$ 13.10
Second Quarter	16.05	13.38
Third Quarter (through September 15)	16.15	13.40

DILUTION

The net tangible book value per share of our common stock will be substantially below the offering price. You will therefore incur immediate and substantial dilution of \$7.71 per share, based on the offering price of \$15.75 per share. As a result, if we are liquidated, you may not receive the full value of your investment.

Dilution in net tangible book value per share represents the difference between the amount per share of our common stock that you pay in this offering and the net tangible book value per share of our common stock. Net tangible book value per share represents (1) the total net tangible assets divided by (2) the number of shares of our common stock outstanding.

Our net tangible book value at June 30, 2004 was \$484.6 million, or \$8.04 per share. This amount represents an immediate dilution in net tangible book value of \$7.71 per share to you. The following table illustrates this dilution per share:

Public offering price per share	\$ 15.75
Net tangible book value per share as of June 30, 2004	8.04
	<hr/>
Dilution per share to you	\$ 7.71
	<hr/>

CAPITALIZATION

The following table sets forth our capitalization as of June 30, 2004. We will not receive any proceeds from this offering.

	June 30, 2004
	(In millions, except share data)
Debt due within one year	\$ 10.8
Long-term debt	17.0
	<hr/>
Total debt	27.8
Shareholders' equity:	
Common stock, \$.01 par value: 500,000,000 shares of Class A common stock authorized, 14,104,448 shares issued and outstanding actual, and 29,702,890 shares issued and outstanding as adjusted for this offering, and 260,000,000 shares of Class B common stock authorized, 46,200,000 shares issued and outstanding actual, and 30,600,000 shares issued and outstanding as adjusted for this offering	0.6
Additional paid-in capital	6,516.0
Retained deficit	(6,028.4)
Unearned compensation	(3.6)
	<hr/>
Shareholders' equity	484.6
	<hr/>
Total capitalization	\$ 512.4
	<hr/>

SELECTED HISTORICAL FINANCIAL DATA

We prepared the selected historical financial data in the following table using our consolidated financial statements. We prepared the historical statement of operations data for the years ended December 31, 2000, 2002 and 2003, the one month ended January 31, 2001 and the eleven months ended December 31, 2001 and the consolidated balance sheet data as of December 31, 2000, 2001, 2002 and 2003 from our financial statements, which have been audited by Ernst & Young LLP, independent registered public accounting firm. We prepared the historical statement of operations data for the year ended December 31, 1999 and the six months ended June 30, 2003 and 2004 and the historical balance sheet data as of December 31, 1999 and June 30, 2004 from our unaudited condensed consolidated financial statements, which, in the case of the June 30, 2004 and 2003 data, in the opinion of our management, include all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the results for the unaudited interim periods.

The selected historical financial data should be read in conjunction with our consolidated financial statements and the related notes included in this prospectus.

On January 31, 2001, we became a wholly owned subsidiary of Transocean as a result of our merger transaction with Transocean. The merger was accounted for as a purchase, with Transocean as the accounting acquiror. The purchase price was allocated to our assets and liabilities based on their estimated fair values on the date of the merger with the excess accounted for as goodwill. The purchase price adjustments were pushed down to our consolidated financial statements. Accordingly, our financial statements for periods subsequent to January 31, 2001 are not comparable to those of prior periods in material respects since those financial statements report financial position, results of operations and cash flows using a different basis of accounting.

Pre-Transocean Merger			Post-Transocean Merger				
Years Ended December 31,		One Month Ended January 31,	Eleven Months Ended December 31,	Years Ended December 31,		Six Months Ended June 30,	
1999	2000	2001	2001	2002	2003	2003	2004

(In millions, except per share data)

Historical Statement of Operations Data:

Operating revenues	\$ 406.5	\$ 406.1	\$ 48.5	\$441.0	\$ 187.8	\$ 227.7	\$ 108.8	\$ 154.6
Operating and maintenance expense	324.2	317.4	23.2	270.0	185.7	227.4	122.0	128.0
Loss from continuing operations before cumulative effect of a change in accounting principle	(139.0) ^(a)	(131.9)	(90.1) ^(b)	(96.7) ^(c)	(529.1) ^(d)	(222.0) ^(e)	(158.7) ^(f)	(29.7) ^(g)
Loss from continuing operations before cumulative effect of a change in accounting principle and after preferred share dividends per common share basic and diluted	\$ (0.90)	\$ (1.72)	\$ (0.43)	\$ (7.96)	\$ (43.57)	\$ (18.28)	\$ (13.07)	\$ (0.58)
Weighted average common shares outstanding:								
Basic	192.7	196.6	211.3	12.1	12.1	12.1	12.1	51.3

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Diluted	192.7	196.6	211.3	12.1	12.1	12.1	12.1	51.3
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	Pre-Transocean Merger		Post-Transocean Merger			
	As of December 31,		As of December 31,			As of June 30,
	1999	2000	2001	2002	2003	2004
	(In millions)					
Balance Sheet Data:						
Total assets	\$4,924.3	\$4,804.4	\$8,838.8	\$2,227.2	\$778.2	\$756.7
Long-term debt (including current portion) and redeemable preferred shares	2,979.5	2,702.9	1,538.0	40.7	26.8	24.8
Long-term debt related party (including current portion)			55.0	1,080.1	525.0	3.0
Total shareholders equity	1,194.7	1,373.5	6,496.5	561.9	137.7	484.6

- (a) Included in 1999 is a \$2.6 million loss on retirement of debt.
- (b) Included in the one month ended January 31, 2001 are \$58.1 million of merger related expenses and a \$64.0 million impairment loss on long-lived assets related to the disposal of the inland marine support vessel business.
- (c) Included in the eleven months ended December 31, 2001 are a \$1.1 million impairment loss on long-lived assets and a \$27.5 million loss on retirement of debt.
- (d) Included in 2002 are a \$17.5 million impairment loss on long-lived assets, a \$381.9 million goodwill impairment and a \$18.8 million loss on retirement of debt.
- (e) Included in 2003 is a \$11.3 million impairment loss on long-lived assets, a \$21.3 million impairment loss on a note receivable from an unconsolidated joint venture and a \$79.5 million loss on retirement of debt.
- (f) Included in the six months ended June 30, 2003 is an \$11.6 million impairment loss on long-lived assets, a \$79.5 million loss on retirement of debt and a \$21.3 million impairment of an investment in and advance to a joint venture.
- (g) Included in the six months ended June 30, 2004 is a \$1.9 million loss on retirement of debt and a \$4.6 million gain on disposal of assets.

UNAUDITED PRO FORMA FINANCIAL INFORMATION

Background

We have completed our IPO and the separation of our business from Transocean. See Certain Relationships and Related Party Transactions Asset Transfers to Transocean, Relationship Between Us and Transocean Master Separation Agreement TODCO Business, Transfer of Assets and Assignment of Liabilities and Working Capital and Tax Sharing Agreement. Before the closing of our IPO in February 2004, we completed the retirement of all of our notes payable to Transocean in exchange for newly issued shares of our Class B common stock (the retirement), as described under Certain Relationships and Related Party Transactions Debt Retirement and Debt Exchange Offers.

How We Prepared the Unaudited Pro Forma Financial Information

A pro forma balance sheet is not included since there are no pro forma balance sheet adjustments necessary as of June 30, 2004. The pro forma results of operations for the six months ended June 30, 2004 and for the year ended December 31, 2003 reflect our continuing operations and assume the retirement was completed on January 1, 2003.

The pro forma information does not necessarily indicate what the operating results or financial position would have been if the retirement and the completion of the separation of our business from Transocean had been completed at the dates indicated. Moreover, this information does not necessarily indicate what our future operating results or financial position will be.

We derived this information from our financial statements for the periods presented. The information is only a summary, and you should read it in conjunction with the other financial information included elsewhere in this prospectus.

Offering-Related Expenses

The third-party expenses related to this offering will be borne by Transocean.

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UNAUDITED CONDENSED PRO FORMA CONSOLIDATED STATEMENT OF OPERATIONS

For the Six Months Ended June 30, 2004

	Pro Forma		
	Historical	Retirement Adjustments ^(a)	Pro Forma Consolidated
	(In millions, except per share data)		
Operating revenues	\$ 154.6	\$	\$ 154.6
Costs and expenses			
Operating and maintenance	128.0		128.0
Depreciation	48.2		48.2
General and administrative ^(b)	19.3		19.3
General and administrative related party	0.3		0.3
Gain from disposal of assets	(4.6)		(4.6)
	<u>191.2</u>	<u>—</u>	<u>191.2</u>
Operating loss	(36.6)	<u>—</u>	(36.6)
Other income (expense)			
Interest income	0.1		0.1
Interest expense	(5.2)	3.1	(2.1)
Loss on retirement of debt ^(c)	(1.9)		(1.9)
Other, net	0.6		0.6
	<u>(6.4)</u>	<u>3.1</u>	<u>(3.3)</u>
Income (loss) from continuing operations before income taxes and minority interest	(43.0)	3.1	(39.9)
Income tax benefit	(13.3)	1.1	(12.2)
Net loss from continuing operations	\$ (29.7)	\$2.0	\$ (27.7)
Net loss from continuing operations per share basic and diluted	\$ (0.58)		\$ (0.46)
Weighted average shares outstanding basic and diluted ^(d)	51.3		60.3

See Notes to Unaudited Condensed Pro Forma Consolidated Financial Statements.

TODCO

UNAUDITED CONDENSED PRO FORMA CONSOLIDATED STATEMENT OF OPERATIONS

For the Year Ended December 31, 2003

	Pro Forma		
	Historical	Retirement Adjustments ^(a)	Pro Forma Consolidated
	(In millions, except per share data)		
Operating revenues	\$ 227.7	\$	\$ 227.7
Costs and expenses			
Operating and maintenance	215.7		215.7
Operating and maintenance related party	11.7		11.7
Depreciation	92.2		92.2
General and administrative	14.9		14.9
General and administrative related party	1.4		1.4
Impairment loss on long-lived assets	11.3		11.3
Gain from disposal of assets, net	(0.8)		(0.8)
	<u>346.4</u>		<u>346.4</u>
Operating loss	(118.7)		(118.7)
Other income (expense)			
Equity in loss of joint ventures	(6.6)		(6.6)
Interest income	3.9		3.9
Interest expense	(46.5)	44.0	(2.5)
Loss on retirement of debt ^(c)	(79.5)		(79.5)
Impairment of investment in and advance to joint venture	(21.3)		(21.3)
Other, net	(2.8)		(2.8)
	<u>(152.8)</u>	<u>44.0</u>	<u>(108.8)</u>
Income (loss) from continuing operations before income taxes and minority interest	(271.5)	44.0	(227.5)
Income tax benefit	(50.1)	(17.2)	(67.3)
Minority interest	0.6		0.6
Net loss from continuing operations	<u>\$(222.0)</u>	<u>\$ 61.2</u>	<u>\$(160.8)</u>
Net loss from continuing operations per share basic and diluted ^(d)	<u>\$(18.28)</u>		<u>\$ (2.68)</u>
Weighted average shares outstanding basic and diluted	12.1		60.0

See Notes to Unaudited Condensed Pro Forma Consolidated Financial Statements.

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NOTES TO UNAUDITED CONDENSED PRO FORMA

CONSOLIDATED FINANCIAL STATEMENTS

- (a) Pro forma adjustments to our consolidated statements of operations required for the removal of the interest expense related to the retirement of our notes payable to Transocean and the related income tax effect as if the debt for stock exchange transactions had occurred at the beginning of the period. Income taxes for the year ended December 31, 2003 include a \$32.6 million increase in the valuation allowances for net tax operating and other loss carryforwards as a result of the increase in net deferred tax assets during the period. This valuation allowance adjustment was also eliminated in the pro forma adjustment as a result of the increase in net deferred tax liabilities that occurred as a result of the tax sharing agreement. As part of the tax sharing agreement, we must pay Transocean for substantially all pre-closing income tax benefits utilized or deemed to have been utilized subsequent to the closing of the IPO. Accordingly, we recorded an equity transaction in conjunction with the IPO to reflect this liability to Transocean of \$174 million, equal to the pre-closing income tax benefits, as a corresponding obligation within the deferred income tax asset accounts and a reduction in additional paid-in capital. See *Certain Relationships and Related Party Transactions Relationship Between Us and Transocean Tax Sharing Agreement*.
- (b) Restricted stock and stock options were granted to some of our officers on the closing date of the IPO. See *Management Employment Agreements and Change of Control Arrangements*. The value of these stock awards and stock options recognized as compensation expense was \$7.9 million in the six months ended June 30, 2004. An additional \$2.8 million will be recognized during the remainder of 2004, and \$4.8 million and \$1.7 million will be recognized as compensation expense in 2005 and thereafter, respectively. In addition, some of our employees held options to purchase Transocean ordinary shares, and we incurred \$1.5 million of compensation expense on the closing of the IPO as a result of the vesting of these options.
- (c) The loss on retirement of debt of \$79.5 million and \$1.9 million for the year ended December 31, 2003 and the six months ended June 30, 2004, respectively, resulted from the retirement of notes payable to Transocean in conjunction with the transfer of assets not related to our shallow and inland water business to Transocean.
- (d) Pro forma net income (loss) from continuing operations applicable to common shareholders per weighted average share outstanding (basic and diluted) for the year ended December 31, 2003 and the six months ended June 30, 2004 is computed using the total shares outstanding after the retirement.

MANAGEMENT'S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with our historical consolidated financial statements for the year ended December 31, 2003 and unaudited condensed consolidated financial statements for the period ended June 30, 2004 and the related notes included in this prospectus. Except for the historical financial information contained herein, the matters discussed below may be considered forward-looking statements. Please see Cautionary Statement About Forward-Looking Statements for a discussion of the uncertainties, risks and assumptions associated with these statements.

Overview of Our Business

We are a leading provider of contract oil and natural gas drilling services, primarily in the United States (U.S. Gulf of Mexico) shallow water and inland marine region, an area that we refer to as the U.S. Gulf Coast. We provide these services primarily to independent oil and natural gas companies, but we also service major international and government-controlled oil and natural gas companies. Our customers in the U.S. Gulf Coast typically focus on drilling for natural gas.

We provide contract oil and gas drilling and other support services and report the results of those operations in four business segments which, for our contract drilling services, correspond to the principal geographic regions in which we operate:

U.S. Inland Barge Segment Our barge rig fleet currently operating in this market segment consists of 12 conventional and 18 posted barge rigs. These units operate in marshes, rivers, lakes and shallow bay or costal waterways that are known as the transition zone. This area along the U.S. Gulf Coast, where jackup rigs are unable to operate, is the world's largest market for this type of equipment.

U.S. Gulf of Mexico Segment We currently have 19 jackup and three submersible rigs in the U.S. Gulf of Mexico shallow water market segment which begins at the outer limit of the transition zone and extends to water depths of about 350 feet. Our jackup rigs in this market segment consist of independent leg cantilever type units, mat-supported cantilever type rigs and mat-supported slot type jackup rigs that can operate in water depths up to 250 feet.

Other International Segment Our other operations are currently conducted in Mexico, Trinidad and Venezuela. In Mexico, we operate two jackup rigs and are preparing our platform rig to operate for PEMEX, the Mexican national oil company. Additionally, we have two jackup rigs in Trinidad and one in Venezuela, where we also have nine land rigs and three Lake Maracaibo barges. We may pursue selected opportunities in other regions from time to time.

Delta Towing Segment The Company has a partial interest in a joint venture that operates a fleet of U.S. marine support vessels consisting primarily of shallow water tugs, crewboats and utility barges (Delta Towing). We are also a substantial creditor of Delta Towing.

Our operating revenues for our drilling segments are based on dayrates received for our drilling services and the number of operating days during the relevant periods. The level of our operating revenues depends on dayrates, which in turn are primarily a function of industry supply and demand for drilling units in the market segments in which we operate. Supply and demand for drilling units in the U.S. Gulf Coast, which is our primary operating region, has historically been volatile. During periods of high demand, our rigs typically achieve higher utilization and dayrates than during periods of low demand.

Our operating and maintenance costs for our drilling segments represent all direct and indirect costs associated with the operation and maintenance of our drilling rigs. The principal elements of these costs are direct and indirect labor and benefits, freight costs, repair and maintenance, insurance, general taxes and licenses, boat and helicopter rentals, communications, tool rentals and services. Labor, repair and maintenance and insurance costs represent the most significant components of our operating and maintenance costs.

Operating and maintenance expenses may not necessarily fluctuate in proportion to changes in operating revenues because we generally seek to preserve crew continuity and maintain equipment when our rigs are

idle. In general, labor costs increase primarily due to higher salary levels, rig staffing requirements and inflation. Equipment maintenance expenses fluctuate depending upon the type of activity the unit is performing and the age and condition of the equipment. Our current deductible level under our hull and machinery and our protection and indemnity policies is \$10.0 million per occurrence.

Industry Background, Trends and Outlook

The drilling industry in the U.S. Gulf Coast is highly cyclical and is typically driven by general economic activity and changes in actual or anticipated oil and gas prices. We believe that both our earnings and demand for our rigs will typically be correlated to our customers expectations of energy prices, particularly natural gas prices, and that sustained energy price increases will generally have a positive impact on our earnings.

We believe that the drilling industry is emerging from a cyclical low point and that there are several trends that should benefit our operations, including:

Redeployment of Jackup Rigs. Greater demand for jackup rigs in international areas over the last two years has reduced the overall supply of jackups in the U.S. Gulf of Mexico. This has created a more favorable supply environment for the remaining jackups, including ours. This favorable supply environment has led to increased jackup dayrates.

High Natural Gas Prices. While U.S. natural gas prices are volatile, the rolling twelve-month average price of natural gas has generally trended upward from January 1994 to August 2004. We believe high natural gas prices in the United States, if sustained, should result in more exploration and development drilling activity and higher utilization and dayrates for drilling companies like us.

Need for Increased Natural Gas Drilling Activity. From 1994 to 2003, U.S. demand for natural gas grew at an annual rate of 0.6% while its supply grew at an annual rate of 0.2%. We believe that this supply and demand growth imbalance will continue if demand for natural gas continues to increase and production decline rates continue to accelerate. Even though the number of U.S. gas wells drilled has increased overall in recent years, a corresponding increase in production has not been realized. We believe that an increase in U.S. drilling activity will be required for the natural gas industry to meet the expected increased demand for, and compensate for the slowing production of, natural gas in the United States.

Trend Towards Drilling Deeper Shallow Water Gas Wells. A current trend by oil and gas companies is to drill deep gas wells along the U.S. Gulf Coast in search of new and potentially prolific untapped natural gas reserves. We believe that this trend towards deeper drilling will benefit premium jackup rigs as well as barge rigs and submersible rigs that are capable of drilling deep gas wells. In addition, we believe this trend will indirectly benefit conventional jackup fleets as the use of premium rigs in the U.S. Gulf Coast to drill deep wells should reduce the supply of rigs available to drill conventional wells.

Market conditions for our U.S. Gulf Coast jackup fleet improved during the first six months of 2004 as a result of declining rig supply in the region. As of September 1, 2004, our 11 jackup rigs working in the U.S. Gulf Coast were contracted at dayrates ranging from \$27,000 to \$36,000. As of September 1, 2004, our 13 inland barges were contracted at dayrates ranging from \$17,000 to \$28,000. We anticipate that the declining jackup rig supply in the U.S. Gulf Coast will continue to result in improved utilization and higher dayrates over the next several quarters. We also have experienced higher dayrates in our U.S. Gulf Coast barge market since early 2004, although utilization has not risen to previous levels. With respect to our Venezuelan operations, political unrest and exchange controls continue to negatively impact our results of operations there. As a result, we have experienced some decrease in utilization in Venezuela during the second half of 2003 and the first half of 2004.

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The following table shows our average rig revenue per day and utilization for the quarterly periods ending on or prior to June 30, 2004 with respect to each of our three drilling segments. Average revenue per day is defined as operating revenue earned per revenue earning day in the period. Utilization in the table below is defined as the total actual number of revenue earning days in the period as a percentage of the total number of calendar days in the period for all drilling rigs in our fleet, as adjusted to include calendar days available for rigs that were held for sale during the periods ended on or prior to December 31, 2002.

Three Months Ended

	June 30, 2002	September 30, 2002	December 31, 2002	March 31, 2003	June 30, 2003	September 30, 2003	December 31, 2003	March 31, 2004	June 30, 2004
Average Revenue Per Day:									
U.S. Gulf of Mexico Jackups and Submersibles	\$ 19,900	\$ 22,400	\$ 21,000	\$ 22,600	\$ 20,200	\$ 22,900	\$ 26,700	\$ 30,600	\$ 30,700
U.S. Inland Barges	20,200	20,700	19,600	19,100	17,600	18,300	18,700	20,300	22,500
Other International	24,100	23,500	19,400	19,700	19,100	21,000	25,600	40,000	37,500
Utilization:									
U.S. Gulf of Mexico Jackups and Submersibles	29%	32%	34%	31%	44%	54%	50%	43%	50%
U.S. Inland Barges	24%	47%	44%	47%	39%	38%	40%	40%	42%
Other International	27%	23%	27%	35%	44%	38%	28%	29%	29%

In the third quarter of 2003, we were awarded contracts with PEMEX, the Mexican national oil company, for two of our jackup rigs and a platform rig. After upgrades to comply with contract specifications, one rig began operating on a 720-day contract in early November 2003 at a contract dayrate of approximately \$42,000. The other jackup rig began operating in early December 2003 on a 1,081-day contract at a contract dayrate of approximately \$39,000. The cost to prepare the two jackup rigs to work in Mexico, including mobilization costs, which are deferred and will be recognized over the primary contract term, was approximately \$22 million in the aggregate. The platform rig contract is 1,289 days in duration and is anticipated to begin operations in late 2004 at a contract dayrate of approximately \$29,000. We are upgrading the platform rig to comply with PEMEX contract specifications and anticipate the upgrade cost will be approximately \$8 million to \$9 million. Each of the contracts can be terminated by PEMEX on five days' notice, subject to certain conditions.

Another of our jackup rigs began operating in Venezuela in mid-December 2003 under a 120-day contract with ConocoPhillips at a contract dayrate of \$48,000. We currently anticipate that this rig will complete operations in Venezuela during September 2004 and return to the U.S. Gulf of Mexico. The cost of the upgrades to the rig to comply with contract specifications and the cost of mobilization to Venezuela was approximately \$5 million in the aggregate.

In January 2003, we renewed our principal insurance coverages for property damage, liability, and occupational injury and illness. Premiums for such coverages would have increased substantially were it not for us taking significantly higher deductibles. The increased premiums were a result of increased rates demanded by the insurance markets for most insurance coverages as a result of losses the insurance industry has sustained in the past several years and perceived increased risks following the terrorist attacks on September 11, 2001. We renewed these insurance coverages again as of March 1, 2004 for a 14 month period ending May 1, 2005. If our occupational claim experience in 2004 is comparable to 2003, we would not expect a significant increase in our insurance and claims related expense.

IPO and Separation from Transocean

We were incorporated in Delaware on July 7, 1997 as R&B Falcon Corporation. On January 31, 2001, we became an indirect wholly owned subsidiary of Transocean as a result of the merger transaction between us and Transocean (the "Transocean Merger"). The merger was accounted for as a purchase, with Transocean as the accounting acquirer. Accordingly, the purchase price was allocated to our assets and liabilities based on estimated fair values as of January 31, 2001 with the excess accounted for as goodwill. The purchase price adjustments were pushed down to our consolidated financial statements, which affects the comparability of the consolidated financial statements for periods before and after the merger. Accordingly, the financial

statements for the periods ended on or before January 31, 2001 were prepared using our historical basis of accounting and the financial statements for the periods subsequent to January 31, 2001 include the effects of the merger. See Note 4 to our consolidated financial statements included in this prospectus for the year ended December 31, 2003. On December 13, 2002, we changed our name from R&B Falcon Corporation to TODCO.

In July 2002, Transocean announced plans to divest its Gulf of Mexico shallow and inland water (Shallow Water) business through an initial public offering of TODCO. During 2003, we completed the transfer to Transocean of all assets not related to our Shallow Water business (Transocean Assets), including the transfer of all revenue-producing Transocean Assets. Accordingly, the Transocean Assets and related operations have been reflected as discontinued operations in our historical financial statements. See Certain Relationships and Related Party Transactions Asset Transfers to Transocean and Relationship between Us and Transocean Master Separation Agreement TODCO Business and Transfer of Assets and Assignment of Liabilities for a description of the separation of our respective businesses.

In February 2004, we completed the initial public offering of 13,800,000 shares of our Class A common stock (the IPO) as part of our separation from Transocean. We did not receive any proceeds from the initial sale of our Class A common stock.

Transocean currently owns 100% of our outstanding Class B common stock giving it approximately 94% of the combined voting power of our outstanding common stock due to the five votes per share of Class B common stock, as compared to the one vote per share of Class A common stock. Transocean does not own any of our outstanding Class A common stock. Transocean has advised us that its current long term intent is to dispose of our Class B common stock owned by it.

As part of the tax sharing agreement, we must pay Transocean for substantially all pre-closing income tax benefits utilized or deemed to have been utilized subsequent to the closing of the IPO. Accordingly, we recorded an equity transaction in February 2004 to reflect this liability to Transocean of \$174 million, equal to the pre-closing income tax benefits, as a corresponding obligation within the deferred income tax asset accounts and a reduction in additional paid-in capital. In addition, Transocean agreed to indemnify us for certain tax liabilities that existed as of the IPO date, which are currently estimated to be \$10.3 million. The tax indemnification by Transocean was recorded as additional paid-in capital with a corresponding related party receivable from Transocean. See Note 10 to our condensed consolidated financial statements for the period ended June 30, 2004 included in this prospectus.

Changes in Financial Reporting of Future Results of Operations

As a result of our separation from Transocean, including the transfer of the Transocean Assets to Transocean in 2003 and the completion of our IPO in February 2004, our reporting of certain aspects of our future results of operations will differ from our historical reporting of results of operations. The following discussion describes these and other differences.

General and administrative expense includes costs related to our corporate executives, corporate accounting and reporting, engineering, health, safety and environment, information technology, marketing, operations management, legal, tax, treasury, risk management and human resource functions. Prior to June 30, 2003 and the transfer of the Transocean Assets to Transocean, general and administrative expense also included an allocation from Transocean for certain administrative support. After June 30, 2003, general and administrative expense includes costs for services provided to us under our transition services agreement with Transocean. In 2004, we expect to incur approximately \$3 million of additional general and administrative expense annually as a result of additional costs associated with being a separate public company. In addition, we incurred additional general and administrative expense associated with the vesting of stock options and restricted stock granted in conjunction with the IPO.

In conjunction with the closing of the IPO, we granted restricted stock and stock options to certain employees and non-employee directors. Based upon the IPO price of \$12.00 per share, the value of these

awards that we will recognize as compensation expense is approximately \$17.2 million. We recognized \$7.9 million of compensation expense related to these awards and grants in the first half of 2004. We will amortize to compensation expense the remaining \$9.3 million over the vesting period of the awards and options with \$2.8 million recognized during the third and fourth quarters of 2004, \$4.8 million in 2005 and \$1.7 million in 2006. In addition, certain of our employees held options to acquire Transocean ordinary shares that were granted prior to the IPO. In accordance with the employee matters agreement, the employees holding such options were treated as terminated for the convenience of Transocean on the IPO date. As a result, these options became fully vested and were modified to remain exercisable over the original contractual life. In connection with the modification of the options, we recognized \$1.5 million in additional compensation expense in the first half of 2004.

Interest income consists of interest earned on our cash balances and, for periods before December 31, 2003, on notes receivable from Delta Towing. Because of the adoption of the Financial Accounting Standards Board's (FASB) Interpretation No. 46, *Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51* (FIN 46) (see Relationships with Variable Interest Entities), and the resulting consolidation of Delta Towing in our consolidated balance sheet effective December 31, 2003, we expect future interest income to consist of interest earned on our cash balances. For periods before the IPO, interest expense consisted of financing cost amortization and interest associated with our senior notes, other debt and other related party debt as described in the notes to our consolidated financial statements. We expect our debt levels and, correspondingly, our interest expense to be substantially lower in 2004 than historical debt levels and interest expense reflected in our historical operating results as a result of the retirement of notes payable to Transocean prior to the IPO. After the closing of the IPO, interest expense primarily includes interest on the approximately \$24 million face value of our senior notes payable to third parties and any borrowings under our credit facility, commitment fees on the unused portion of our line of credit and the amortization of financing costs.

In conjunction with the IPO, we entered into a tax sharing agreement with Transocean, whereby, Transocean will indemnify TODCO against substantially all pre-IPO income tax liabilities. However, we must pay Transocean for substantially all pre-closing income tax benefits utilized subsequent to the closing of the IPO. As of June 30, 2004, we had approximately \$485 million of estimated pre-closing income tax benefits subject to this obligation to reimburse Transocean of which approximately \$173 million of the tax benefits were reflected in our historical financial statements at December 31, 2003. The additional estimated tax benefits resulted from the closing of the IPO, specified ownership changes, statutory allocations of tax benefits among Transocean's consolidated group members and other events. Depending upon certain tax planning strategies executed by Transocean during 2004 and actual Transocean taxable income for the current year, this pre-closing tax benefit amount could change.

As part of the tax sharing agreement, we must pay Transocean for substantially all pre-closing income tax benefits utilized or deemed to have been utilized subsequent to the closing of the IPO. Accordingly, we recorded an equity transaction in February 2004 to reflect this liability to Transocean of \$174 million, equal to the pre-closing income tax benefits, as a corresponding obligation within the deferred income tax asset accounts and a reduction in additional paid-in capital. In addition, Transocean agreed to indemnify TODCO for certain tax liabilities that existed as of the IPO date, which are currently estimated to be \$10.3 million. The tax indemnification by Transocean was recorded as a credit to additional paid-in capital with a corresponding offset to a related party receivable from Transocean.

Additionally, the tax sharing agreement provides that if any person other than Transocean or its subsidiaries becomes the beneficial owner of greater than 50% of the total voting power of TODCO's outstanding voting stock, we will be deemed to have utilized all of these pre-closing tax benefits, and we will be required to pay Transocean an amount for the deemed utilization of these tax benefits adjusted by a specified discount factor. If an acquisition of beneficial ownership had occurred on June 30, 2004, the estimated amount that we would have been required to pay to Transocean would have been approximately \$390 million. See Certain Relationships and Related Party Transactions Relationship Between Us and Transocean Tax Sharing Agreement.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations is based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, operating revenues, expenses and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to bad debts, materials and supplies obsolescence, investments, property, equipment and other long-lived assets, income taxes, workers' injury claims, employment benefits and contingent liabilities. We base our estimates on historical experience and on various other assumptions we believe are reasonable under the circumstances. The results of these estimates form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

We believe the following are our most critical accounting policies. These policies require significant judgments and estimates used in the preparation of our consolidated financial statements.

Property and Equipment. Our property and equipment represent approximately 81% of our total assets as of June 30, 2004. We determine the carrying value of these assets based on our property and equipment accounting policies, which incorporate our estimates, assumptions and judgments relative to capitalized costs, useful lives and salvage values of our rigs. We review our property and equipment for impairment when events or changes in circumstances indicate that the carrying value of these assets or asset groups may be impaired or when reclassifications are made between property and equipment and assets held for sale as prescribed by the FASB's Statement of Financial Accounting Standards (SFAS) 144, *Accounting for Impairment or Disposal of Long-Lived Assets*. Asset impairment evaluations are based on estimated undiscounted cash flows for the assets being evaluated. Our estimates, assumptions and judgments used in the application of our property and equipment accounting policies reflect both historical experience and expectations regarding future industry conditions and operations. Using different estimates, assumptions and judgments, especially those involving the useful lives of our rigs and expectations regarding future industry conditions and operations, would result in different carrying values of assets and results of operations. For example, a prolonged downturn in the drilling industry in which utilization and dayrates were significantly reduced could result in an impairment of the carrying value of our drilling rigs.

Allowance for Doubtful Accounts. We establish reserves for doubtful accounts on a case-by-case basis when we believe the collection of specific amounts owed to us is unlikely to occur. Our operating revenues are principally derived from services to U.S. independent oil and natural gas companies and international and government-controlled oil companies and our receivables are concentrated in the United States. We generally do not require collateral or other security to support customer receivables. If the financial condition of our customers deteriorates, we may be required to establish additional reserves.

Provision for Income Taxes. Our tax provision is based on expected taxable income, statutory rates and tax planning opportunities available to us in the various jurisdictions in which we operate. Determination of taxable income in any jurisdiction requires the interpretation of the related tax laws. Our effective tax rate 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. Currently payable income tax expense represents either nonresident withholding taxes or the liabilities expected to be reflected on our income tax returns for the current year while the net deferred tax expense or benefit represents the change in the balance of deferred tax assets or liabilities as reported on the balance sheet.

Valuation allowances are established to reduce deferred tax assets when it is more likely than not that some portion or all of the deferred tax assets will not be realized in the future. While we have considered estimated future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowances, changes in these estimates and assumptions, as well as changes in tax laws could require us to adjust the valuation allowances for our deferred tax assets. These adjustments to the valuation allowance would impact our income tax provision in the period in which such adjustments are identified and recorded.

Contingent Liabilities. We establish reserves for estimated loss contingencies when we believe a loss is probable and we can reasonably estimate the amount of the loss. Revisions to contingent liabilities are reflected in income in the period in which different facts or information become known or circumstances change that affect our previous assumptions with respect to the likelihood or amount of loss. Reserves for contingent liabilities are based upon our assumptions and estimates regarding the probable outcome of the matter. Should the outcome differ from our assumptions and estimates, we would make revisions to the estimated reserves for contingent liabilities, and such revisions could be material.

Results of Continuing Operations

The following table sets forth our operating days, average rig utilization rates, average rig revenue per day, revenues and operating expenses by operating segment for the periods indicated:

	For the Six Months Ended June 30,		For the Years Ended December 31,		
	2004	2003	2003	2002	2001
(In millions, except per day data)					
U.S. Gulf of Mexico Segment:					
Operating days	1,847	2,055	4,388	3,061	6,420
Available days ^(a)	4,004	5,430	9,914	10,744	11,436
Utilization ^(b)	46%	38%	44%	28%	56%
Average rig revenue per day ^(c)	\$30,600	\$21,200	\$23,100	\$21,500	\$38,100
Revenue	\$ 56.6	\$ 43.6	\$ 101.2	\$ 65.7	\$ 244.6
Operating and maintenance expenses ^(d)	45.4	54.4	98.6	87.1	138.8
Depreciation	24.6	28.7	55.3	58.1	66.2
Impairment loss on long-lived assets		10.6	10.6	1.1	
(Gain) loss on disposal of assets, net	(1.5)	(0.1)	(0.1)	0.1	(2.7)
Operating income (loss)	(11.9)	(50.0)	(63.2)	(80.7)	42.3
U.S. Inland Barge Segment:					
Operating days	2,237	2,414	4,558	4,392	7,672
Available days ^(a)	5,460	5,581	11,101	11,315	11,709
Utilization ^(b)	41%	43%	41%	39%	66%
Average rig revenue per day ^(c)	\$21,400	\$18,400	\$18,500	\$19,900	\$22,500
Revenue	\$ 47.9	\$ 44.4	\$ 84.2	\$ 87.5	\$ 172.9
Operating and maintenance expenses ^(d)	42.3	52.0	95.8	67.7	96.2
Depreciation	11.2	11.7	23.3	23.3	23.1
Gain on disposal of assets, net	(1.0)		(0.4)	(1.2)	(3.1)
Operating income (loss)	(4.6)	(19.3)	(34.5)	(2.3)	56.7

	For the Six Months Ended June 30,		For the Years Ended December 31,		
	2004	2003	2003	2002	2001
(In millions, except per day data)					
Other International Segment:					
Operating days	942	1,072	2,007	1,648	4,051
Available days ^(a)	3,276	2,715	5,591	4,478	5,110
Utilization ^(b)	29%	40%	36%	37%	79%
Average rig revenue per day ^(c)	\$38,700	\$19,400	\$21,100	\$21,000	\$17,800
Revenue	\$ 36.5	\$ 20.8	\$ 42.3	\$ 34.6	\$ 72.0
Operating and maintenance expenses ^(d)	30.2	15.6	33.0	30.9	58.2
Depreciation	9.8	6.0	13.6	10.5	13.5
Impairment loss on long-lived assets		1.0	0.7	16.4	1.1
(Gain) loss on disposal of assets, net	(0.3)	(0.3)	(0.3)	0.1	2.1
Operating loss	(3.2)	(1.5)	(4.7)	(23.3)	(2.9)
Delta Towing Segment^(e):					
Revenue	\$ 13.6				
Operating and maintenance expenses ^(d)	10.1				
Depreciation	2.6				
General and administrative expenses	1.8				
Gain on disposal of assets	(1.8)				
Operating income	0.9				
Total Company:					
Rig operating days	5,026	5,541	10,953	9,101	18,143
Rig available days ^(a)	12,740	13,726	26,606	26,537	28,255
Rig utilization ^(b)	40%	40%	41%	34%	64%
Average rig revenue per day ^(c)	\$28,100	\$19,600	\$20,800	\$20,600	\$27,000
Revenue	\$ 154.6	\$ 108.8	\$ 227.7	\$ 187.8	\$ 489.5
Operating and maintenance expenses ^(d)	128.0	122.0	227.4	185.7	293.2
Depreciation	48.2	46.4	92.2	91.9	145.9
General and administrative expenses	19.6	8.6	16.3	28.9	80.2
Impairment loss on long-lived assets		11.6	11.3	17.5	65.1
Impairment loss on goodwill				381.9	
Gain on disposal of assets, net	(4.6)	(0.4)	(0.8)	(1.0)	(3.7)
Operating loss	(36.6)	(79.4)	(118.7)	(517.1)	(91.2)

- (a) Available days are the total number of calendar days in the period for all drilling rigs in our fleet.
- (b) Utilization is the total number of operating days in the period as a percentage of the total number of calendar days in the period for all drilling rigs in our fleet.
- (c) Average rig revenue per day is defined as revenue earned per operating day for the applicable segment, and as total U.S. Gulf of Mexico, U.S. Inland Barge and Other International revenues per rig operating days for Total Company .
- (d) Excludes depreciation, amortization and general and administrative expenses.
- (e) Our consolidated results of operations for the first six months of 2004 reflect the consolidation of Delta Towing effective January 1, 2004 in accordance with FIN 46.

Six Months Ended June 30, 2004 and 2003

Revenues. Total revenues increased \$45.8 million, or 42%, during the first half of 2004, as compared to the same period in 2003. The increase in revenues is primarily attributable to higher overall average rig revenue per day earned in 2004, as compared to the prior year period, and the inclusion of revenues from the operation of Delta Towing's fleet of marine support vessels. Overall average rig revenue per day increased from \$19,600 for the six months ended June 30, 2003 to \$28,100 for the six months ended June 30, 2004. The increase in average rig revenue per day reflects the continued improvement of market conditions in the U.S. Gulf of Mexico and transition zone along the U.S. Gulf Coast, as well as the addition of two of our jackup rigs which began operating offshore Mexico in late 2003 and a jackup rig that is currently working offshore Venezuela. Average rig utilization of 40% for the six months ended June 30, 2004 remained unchanged from the comparable period in 2003 due to a decrease in total available rig operating days in the 2004 period as a result of the removal of five jackup rigs from our actively marketed fleet in the second quarter of 2003, combined with the effect of lower land rig utilization in Venezuela during 2004.

Revenues for our U.S. Gulf of Mexico segment increased \$13.0 million, or 30%, in the six months ended June 30, 2004, as compared to the first half of 2003. In 2004, we achieved higher average rig revenue per day for our jackup and submersible drilling fleet, which resulted in an additional \$18.0 million in operating revenues for six months ended June 30, 2004, as compared to the same period in 2003. The increase in average rig revenue per day is the result of our success in obtaining contracts with our customers at higher day rates in response to increased market demand. Results for the first half of 2004 also reflect higher utilization for our current rig fleet in this market, after giving effect to the transfers of the jackup drilling units THE 156, THE 205 and THE 206 to our Other International segment in the fourth quarter of 2003. This increase in utilization resulted in \$5.0 million in additional rig revenues in the six months ended June 30, 2004, as compared to the same period in 2003. The drilling units transferred to our Other International segment generated revenues of \$10.0 million in the six months ended June 30, 2003.

Revenues for our U.S. Inland Barge segment increased \$3.5 million, or 8%, in the six months ended June 30, 2004, as compared to the same period in the prior year, primarily due to higher average rig revenue per day achieved in 2004, as compared to 2003. Average rig revenue per day increased from \$18,400 for the six months ended June 30, 2003 to \$21,400 for the six months ended June 30, 2004, as a result of our successful marketing efforts in negotiating higher day rates for our fleet of inland barges during 2004. The increase in average rig revenue per day resulted in additional revenues of \$6.8 million for the six months ended June 30, 2004, as compared to the same period in 2003. Although this market has improved slightly in 2004, utilization of our inland barge fleet has still not risen to the levels experienced in the first half of 2003. Utilization of our inland barge fleet was 41% for the year-to-date period in 2004, as compared to 43% for the first six months of 2003, which resulted in \$3.3 million lower operating revenues in the first six months of 2004, as compared to the same period in 2003.

Revenues for our Other International segment were \$36.5 million for the six months ended June 30, 2004. The 75%, or \$15.7 million, increase over operating revenues reported for the six months ended June 30, 2003 reflects the operation of two of our jackup rigs, (THE 205 and THE 206), which began working offshore Mexico in late 2003 under long-term contracts and the operation of THE 156, which began operating under a multi-well contract with ConocoPhillips in late December 2003. The operation of these rigs in 2004 contributed an additional \$26.2 million in operating revenues during the six months ended June 30, 2004. The favorable contribution by these jackup rigs was partially offset by lower utilization for our land rigs in Venezuela and a platform rig in Trinidad that completed its contract in the second half of 2003. The lower utilization for our land rigs in Venezuela resulted in a \$6.1 million decrease in operating revenues for the six months ended June 30, 2004, as compared to the same period in 2003. Our platform rig, which was operating in Trinidad until the third quarter of 2003, generated \$4.7 million of operating revenues in the six months ended June 30, 2003.

Our revenues for the first half of 2004 included \$13.6 million related to the operation of Delta Towing's fleet of U.S. marine support vessels.

Operating and Maintenance Expenses. Total operating and maintenance expenses increased \$6.0 million in the first six months of 2004, as compared to operating expenses of \$122.0 million for the same period in 2003. A decrease in operating expenses for our U.S. Gulf of Mexico and Inland Barge segments was partly offset by higher operating expenses in our Other International segment, primarily due to the transfer of three jackup drilling rigs from the U.S. Gulf of Mexico to international locations, the absence of one-time charges related to a well-control incident on one of our barge rigs and an insurance provision for damages sustained to the mat finger on one of our jackup rigs in 2003. Our results for the first half of 2004 also included \$10.1 million in operating expenses related to Delta Towing.

Operating costs for our U.S. Gulf of Mexico segment declined \$9.0 million, or 17%, in the first half of 2004, as compared to the same period of 2003, primarily due to the transfer of three of our jackup rigs to locations in Mexico and Venezuela in the fourth quarter of 2003 (\$10.2 million), an insurance provision in 2003 for damages sustained to one of our jackup rigs (\$2.2 million), lower personal injury and property damage claims costs during the first half of 2004 (\$1.4 million) and higher write-downs, net of recoveries, of accounts and other receivables in the first six months of 2003 (\$1.2 million). These favorable variances in operating costs were partly offset by higher maintenance costs for our jackup rig fleet in the U.S. Gulf of Mexico (\$3.0 million), higher personnel-related charges (\$1.8 million), including higher labor and health benefits costs, and higher mobilization costs (\$1.2 million), associated with well-to-well rig moves during the first half of 2004, as compared to the comparable period in 2003.

Operating and maintenance expenses for our U.S. Inland Barge segment were \$42.3 million for the six months ended June 30, 2004, as compared to \$52.0 million for the same period in 2003. Our results for the first half of 2003 included a one-time charge of \$7.2 million related to a June 2003 well-control incident on one of our inland barge rigs. The further decrease in operating expenses for this segment in the first six months of 2004, as compared to the comparable period in 2003, was primarily the result of lower personnel-related charges (\$2.3 million) due primarily to lower labor costs, partly offset by higher health benefits costs, lower personal injury and property damage claims costs (\$1.9 million) and lower operating costs related to support vessels and other equipment rentals (\$1.0 million). These favorable decreases were partly offset by \$2.0 million in higher maintenance costs in the second quarter of 2004, as compared to the second quarter of 2003, and the write-down of other receivables of \$0.9 million in the first half of 2004.

Operating costs for our Other International segment for the first six months of 2004 increased \$14.6 million, as compared to the same period in 2003, primarily due to \$13.2 million of additional operating expenses as a result of our jackup drilling operations in Mexico. Operating expenses in the first half of 2004 also included \$7.6 million of costs related to the operation of the THE 156 offshore Venezuela beginning in December 2003, partly offset by lower operating costs of \$3.2 million as a result of lower utilization for our land rigs in Venezuela. Our results for this segment in the first six months of 2003 included \$3.3 million of additional operating costs related to our platform rig in Trinidad, which completed its contract in the third quarter of 2003.

General and Administrative Expenses. General and administrative expenses were \$19.6 million for the six months ended June 30, 2004, as compared to \$8.6 million for the comparable period in 2003. General and administrative expenses for the six months ended June 30, 2004 increased \$11.0 million, as compared to the same period in 2003, due primarily to the inclusion of \$7.9 million of stock compensation expense associated with post-IPO grants of stock options and restricted stock awards, \$1.5 million in stock compensation expense related to the modification of Transocean stock options held by some of our employees, \$1.8 million in general and administrative expenses for Delta Towing and \$0.8 million in higher other overhead costs, primarily related to corporate insurance policies and professional fees. These unfavorable variances in general and administrative expenses in the first six months of 2004, as compared to the same period in 2003, were partly offset by lower administrative charges of \$1.0 million for the six months ended June 30, 2004 under our transition services agreement with Transocean, which became effective in the third quarter of 2003. See [Related Party Transactions](#) [Allocation of Administrative Costs](#).

Impairment Loss on Long-Lived Assets. During the second quarter of 2003, we recorded a non-cash impairment charge of \$10.6 million resulting from our decision to take five jackup rigs out of drilling service

and market the rigs for alternative uses. We do not anticipate returning these rigs to drilling service, as we believe it would be cost prohibitive to do so. As a result of this decision, and in accordance with SFAS 144, the carrying value of these assets was adjusted to fair market value. The fair market value of these units as non-drilling rigs was based on third party valuations. Additionally in the second quarter of 2003, we recorded a \$1.0 million non-cash impairment resulting from our determination that assets of entities in which we had an investment did not support our recorded investment. The impairment was determined and measured based upon the remaining book value of the assets and our assessment of the fair value at the time the decision was made. The entities were liquidated in early 2004.

Gain on Disposal of Assets, Net. During the six months ended June 30, 2004, we realized gains on disposal of assets of \$4.6 million, primarily related to the sale of four marine support vessels by Delta Towing (\$1.0 million in March 2004 and \$0.8 million in the second quarter of 2004), the settlement of an October 2000 insurance claim for one of our jackup rigs (\$1.5 million in March 2004), and the sale of used drill pipe (\$0.9 million in June 2004). Net gains (losses) on disposal of assets were not significant in the first half of 2003.

Interest Expense. Third party interest expense and interest expense-related party decreased \$23.0 million in the six months ended June 30, 2004, as compared to the same period in 2003, primarily due to lower debt balances owed to third parties and Transocean. In 2003, we repaid \$15.2 million of third party debt and, in conjunction with the transfer of the Transocean Assets, we retired \$529.7 million in related party debt payable to Transocean during 2003. Additionally, prior to the closing of our IPO, we completed a debt-for-equity exchange of all our remaining outstanding related party debt payable to Transocean.

Loss on Retirement of Debt. In conjunction with the retirement of debt held by Transocean in the first half of 2003, we recorded losses on retirement of related party debt for the six months ended June 30, 2003 of \$79.5 million. In the first quarter of 2004, we wrote off the remaining balance of unamortized fees of approximately \$1.9 million associated with the exchange of Transocean debt for our outstanding senior notes in March 2002 due to the retirement of the debt in conjunction with the IPO. See [Related Party Transactions](#) [Long-Term Debt](#) [Transocean](#).

Impairment of Investment in and Advance to Joint Venture. Based on cash flow projections and industry conditions, we recorded a \$21.3 million impairment of our notes receivable from Delta Towing during the second quarter of 2003. See [Relationships with Variable Interest Entities](#).

Other, Net. Other income, net was \$0.6 million for the six months ended June 30, 2004 and related primarily to foreign currency translation gains recognized during the period. Other expense, net was \$2.5 million for the six months ended June 30, 2003, including a \$2.4 million loss on revaluation of our local currency in Venezuela. In January 2003, Venezuela implemented foreign exchange controls that limit our ability to convert local currency into U.S. dollars and transfer excess funds out of Venezuela. The exchange controls caused an artificially high value to be placed on the local currency. As a result, we recognized a loss on revaluation of the local currency into functional U.S. dollars during the second quarter of 2003.

Income Tax Benefit. The income tax benefit of \$13.3 million for the six months ended June 30, 2004 reflects an effective tax rate (ETR) of 30.75%, as compared to \$51.0 million for the comparable period in 2003, based on an ETR of 24.3%. The increased ETR is primarily the result of not providing a valuation allowance on net operating losses generated in the first half of 2004.

Years Ended December 31, 2003 and 2002

Revenue. Total revenue increased \$39.9 million, or 21%, during 2003 as compared to 2002. Overall average revenue per day and utilization increased slightly from \$20,600 and 34%, respectively, in 2002 to \$20,800 and 41%, respectively, in 2003. The increase in average revenue per day and utilization reflects improving market conditions in the U.S. Gulf of Mexico, as well as the addition of two of our jackup rigs which began operating offshore Mexico in late 2003 and a jackup rig that is currently working offshore Venezuela.

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Revenue for our U.S. Gulf of Mexico segment increased \$35.5 million in 2003 as compared to 2002. Increased utilization for our jackup and submersible fleet for 2003 as compared to the prior year, increased revenue by \$30.3 million. Additionally, we were able to achieve a slightly higher average revenue per day in this market segment in 2003, as compared to 2002, which resulted in an additional \$6.9 million of operating revenues. This segment's results for 2002 included \$1.7 million relating to a jackup rig that was transferred to Transocean in the second quarter of 2002.

Revenue for our U.S. Inland Barge segment decreased \$3.3 million in 2003, as compared to 2002, primarily due to a lower average revenue per day earned by our fleet of barge rigs due to a continued softening in this market segment. The decrease in average revenue per day resulted in a \$6.6 million decrease in revenue that was partly offset by an increase in revenue of \$3.3 million due to increased utilization.

The \$7.7 million increase in revenue in 2003, as compared to 2002, for our Other International segment includes \$3.5 million of revenue related to our two jackup rigs which began working offshore Mexico in late 2003 under long-term contracts and the effect of slightly higher utilization of our Venezuela rigs (\$7.3 million), including the newly upgraded THE 156 which began operating under a 120-day contract with ConocoPhillips in late December 2003. These favorable variances were partly offset by the effect of lower average revenues per day earned by our Venezuela land rigs, which resulted in a \$2.4 million decrease in revenues. Revenues attributable to our Trinidad rigs remained unchanged between the periods.

Operating and Maintenance Expenses. Operating and maintenance expenses increased \$41.7 million, or 22%, in 2003, as compared to 2002. Operating expenses in 2003 increased approximately \$31 million associated with an increase in overall average utilization and client reimbursable costs. Operating costs for 2003 also included one-time charges relating to a well control incident and fire on two of our inland barges (\$11.0 million), a write-down of other receivables (\$3.6 million) and an insurance provision for damages sustained to the mat finger on jackup rig THE 207 (\$2.3 million). These increased costs were partially offset by a decrease in the provision for doubtful accounts (\$1.7 million) in 2003 as a result of the collection of amounts previously reserved, reduced expense relating to our insurance program in 2003 compared to 2002 (\$2.9 million), lower expenses (\$1.5 million) resulting from the transfer of a jackup rig to Transocean during the second quarter of 2002, and lower maintenance expenses related to our Trinidad operations.

General and Administrative Expense. General and administrative expense decreased \$12.6 million in 2003, as compared to 2002. This decrease in general and administrative expense was primarily attributable to lower allocations and charges from Transocean in 2003 for support provided related to the Transocean Assets (\$8.3 million) since these assets had been sold or transferred prior to June 30, 2003 and a decrease in severance-related costs, other restructuring charges and compensation-related expenses incurred in 2002 (\$4.4 million), with no comparable activity in 2003, associated with the late 2002 closure of our administrative office and warehouse in Louisiana and relocation of most of the operations and administrative functions to Houston, Texas. See *Restructuring Charge*. Additionally, during 2002, we incurred \$1.8 million of costs in connection with the exchange of our notes for Transocean Assets as more fully described in Note 6 of our consolidated financial statements for the year ended December 31, 2003. Partly offsetting these cost decreases were increased costs in 2003 related to the hiring of additional Houston-based staff to perform managerial and other administrative functions in connection with our anticipated separation from Transocean.

Impairment Loss on Long-Lived Assets. During 2003, we recorded a non-cash impairment charge of \$10.6 million resulting from our decision to take five jackup rigs out of drilling service and market the rigs for alternative uses. We do not anticipate returning these rigs to drilling service, as we believe it would be cost prohibitive to do so. As a result of this decision, and in accordance with SFAS 144, the carrying value of these assets was adjusted to fair market value. The fair market value of these units as non-drilling rigs was based on third party valuations. Additionally in 2003, we recorded a \$1.0 million non-cash impairment resulting from our determination that assets of entities in which we have an investment did not support our recorded investment. The impairment was determined and measured based upon the remaining book value of the assets and our assessment of the fair value at the time the decision was made. These entities are currently in the process of being liquidated, and, in December 2003, we received \$0.3 million in proceeds from certain assets sold by these entities, which was recorded as a reduction to the impairment charge.

In 2002, we recorded non-cash impairment charges of \$1.1 million relating to an asset held for sale. The impairment resulted from deterioration in market conditions and was determined and measured based on an estimate of fair market value derived from an offer from a potential buyer. In 2002, we also recorded non-cash impairment charges totaling \$16.4 million relating to the reclassification of assets held for sale to assets held and used. The impairment of these assets resulted from management's assessment that the assets no longer met the held for sale criteria under SFAS 144. In accordance with SFAS 144, the carrying value of these assets was adjusted to the lower of fair market value or carrying value adjusted for depreciation from the date the assets were classified as held for sale. The fair market value of the assets was based on third party valuations.

Impairment Loss on Goodwill. As a result of our adoption of SFAS 142, as of January 1, 2002, goodwill is no longer amortized but reviewed at least annually for impairment. During the fourth quarter of 2002, we completed our annual impairment test and recognized a non-cash impairment of our remaining goodwill balance of \$381.9 million. As of December 31, 2002, we had no goodwill balance. See Note 2 to our consolidated financial statements for the year ended December 31, 2003 included in this prospectus.

Equity in Loss of Joint Ventures. In 2003, we recognized \$6.5 million in equity losses related to our 25% ownership interest in Delta Towing as compared to equity losses of \$3.2 million in 2002. The results for Delta Towing continue to be impacted by the downturn in the Gulf of Mexico oil and gas exploration and production market and related downturn in the energy services market, including the marine support vessel business, which has been slower to recover than other types of service providers. In addition, our 2003 results for Delta Towing include our share of a \$2.5 million non-cash impairment charge on the carrying value of idle equipment recorded in the first quarter of 2003 and a December 2003 non-cash impairment charge of \$1.9 million as a result of Delta Towing's annual test of impairment of long-lived assets. See Relationships with Variable Interest Entities.

Our 2002 results reflect \$0.5 million in earnings attributable to our other investments in unconsolidated affiliates, which were written off in 2003.

Interest Income. Interest income decreased \$32.7 million in 2003 as compared to 2002. Our 2002 results included \$27.0 million of interest income related to our notes receivable from Transocean, which was repaid by Transocean in December 2002. In addition, we have previously recorded interest income related to our notes receivable from Delta Towing; however, in the second half of 2003 we established a reserve on interest earned on our notes receivable due to Delta Towing's continued default on the notes. Interest income related to our notes receivable from Delta Towing decreased \$3.3 million in 2003 as compared to 2002 as a result of this reserve. See Relationships with Variable Interest Entities for a discussion of the effects of FIN 46 on our investment in Delta Towing.

Interest Expense. The \$55.6 million decrease in third party interest expense and interest expense-related party in 2003, as compared to 2002, is attributable to lower debt balances owed to third parties and Transocean. In 2003, we repaid \$15.2 million of debt and, in conjunction with the transfer of the Transocean Assets, we retired \$529.7 million in related party debt to Transocean during 2003.

Loss on Retirement of Debt. In conjunction with the retirement of debt held by Transocean, we recorded a \$79.5 million and \$18.8 million loss on retirement of related party debt in 2003 and 2002, respectively. For a further discussion of these retirements, see Related Party Transactions and Note 6 to our consolidated financial statements for the year ended December 31, 2003.

Income Tax Benefit. The \$24.5 million decrease in the income tax benefit for 2003 as compared to 2002 is the result of valuation allowances recorded on net operating loss carryforwards and foreign tax credits in 2003.

Years Ended December 31, 2002 and 2001

Revenue. Total revenue decreased \$301.7 million, or 62%, during 2002 as compared to 2001 due primarily to the further weakening in 2002 of the U.S. Gulf of Mexico shallow and inland water market sector, a decline that began in mid-2001. Overall average revenue per day and utilization decreased from \$27,000 and

64%, respectively, in 2001 to \$20,600 and 34%, respectively, in 2002. Also, contributing to this decrease is the absence of revenue attributable to three jackup rigs that were transferred to Transocean in late 2001 as further discussed in Related Party Transactions.

Revenue for our U.S. Gulf of Mexico segment decreased \$178.9 million in 2002, as compared to 2001, due to decreased utilization and average revenue per day for our jackup and submersible fleet as compared to the prior year, which resulted in a \$103.7 million and \$47.4 million decrease in revenues, respectively. This segment's decrease in revenue for 2002 also reflects the effect of transferring three jackup rigs to Transocean in late 2001 and in the second quarter of 2002 (\$27.8 million).

Revenue for our U.S. Inland Barge segment decreased \$85.4 million in 2002, as compared to 2001, primarily due to both a lower average revenue per day earned by our fleet of barge rigs and a 27% decrease in utilization as a result of the continued weakening in this market segment. The decrease in utilization resulted in a \$73.9 million decrease in revenue in 2002 compared to 2001 and the lower average revenue per day resulted in a \$11.5 million decrease in revenue in 2002 compared to 2001.

Revenue for our Other International segment decreased \$37.4 million, or 52%, in 2002, as compared to 2001, primarily due to the stacking of idle rigs in response to weakened market conditions and an increasingly unstable political environment in Venezuela (\$31.9 million). The decline in revenue for our Other International segment also reflects the stacking of a rig in Mexico (\$3.5 million). Only our Trinidad operations reflected an increase in revenue (\$2.4 million) in 2002, as compared to 2001, due to the award of a three-year contract for our jackup rig.

Operating and Maintenance Expenses. Operating and maintenance expenses decreased \$107.5 million, or 37%, in 2002, as compared to 2001, primarily as a result of the stacking of idle rigs (\$74.1 million) in response to weakening market conditions in the U.S. Gulf of Mexico jackup and inland barge markets. Our transfer of three jackup rigs to Transocean in late 2001 and in the second quarter of 2002 (\$17.6 million) also contributed to the decrease in operating and maintenance expenses in 2002 compared to 2001.

General and Administrative Expense. General and administrative expense decreased \$51.3 million in 2002, as compared to 2001. This \$51.3 million decrease in general and administrative expense is primarily attributable to expenses incurred in connection with the closing of our merger transaction with Transocean in January 2001 of approximately \$58 million with no comparable expenses in 2002. The January 2001 expenses included an investment advisory fee, termination benefits to seven employees in accordance with employment contracts and an additional expense due to the acceleration of vesting of certain stock options and unearned compensation of restricted stock grants previously awarded to certain employees. General and administrative expense in 2001 also included a reduction in unemployment tax expense related to a claim settlement. General and administrative expense in 2002 included severance-related costs, other restructuring charges and compensation-related expenses (\$4.4 million) associated with the 2002 closure of our administrative office and warehouse in Louisiana and relocation of most of the operations and administrative functions to Houston, Texas (see Restructuring Charge) and \$1.8 million of costs in connection with the exchange of our notes for Transocean notes as more fully described in Note 6 of our consolidated financial statements for the year ended December 31, 2003 included in this prospectus.

Depreciation Expense. Depreciation expense decreased \$10.9 million in 2002, as compared to 2001. This decrease is primarily the result of depreciation on rigs sold, scrapped or classified as held for sale from late 2001 and during 2002 (\$3.2 million), the transfer of three rigs to Transocean in late 2001 and in mid-2002 (\$12.7 million) and the contribution of our marine support vessel business to Delta Towing (\$0.8 million), partially offset by increased expense as a result of conforming estimated rig lives and salvage values to Transocean's policies (\$3.4 million) subsequent to the merger.

Impairment Loss on Long-Lived Assets. During 2002, we recorded non-cash impairment charges of \$16.4 million relating to the reclassification of assets held for sale to assets held and used. The impairment of these assets resulted from management's assessment that these assets no longer met the held for sale criteria under SFAS 144. In accordance with SFAS 144, the carrying value of these assets was adjusted to the lower of fair market value or carrying value adjusted for depreciation from the date the assets were classified as held

for sale. The fair market values were based on third party valuations. We also recorded non-cash impairment charges of \$1.1 million in 2002 relating to an asset held for sale. The impairment resulted from deterioration in market conditions and was determined and measured based on an offer from a potential buyer. During 2001, we recorded non-cash impairment charges of \$64.0 million related to the contribution of our marine support vessel business to Delta Towing. We also recorded a non-cash impairment charge related to an asset held and used of \$1.1 million as a result of deterioration in market conditions.

Impairment Loss on Goodwill. As a result of our adoption of SFAS 142 as of January 1, 2002, goodwill is no longer amortized but reviewed at least annually for impairment. During the fourth quarter of 2002, we completed our annual impairment test and recognized a non-cash impairment of our remaining goodwill balance of \$381.9 million. As of December 31, 2002, we had no goodwill balance. See Note 2 to our consolidated financial statements for the year ended December 31, 2003 included in this prospectus.

Interest Income. Interest income increased \$13.9 million in 2002, as compared to 2001, primarily due to interest earned on our notes receivable from Transocean (\$10.6 million) and interest earned on our notes from Delta Towing (\$6.6 million). The increase in interest income-related party was partially offset by lower interest earned due to lower cash balances available for investment in 2002 as compared to 2001.

Interest Expense. Interest expense, net of amounts capitalized, decreased \$42.7 million in 2002, as compared to 2001. Third party interest expense decreased \$85.6 million due to the early retirement of debt in 2001 and the exchange by Transocean of third party debt for notes issued by Transocean, partially offset by an increase in interest expense in 2002 due to the absence of capitalized interest associated with the construction of Transocean newbuild deepwater rigs in 2001. The increase in related party interest expense of \$42.9 million is the result of interest earned on the exchanged notes and additional interest on the two-year revolver with Transocean, partially offset by a decrease in interest expense from the early retirement of debt in 2001.

Loss on Retirement of Debt. In conjunction with the retirement of debt held by Transocean, we recorded a \$18.8 million and \$27.5 million loss on retirement of related party debt in 2002 and 2001, respectively. For a further discussion of these retirements, see Related Party Transactions and Note 6 to our consolidated financial statements for the year ended December 31, 2003 included in this prospectus.

Income Tax Benefit. The amount of tax benefit recognized is primarily dependent on the loss realized and the valuation of operating loss carryforwards during the period. The \$19.6 million increase in the income tax benefit recognized in 2002, as compared to 2001, is primarily attributable to the inclusion of a larger amount of expenses not deductible for tax purposes than the 2001 period such as the impairment charge to goodwill in 2002, partially offset by goodwill amortization expense in 2001.

Discontinued Operations

In July 2002, Transocean announced plans to divest its Shallow Water business through an initial public offering of TODCO. During 2003, we completed the transfer to Transocean of the Transocean Assets, including all revenue-producing Transocean Assets. Accordingly, the Transocean Assets and related operations have been reflected as discontinued operations in our historical financial statements. See Note 23 to our consolidated financial statements for the year ended December 31, 2003 and Note 15 to our condensed consolidated financial statements for the period ended June 30, 2004, for a discussion of discontinued operations. See Certain Relationships and Related Party Transactions Asset Transfers to Transocean, Certain Relationships and Related Party Transactions Relationships Between Us and Transocean Master Separation Agreement TODCO Business, and Transfer of Assets and Assignment of Liabilities for a description of the separation of our respective businesses.

Restructuring Charge

In September 2002, we committed to a restructuring plan to consolidate some functions and offices. The plan resulted in the closure of an administrative office and warehouse in Louisiana and relocation of most of the operations and administrative functions previously conducted at that location to Houston, Texas. We established a liability of \$1.2 million for the estimated severance-related costs associated with the involuntary

termination of 57 employees pursuant to this plan. The charge was reported as operating and maintenance expense in our consolidated statements of operations for the year ended December 31, 2002. As of December 31, 2003, substantially all severance-related costs had been paid. We do not currently expect other significant restructuring plans in the near term.

Cumulative Effect of a Change in Accounting Principle

As a result of our adoption of FIN 46 as of December 31, 2003, we recognized a \$0.8 million gain as a cumulative effect of a change in accounting principle related to our consolidation of Delta Towing. See Relationships with Variable Interest Entities.

During the year ended December 31, 2002, we recognized a non-cash impairment charge to goodwill of \$1,363.7 million as a cumulative effect of a change in accounting principle related to the implementation of SFAS 142. Additionally, due to a general decline in market conditions and other factors, we recorded a \$3,153.3 million impairment charge to goodwill related to our discontinued operations as a cumulative effect of a change in accounting principle. For a discussion of changes in accounting principle, see Note 2 to our consolidated financial statements for the year ended December 31, 2003 included in this prospectus.

Financial Condition

At June 30, 2004 and December 31, 2003, we had total assets of \$756.7 million and \$778.2 million, respectively. The \$21.5 million decrease in assets during the first six months of 2004, is primarily attributable to normal depreciation of \$48.2 million, \$3.3 million in net amortization of deferred preparation and mobilization costs and the write-off of \$1.9 million in unamortized consent fees associated with the Transocean senior note exchange. These decreases in assets were partly offset by \$14.6 million in deferred income tax assets recognized in the first half of 2004, a \$10.1 million increase in amounts receivable from Transocean in recognition of the post-IPO business and tax indemnities, \$7.9 million in higher cash and cash equivalents (see Liquidity and Capital Resources), and other net decreases in assets of \$0.7 million.

At December 31, 2003 and December 31, 2002, we had total assets of \$778.2 million and \$2,227.2 million, respectively. The \$1,449.0 million decrease in assets in 2003, as compared to 2002, is primarily attributable to the distribution and sale of Transocean Assets (\$891.5 million) (see Certain Relationships and Related Party Transactions Asset Transfers to Transocean) and the transfer of \$103.9 million in cash in connection with the distribution of some of our subsidiaries to Transocean. The remaining decrease in assets is primarily attributable to normal depreciation of \$92.2 million and a \$344.8 million decrease in amounts receivable from Transocean.

Total assets by business segment were as follows for the periods indicated below:

	June 30, 2004	December 31,		
		2003	2002	2001
U.S. Gulf of Mexico Segment	\$ 323.3	\$ 334.6	\$ 447.8	\$ 508.1
U.S. Inland Barge Segment	166.5	170.4	210.6	240.4
Other International Segment	160.3	171.3	103.3	155.1
Delta Towing Segment	52.0	63.5		
Corporate and Other ^(a)	54.6	38.4	1,465.5	7,935.2
Total assets	\$756.7	\$778.2	\$2,227.2	\$8,838.8

(a) Includes assets related to discontinued operations of \$0, \$0.1 million, \$995.9 million and \$5,446.9 million at June 30, 2004 and December 31, 2003, 2002 and 2001, respectively.

Liquidity and Capital Resources

Sources and Use of Cash

The following discussion relates to our historical sources and uses of cash, which includes components from both continuing operations and discontinued operations.

Six Months Ended June 30, 2004 Compared to Six Months Ended June 30, 2003. Net cash provided by operating activities was \$4.9 million for the six months ended June 30, 2004, as compared to \$77.0 million for the same period in 2003. The \$72.1 million decrease in net cash provided by operating activities is primarily attributable to lower adjustments to reconcile net loss as reported to net cash used in operating activities and less cash provided by changes in operating assets and liabilities, partly offset by a lower reported net loss in the first six months of 2004 as compared to the same period of 2003. We reported a \$194.0 million lower net loss in the first half of 2004, as compared to the first half of 2003, primarily due to the absence of net losses attributable to the Transocean Assets (\$65.0 million) which were transferred to Transocean during 2003, a lower operating loss from continuing operations, lower net interest expense (\$19.4 million) and lower other non-cash charges in the first half of 2004. Non-cash adjustments decreased \$82.1 million for the six months ended June 30, 2004, as compared to the first six months of 2003, primarily related to depreciation, deferred income taxes, (gain) loss on disposal of assets, loss on retirement of debt and impairment losses on long-lived assets and our investment in and advances to Delta Towing. Non-cash adjustments for the first half of 2004 also included a \$9.4 million favorable adjustment related to stock-based compensation expense associated with our post-IPO stock option grants and restricted stock awards, as well as the modification of the Transocean stock options held by TODCO employees. Cash used by changes in operating assets and liabilities, net of effect of distributions to affiliates, was \$3.1 million for the first six months of 2004 as compared to \$180.9 million in cash provided by changes in operating assets and liabilities for the same period in 2003. The \$184.0 million decrease in cash provided by changes in operating assets and liabilities is primarily the result of the transfer of the Transocean Assets to Transocean and the related settlement of outstanding balances with Transocean.

Net cash provided by investing activities amounted to \$4.9 million for the first six months of 2004 compared to \$69.3 million for the same period in 2003. The \$64.4 million decrease in net cash provided by investing activities relates primarily to the sales of the Transocean Assets to Transocean, which were completed by the end of the second quarter of 2003.

Net cash used in financing activities amounted to \$1.9 million for the first six months of 2004, as compared to a usage of \$235.6 million for the same period in 2003. Financing activities for the 2004 period included the payoff of our capital lease obligations in the second quarter of 2004. Cash used in financing activities in the first half of 2003 included \$103.9 million in cash balances transferred to Transocean in connection with the sale and distribution of subsidiaries to Transocean, the net repayment of long-term advances from Transocean of \$54.0 million and \$78.8 million in repayments of other debt.

2003 Compared to 2002. Net cash provided by operating activities was \$103.1 million for year ended December 31, 2003 compared to \$14.1 million for the same period in 2002. The \$89.0 million increase is primarily related to a \$754.2 million greater loss before cumulative effect of a change in accounting principle for the year ended December 31, 2002, as compared to the same period in 2003, a \$60.7 million greater non-cash loss from the retirement of debt in 2003, as compared to 2002, a \$21.3 million non-cash impairment charge of our investment in and advance to Delta Towing recorded in June 2003, and a \$21.6 million decrease in deferred income tax benefits in 2003, as compared to 2002. These increases in net cash provided by operating activities are partially offset by a \$932.2 million impairment loss on goodwill in 2002, \$44.1 million of greater impairment losses on other long-lived assets recorded in 2002, as compared to 2003, and \$66.8 million lower depreciation expense in 2003, as compared to 2002. Cash provided by changes in operating assets and liabilities, net of effect of distributions to affiliates, was \$224.0 million for the year ended December 31, 2003 as compared to a usage of \$(50.4) million for the same period in 2002. The \$274.4 million increase in cash provided by changes in operating assets and liabilities is primarily due to lower activity with related parties, the settlement of outstanding balances with Transocean and the working capital effect of

reduced operating levels in 2003 as compared to 2002, as a result of the transfer of the Transocean Assets to Transocean.

Net cash provided by investing activities amounted to \$59.5 million for the year ended December 31, 2003 compared to \$555.8 million for the same period in 2002. The \$496.3 million decrease in net cash provided by investing activities relates primarily to the \$518.0 million repayment by Transocean of notes receivable by us in December 2002, partly offset by \$21.6 million higher proceeds from the disposal of assets as a result of the sale of some of the Transocean Assets to Transocean in 2003 as compared to 2002.

Net cash used in financing activities amounted to \$245.5 million for the year ended December 31, 2003, compared to \$535.5 million for the same period in 2002. The \$290.0 million decrease in net cash used in financing activities in 2003 compared to 2002 is primarily due to the 2002 repayment of \$529.2 million of debt payable to Transocean and \$8.3 million in consent payments made in connection with the exchange offer for our senior notes. These decreases in cash used in financing activities was partly offset by a \$93.5 million increase in cash balances transferred to Transocean in connection with the sale and distribution of subsidiaries to Transocean in 2003, higher net repayment of long-term advances from Transocean of \$101.3 million in 2003 compared to 2002 and \$50.5 million higher repayments of other debt in 2003 compared to 2002. See Related Party Transactions.

2002 Compared to 2001. Net cash provided by operating activities amounted to \$14.1 million for the year ended December 31, 2002 compared to \$63.0 million for the same period in 2001. The \$48.9 million decrease in net cash provided by operating activities is primarily related to a \$797.8 million greater loss before cumulative effect of a change in accounting principle and \$186.4 million lower depreciation and amortization for the year ended December 31, 2002, as a result of the transfer to Transocean of Transocean Assets in the second half of 2002 and the write-off of goodwill in 2002. Additionally, other non-cash adjustments to net income related to deferred taxes, gain on disposal of assets, impairment losses on long-lived assets, equity in losses of joint ventures and other deferred items were \$87.0 million lower in 2002 as compared to 2001, which further decreased net cash provided by operating activities. These decreases were partially offset by a \$932.2 million non-cash impairment loss on goodwill recognized in 2002 and an \$89.5 million increase in cash provided by changes in operating assets and liabilities, net of effect of distributions to affiliates for the year ended December 31, 2002.

Net cash provided by investing activities amounted to \$555.8 million for the year ended December 31, 2002 compared to a use of \$79.4 million for the same period in 2001 primarily as a result of \$518.0 million in proceeds from settlement of notes receivable with Transocean, coupled with significantly lower capital expenditures due to the completion of the Transocean rig expansion program in 2001.

Net cash used in financing activities amounted to \$535.5 million for the year ended December 31, 2002 compared to a use of \$273.1 million for the same period in 2001 primarily as a result of \$529.2 million in repayments of debt to Transocean. See Related Party Transactions. During the year ended December 31, 2001, we made \$1.5 billion of early repayments of debt instruments, partially offset by proceeds from long-term advances from Transocean of \$1.2 billion in 2001 to finance the early repayment of debt. We also made net repayments of our debt of \$38.6 million during 2002 compared to \$35.9 million in 2001. During the year ended December 31, 2002, we paid \$8.3 million in financing costs related to the exchange of our notes for Transocean notes.

Sources of Liquidity and Capital Expenditures

Asset sales and our cash flows from operations were our primary sources of liquidity for the six months ended June 30, 2004. Asset sales and our existing cash balances were our primary sources of liquidity for the year ended December 31, 2003. Our primary sources of liquidity for the year ended December 31, 2002 were our cash flows from operations, asset sales, repayment of notes receivable from Transocean and proceeds from long term debt with related party.

For the six months ended June 30, 2004, our primary uses of cash were capital expenditures of \$4.8 million related to upgrades and replacements of equipment and the retirement of amounts owed under

capital lease obligations. Primary uses of cash for the first six months of 2004 and the year ended December 31, 2003 were debt repayments, including amounts due to Transocean, the transfer of cash balances in conjunction with the sale or distribution of Transocean Assets to Transocean and capital expenditures for upgrades and replacements of equipment. Primary uses of cash for the year ended December 31, 2002 were capital expenditures and debt repayments. At June 30, 2004, we had \$27.9 million in cash and cash equivalents.

During 2002 and until April 6, 2003, we had access to a \$1.8 billion revolving line of credit with Transocean of which \$100.0 million was outstanding at December 31, 2002. At expiration, on April 6, 2003, the approximately \$81.2 million then outstanding under this line of credit was converted to a two year, 2.76% fixed rate note to Transocean that was subsequently cancelled in connection with the transfer of some of the Transocean Assets to Transocean.

Capital expenditures were \$4.8 million, \$16.1 million and \$17.7 million for the six months ended June 30, 2004 and for the years ended December 31, 2003 and 2002, respectively. Capital expenditures in 2004 and 2003 related to upgrades and replacements of equipment including approximately \$9 million in 2003 for rig upgrades on two of our jackup rigs that were awarded contracts for work in Mexico. Additionally, we incurred approximately \$22 million in mobilization and other contract preparation costs relating to these rigs that have been deferred and will be recognized over the primary contract term. The majority of our capital expenditures in 2002 related to upgrades and replacements of equipment.

We anticipate that we will rely primarily on internally generated cash flows and our revolving line of credit to maintain liquidity. In December 2003, we entered into a two-year \$75 million floating-rate secured revolving credit facility that will decline to \$60 million in December 2004.

The facility is secured by most of our drilling rigs, our receivables, and the stock of most of our U.S. subsidiaries and is guaranteed by some of our 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%, plus a margin in either case of 2.50% or (2) the Eurodollar rate plus a margin of 3.50%. Commitment fees on the unused portion of the facility are 1.50% 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% 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% of the orderly liquidated value of the drilling rigs securing the facility plus 80% 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 the following:

a ratio of (1) current assets plus unused availability under the facility to (2) current liabilities (excluding specified subordinated liabilities owed to Transocean) of at least 1.2 to 1,

a ratio of total debt to total capitalization of not more than 20% (excluding specified subordinated liabilities owed to Transocean from debt but including those liabilities in total capitalization),

tangible net worth plus specified subordinated liabilities owed to Transocean of not less than the sum of (1) \$425 million plus (2) to the extent positive, 50% of net income after December 31, 2003,

a ratio of (1) the orderly liquidation value of the drilling rigs securing the facility to (2) the amount of borrowings and letters of credit outstanding under the facility of not less than 3 to 1, and

in the event liquidity (defined as working capital (excluding specified subordinated liabilities owed to Transocean) plus availability under the facility) is less than \$25 million, a ratio of (1) EBITDA minus capital expenditures during the preceding 12 fiscal months to (2) interest expense (excluding interest on specified subordinated debt owed to Transocean) during such period of not less than 2 to 1.

The revolving credit facility provides, among other things, for the issuance of letters of credit that we may utilize to guarantee our 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.

We expect capital expenditures to be approximately \$14 million in 2004, primarily for rig refurbishments and the purchase of capital equipment. The timing and amounts we actually spend in connection with our plans to upgrade and refurbish other selected rigs, including rigs requiring substantial refurbishment, is subject to our discretion and will depend on our view of market conditions and our cash flows. We would expect capital expenditures to increase as market conditions improve. Our rigs requiring substantial refurbishment to be ready for service are noted in the tables in Business Drilling Rig Fleet. From time to time we may review possible acquisitions of drilling rigs or businesses, joint ventures, mergers or other business combinations and may in the future make significant capital commitments for such purposes. Any such transactions could involve the issuance of a substantial number of additional shares or other securities or the payment by us of a substantial amount of cash. We would likely fund the cash portion, if any, of such transactions through cash balances on hand, the incurrence of additional debt, sales of assets, shares or other securities or a combination thereof. In addition, from time to time we may consider possible dispositions of drilling rigs. Our ability to fund capital expenditures or acquisitions would be adversely affected if conditions deteriorate in our business, we experience poor results in our operations or we fail to meet covenants under the revolving credit facility described in the previous paragraph.

We anticipate that our available funds, together with our cash generated from operations and amounts that we may borrow, will be sufficient to fund our required capital expenditures, working capital and debt service requirements for the foreseeable future. Future cash flows and the availability of outside funding sources, however, are subject to a number of uncertainties, especially the condition of the oil and natural gas industry. Accordingly, these resources may not be available or sufficient to fund our cash requirements.

As of June 30, 2004, our scheduled debt maturities and other contractual obligations are presented in the table below with debt obligations presented at face value:

	Total	For the Twelve Month Periods Ending June 30,			Thereafter
		2005	2006 to 2007	2008 to 2009	
(In millions)					
Contractual Obligations					
Debt	\$23.6	\$ 7.7	\$	\$12.4	\$3.5
Debt - Related Party	3.0	3.0			
Operating Leases	4.6	1.5	1.7	0.8	0.6
Total Contractual Obligations	\$31.2	\$12.2	\$1.7	\$13.2	\$4.1

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At June 30, 2004, we had other commitments that we are contractually obligated to fulfill with cash should the obligations be called. These obligations represent surety bonds that guarantee our performance as it relates to our drilling contracts, insurance, tax and other obligations in various jurisdictions. These obligations could be called at any time prior to their expiration dates. The obligations that are the subject of these surety bonds are geographically concentrated in the United States and Mexico.

	For the Twelve Month Periods Ending June 30,				
	Total	2005	2006 to 2007	2008 to 2009	
(In millions)					
Other Commercial Commitments					
Surety Bonds ^(a)	\$13.0	\$1.1	\$3.3	\$4.5	\$4.1

- (a) Relates to bonds issued primarily in connection with our contracts with Pemex. These bonds have been issued under a Transocean facility. The Master Separation Agreement requires us to use our reasonable best efforts to replace these bonds with our own bonds and to indemnify Transocean for any claims related to the bonds. Transocean has agreed to leave these bonds in place, subject to certain conditions. See Certain Relationships and Related Party Transactions Relationship Between Us and Transocean Master Separation Agreement Letters of Credit and Guarantees.

Derivative Instruments

We have established policies and procedures for derivative instruments that have been approved by our board of directors. These policies and procedures provide for the prior approval of derivative instruments by our board of directors. From time to time, we may enter into a variety of derivative financial instruments in connection with the management of our exposure to fluctuations in foreign exchange rates and interest rates. We do not plan to enter into derivative transactions for speculative purposes; however, for accounting purposes, certain transactions may not meet the criteria for hedge accounting.

Gains and losses on foreign exchange derivative instruments that qualify as accounting hedges are deferred as accumulated other comprehensive income and recognized when the underlying foreign exchange exposure is realized. Gains and losses on foreign exchange derivative instruments that do not qualify as hedges for accounting purposes are recognized currently based on the change in market value of the derivative instruments. At June 30, 2004, we did not have any outstanding foreign exchange derivative instruments.

From time to time, we may use interest rate swaps to manage the effect of interest rate changes on future income. Interest rate swaps would be designated as a hedge of underlying future interest payments and would not be used for speculative purposes. The interest rate differential to be received or paid under the swaps is recognized over the lives of the swaps as an adjustment to interest expense. If an interest rate swap is terminated, the gain or loss is amortized over the life of the underlying debt. At June 30, 2004, we did not have any outstanding interest rate swaps.

Relationships with Variable Interest Entities

We own a 25% equity interest in Delta Towing, which was formed to own and operate our U.S. marine support vessel business consisting primarily of shallow water tugs, crewboats and utility barges. We contributed this business to Delta Towing in return for a 25% ownership interest and secured notes issued by Delta Towing with a face value of \$144.0 million. No value was assigned to the ownership interest in Delta Towing. The note agreement was subsequently amended to provide for a \$4.0 million, three-year revolving credit facility which has since been cancelled. Delta Towing's property and equipment, with a net book value of \$43.1 million at June 30, 2004, are collateral for the Company's notes receivable. The remaining 75% ownership interest is held by Beta Marine Services, L.L.C. (Beta Marine), which also loaned Delta Towing \$3.0 million. See Related Party Transactions Long-Term Debt Beta Marine.

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As a result of restrictions on the ownership or operation of vessels involved in the coastwise trade by non-U.S. citizens, our ability to take ownership of the assets owned by Delta Towing in connection with its default under its notes issued to us would be restricted. These restrictions apply to us because Transocean, a company organized under the laws of the Cayman Islands, currently owns the majority of our common stock.

In January 2003, the FASB issued FIN 46 which requires that an enterprise consolidate a variable interest entity (VIE) if the enterprise has a variable interest that will absorb a majority of the entity's expected losses and/or receives a majority of the entity's expected residual returns as a result of ownership, contractual or other financial interests in the entity, if such loss or residual return occurs. If one enterprise absorbs a majority of a VIE's expected losses and another enterprise receives a majority of that entity's expected residual returns, the enterprise absorbing a majority of the expected losses is required to consolidate the VIE and will be deemed the primary beneficiary for accounting purposes.

Under FIN 46, Delta Towing is considered a VIE because its equity is not sufficient to absorb the joint venture's expected future losses. TODCO is deemed to be the primary beneficiary of Delta Towing for accounting purposes because we have the largest percentage of investment at risk through the secured notes held by us and would thereby absorb the majority of the expected losses of Delta Towing. We have consolidated Delta Towing as of December 31, 2003. As of December 31, 2003, the consolidation of Delta Towing resulted in an increase in our net assets, and a corresponding gain of, \$0.8 million, which was presented as a cumulative effect of a change in accounting principle in our 2003 consolidated statement of operations.

As of June 30, 2004 and December 31, 2003, we have eliminated in consolidation all intercompany account balances with Delta Towing as a result of the adoption of FIN 46, as well as the elimination of all intercompany transactions during the six months ended June 30, 2004.

Prior to December 31, 2003, we accounted for our investment in Delta Towing under the equity method and recorded \$1.5 million in equity losses as a reduction in the carrying value of Delta Towing's notes receivable held by us. In addition, during the years ended December 31, 2002 and 2003 and the six months ended June 30, 2003, we earned interest income of \$6.6 million, \$3.3 million and \$3.3 million, respectively, on interest-bearing debt due from Delta Towing.

In 2001, Delta Towing paid approximately \$1.1 million in principal payments on the notes from net proceeds on assets sold during the year. During the years ended December 31, 2003 and 2002, Delta Towing paid approximately \$1.8 million and \$0.1 million, respectively, on the Delta Towing Revolver (as defined in Note 18 to the consolidated financial statements for the year ended December 31, 2003).

During the years ended December 31, 2003, 2002 and 2001, our equity in losses of Delta Towing reduced the carrying value of the notes by \$6.6 million, \$3.2 million and \$0.9 million, respectively.

As a result of its issuance of notes to us, Delta Towing is highly leveraged. Delta Towing defaulted on the notes in January 2003 by failing to make its scheduled quarterly interest payment and remains in default as a result of its continued failure to make its quarterly interest payments as well as a scheduled principal repayment due in January 2004. As a result of our continued evaluation of the collectibility of the notes, we recorded a \$21.3 million impairment of the notes in June 2003 based on Delta Towing's discounted cash flows over the terms of the notes, which deteriorated in the second quarter of 2003 as a result of the continued decline in Delta Towing's business outlook. As permitted in the notes in the event of default, we began offsetting a portion of the amount owed by us to Delta Towing against the interest due under the notes. Additionally, we established a reserve of \$1.6 million for interest income earned during 2003 on the notes receivable.

As part of the formation of the joint venture on January 31, 2001, we entered into a charter arrangement with Delta Towing under which we committed to charter for a period of 2.5 years from date of delivery 10 crewboats then under construction, all of which were in service as of June 30, 2004. We also entered into an alliance agreement with Delta Towing under which we agreed to treat Delta Towing as a preferred supplier for the provision of marine support services. During the year ended December 31, 2003 and the six months ended

June 30, 2003, we incurred charges totaling \$11.7 million and \$5.8 million, respectively, from Delta Towing for services rendered which were reflected in operating and maintenance related party expense. During the year ended December 31, 2002, we incurred charges totaling \$10.7 million from Delta Towing for services rendered, of which \$1.6 million was rebilled to our customers and \$9.1 million was reflected in operating and maintenance related party expense.

Related Party Transactions

Long-Term Debt Beta Marine

In connection with the acquisition of the marine business, Delta Towing entered into a \$3.0 million note agreement with Beta Marine dated January 30, 2001. The note bears interest at 8%, payable quarterly. In January 2004, Delta Towing failed to make its scheduled principal payment to Beta Marine. The \$3.0 million principal amount of the note payable has been classified as a current obligation in our consolidated balance sheet. In the first half of 2004, Delta Towing repaid a portion of accrued interest payable to Beta Marine from proceeds from the sale of four marine vessels. We have no obligation to fund this debt on behalf of Delta Towing. Interest expense related to the note payable to Beta Marine was \$0.1 million for the six months ended June 30, 2004.

Allocation of Administrative Costs

Transocean has historically provided specified administrative support to us. Transocean has charged us a proportional share of its administrative costs based on estimates of the percentage of work each Transocean department performs for us. The amount of expense allocated to us was \$1.3 million for the six months ended June 30, 2003, and was classified as general and administrative related party expense. Following the IPO, some of these functions are provided to us under the transition services agreement with Transocean. Charges under the transition services agreement amounted to \$0.3 million for the six months ended June 30, 2004 and are reported as general and administrative related party expense. Some of these functions are provided to us under the transition services agreement described under Certain Relationships and Related Party Transactions Relationship Between Us and Transocean Transition Services Agreement.

Long-Term Debt Transocean

We were party to a \$1.8 billion two-year revolving credit agreement (the Transocean Revolver) with Transocean, dated April 6, 2001. During the years ended December 31, 2002 and 2003 and six months ended June 30, 2003, we recognized \$0.8 million, \$1.8 million and \$0.8 million, respectively, in interest expense related to the Transocean Revolver. On April 6, 2003, the approximately \$81.2 million then outstanding under the Transocean Revolver was converted to a 2.76% fixed rate promissory note issued by us to Transocean which was scheduled to mature on April 6, 2005. This note was cancelled in 2003 in connection with a series of transactions.

In March 2002, together with Transocean, we completed exchange offers and consent solicitations for our 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, Transocean exchanged approximately \$234.5 million, \$342.3 million, \$247.8 million, \$246.5 million, \$76.9 million and \$289.8 million principal amount of our outstanding 6.5%, 6.75%, 6.95%, 7.375%, 9.125% and 9.5% Senior Notes, respectively (the Exchanged Notes), for newly issued Transocean notes having the same principal amount, interest rate, redemption terms and payment and maturity dates. As of June 30, 2004, we had approximately \$7.7 million, \$2.2 million, \$3.5 million and \$10.2 million principal amount of the 6.75%, 6.95%, 7.375% and 9.5% Senior Notes, respectively, outstanding that were not exchanged in the Exchange Offer. Both the exchanged notes and the notes not exchanged remained our obligation. As a result of the consent payments made in connection with the Exchange Offer, interest expense for 2003 and 2002 increased by approximately \$0.5 million and \$1.3 million, respectively.

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In December 2002, we repurchased all of the approximately \$234.5 million and \$76.9 million principal amount outstanding of our 6.5% and 9.125% Exchanged Notes held by Transocean, respectively, and approximately \$189.8 million principal amount outstanding of our 6.75% Exchanged Notes held by Transocean plus accrued and unpaid interest. We recorded a net after-tax loss of \$12.2 million in conjunction with the repurchase of these notes. We funded the repurchase from cash received from Transocean's repayment of approximately \$518.0 million aggregate principal amount of outstanding notes receivable plus accrued and unpaid interest.

During 2003, we sold to Transocean, in separate transactions, our investment in Arcade Drilling AS, *Cliffs Platform Rig 1*, our 50% interest in Deepwater Drilling LLC, our 60% interest in Deepwater Drilling II LLC and our membership interests in R&B Falcon Drilling (International & Deepwater) Inc. LLC. As consideration for the sale of these assets, Transocean cancelled \$529.7 million principal amount outstanding of the Exchanged Notes. See *Certain Relationships and Related Party Transactions - Asset Transfers to Transocean* for a further description of these transactions.

The book value of the Exchanged Notes was \$522.0 million at December 31, 2003 and \$980.1 million at December 31, 2002. We recognized \$42.7 million and \$77.9 million in interest expense related to these notes for the years ended December 31, 2003 and 2002, respectively.

In February 2004, prior to the closing of our IPO, we exchanged \$45.8 million in principal amount of our outstanding 7.375% Exchanged Notes held by Transocean Holdings Inc. (a wholly owned subsidiary of Transocean), plus accrued interest thereon, for 359,638 shares of our Class B common stock (4,367,714 shares of Class B common stock after giving effect to the stock dividend, see *Other Transactions Between Us and Transocean*). Immediately following this exchange, we exchanged \$152.5 million and \$289.8 million principal amount of our outstanding 6.75% and 9.5% Exchanged Notes, respectively, held by Transocean, plus accrued interest thereon, for 3,580,768 shares of our Class B common stock (43,487,535 shares of Class B common stock after giving effect to the 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 - related party and interest payable - 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. There were no Exchanged Notes payable to Transocean outstanding at June 30, 2004. We recognized \$3.1 million in interest expense - related party associated with these notes prior to their cancellation in February 2004. For the six months ended June 30, 2003, we recognized \$25.8 million in interest expense - related party with respect to the Exchanged Notes.

In connection with the Exchange Offer, we made an aggregate of \$8.3 million in consent payments to holders of our notes that were exchanged. The consent payments were amortized as an increase to interest expense over the remaining term of the respective exchanged notes using the interest method and such amortization totaled \$0.5 million and \$1.3 million for the years ended December 31, 2003 and 2002, respectively. In connection with the retirement of the Exchanged Notes prior to the completion of the IPO, we 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 our condensed consolidated statement of operations for the six months ended June 30, 2004.

Asset Transfers to Transocean

We transferred the Transocean Assets to Transocean primarily as in-kind dividends and transfers in exchange for the cancellation of debt to Transocean and, in some instances, for cash. Specified contracts were assigned to Transocean for no consideration. These transactions had no effect on our results of continuing operations except to the extent that debt was retired and any gain or loss was recognized. See *Certain Relationships and Related Party Transactions - Asset Transfers to Transocean*.

Other Transactions Between Us and Transocean

In February 2004, we 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 us and Transocean (see Certain Relationships and Related Party Transactions Relationship Between Us and Transocean Indemnification and Release). 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.

As part of the tax sharing agreement, we must pay Transocean for substantially all pre-closing income tax benefits utilized or deemed to have been utilized subsequent to the closing of the IPO. Accordingly, we recorded an equity transaction in February 2004 to reflect this liability to Transocean of \$174 million, equal to the pre-closing income tax benefits, as a corresponding obligation within the deferred income tax asset accounts and a reduction in additional paid-in capital. In addition, Transocean agreed to indemnify us for certain tax liabilities that existed as of the IPO date which are currently estimated to be \$10.3 million. We recorded the tax indemnification by Transocean as a credit to additional paid-in capital with a corresponding offset to a related party receivable from Transocean. See Certain Relationships and Related Party Transactions Relationship Between Us and Transocean Tax Sharing Agreement.

Interest Rate Risk

The table below presents scheduled debt maturities and related weighted-average interest rates for each of the twelve month periods ending June 30, relating to debt obligations as of June 30, 2004:

	Scheduled Maturity Date						Fair Value
	2005	2006	2007	2008	2009	Thereafter	June 30, 2004
(In millions, except interest rate percentages)							
Total Debt							
Fixed Rate ^(a)	\$ 10.7	\$	\$	\$ 2.2	\$ 10.2	\$ 3.5	\$ 26.6
Average interest rate	7.1%			7.0%	9.5%	7.4%	8.0%

(a) Expected maturity amounts are based on the face value of debt and do not reflect fair market value of debt.

Foreign Exchange Risk

Our international operations in Mexico, Trinidad and Venezuela, expose us to foreign exchange risk. We use a variety of techniques to minimize the exposure to foreign exchange risk. Our primary foreign exchange risk management strategy involves structuring customer contracts to provide for payment in both U.S. dollars and local currency. The payment portion denominated in local currency is based on anticipated local currency requirements over the contract term. We may also use foreign exchange derivative instruments or spot purchases. We do not enter into derivative transactions for speculative purposes. At June 30, 2004, we did not have any outstanding foreign exchange contracts.

In January 2003, Venezuela implemented foreign exchange controls that limited our ability to convert local currency into U.S. dollars and transfer excess funds out of Venezuela. Although our current drilling contracts in Venezuela call for a significant portion of our dayrates to be paid in U.S. dollars, changes in existing regulation or the interpretation or enforcement of those regulations could further restrict our ability to receive U.S. dollar payments. The exchange controls could also result in an artificially high value being placed on the local currency.

Due to the continuation of these foreign exchange controls as well as continuing political instability in Venezuela, we established a currency valuation allowance pertaining to cash receivables in Venezuela of \$2.4 million in the second quarter of 2003 to adjust our Venezuelan financial assets to net realizable value. As of June 30, 2004, no additional currency valuation allowance was deemed necessary, and we do not anticipate having to continue to provide a currency valuation allowance related to our Venezuelan operations.

OUR BUSINESS

Overview

TODCO is a leading provider of contract oil and gas drilling services, primarily in the U.S. Gulf of Mexico shallow water and inland marine region, an area that we refer to as the U.S. Gulf Coast. We have the largest fleet of drilling rigs in the U.S. Gulf Coast and believe that, as a result of our leading position and geographic focus, we are well-positioned to benefit from a potential increase in drilling activity associated with the search for natural gas in this region. We are a majority owned subsidiary of Transocean, the world's largest offshore oil and gas drilling contractor.

We operate a fleet of 70 drilling rigs consisting of 30 inland barge rigs, 24 jackup rigs, three submersible rigs, one platform rig, nine land rigs and three lake barge rigs. Currently, 52 of these rigs are located in shallow and inland waters of the United States with the remainder in Mexico, Trinidad and Venezuela.

Our core business is to contract our drilling rigs, related equipment and work crews on a dayrate basis to customers who are drilling oil and gas wells. We provide these services mainly to independent oil and gas companies, but we also service major international and government-controlled oil and gas companies. Our customers in the U.S. Gulf Coast typically focus on drilling for natural gas.

After the closing of this offering, we will continue to be controlled by Transocean. For a discussion of related risks, see **Risk Factors** **Risks Related to Our Principal Stockholder Transocean**.

Recent Industry Trends

The drilling industry in the U.S. Gulf Coast is highly cyclical and is typically driven by general economic activity and changes in actual or anticipated oil and gas prices. We believe that both our earnings and demand for our rigs will typically be correlated to our customers' expectations of energy prices, particularly natural gas prices, and that sustained high energy prices will generally have a positive impact on our earnings. We believe that the drilling industry has emerged from a cyclical low point and that there are several trends that should benefit our operations, including:

Redeployment of Jackup Rigs. Greater demand for jackup rigs in international areas over the last two years has reduced the overall supply of jackups in the U.S. Gulf Coast. This has created a more favorable supply environment for the remaining jackups, including ours. This favorable supply environment has led to increased jackup dayrates.

High Natural Gas Prices. While U.S. natural gas prices are volatile, the rolling twelve-month average price of natural gas has increased from January 1994 to August 2004. We believe high natural gas prices in the United States, if sustained, should result in more exploration and development drilling activity and higher utilization and dayrates for drilling companies like us.

Need for Increased Natural Gas Drilling Activity. From 1994 to 2003, U.S. demand for natural gas grew at an annual rate of 0.6% while its supply grew at an annual rate of 0.2%. We believe that this supply and demand growth imbalance will continue if demand for natural gas continues to increase and production decline rates continue to accelerate. Even though the number of U.S. gas wells drilled has increased overall in recent years, a corresponding increase in production has not been realized. We believe that an increase in U.S. drilling activity will be required for the natural gas industry to meet the expected increased demand for, and compensate for the slowing production of, natural gas in the United States.

Trend Towards Drilling Deeper Shallow Water Gas Wells. A current trend by oil and gas companies is to drill deep gas wells along the U.S. Gulf Coast in search of new and potentially prolific untapped natural gas reserves. We believe that this trend towards deeper drilling will benefit premium jackup rigs as well as barge rigs and submersible rigs that are capable of drilling deep gas wells. In addition, we believe this trend will indirectly benefit conventional jackup fleets as the use of premium rigs in the

U.S. Gulf Coast to drill deep wells should reduce the supply of rigs available to drill conventional wells.

Our Strengths

We believe that we have the following strengths:

Leading Presence in the U.S. Gulf Coast. We have the largest combined jackup and inland barge fleet in the U.S. Gulf Coast. Our leading presence and geographic focus provide us with logistical advantages in servicing our customers, including reduced mobilization times and costs and increased flexibility of rig and crew deployment. Our size also generates economies of scale and helps us attract, train and retain qualified crew personnel.

Well-Positioned to Benefit from an Upturn in Natural Gas Drilling Activity. Our customers in the U.S. Gulf Coast drill primarily for natural gas. Given our leading presence in this market, we believe we are well-positioned to benefit from any significant increases in U.S. natural gas drilling activity in the U.S. Gulf Coast. Because operating costs in our industry are largely fixed, our earnings and cash flow are very sensitive to improvements in utilization rates and dayrates.

Strong Balance Sheet. At June 30, 2004 we had \$27.8 million of total debt and a total debt to total capitalization ratio of 5.4%. We believe this strong balance sheet should enable us to take advantage of opportunities for growth as the market improves and to respond effectively to market downturns.

Experienced and Incentivized Management Team. Our senior and operating level management team has extensive industry experience in the U.S. Gulf Coast. Their considerable knowledge of and experience with the cyclical nature of our business should enhance our ability to operate effectively through industry cycles. Additionally, our management's participation in incentive compensation plans is designed to align their interests with our operating and financial performance. For a discussion of risks related to potential conflicts of interest involving our management, see **Risk Factors** **Risks Related to Our Principal Stockholder Transocean**. Some of our executive officers and directors may have potential conflicts of interest because of their ownership of Transocean ordinary shares or their role as directors or executive officers of Transocean.

Our Strategy

Our objective is to continue to be a leading offshore drilling company with a focus on the North American natural gas industry. Specifically, we intend to:

Focus on Marine Assets and Drilling for Natural Gas along the U.S. Gulf Coast. We plan to maintain our position as the leading contractor of jackup rigs and drilling barges in the U.S. Gulf Coast. We believe that this approach will allow us to take advantage of improvements in dayrates and rig demand that may result from increased drilling activity in this region. We believe that our focus on this region will also allow us to take advantage of deep gas drilling opportunities. Although we intend to focus on the U.S. Gulf Coast, we also plan to pursue selective opportunities for our rigs in Mexico, Trinidad, Venezuela and possibly other regions.

Pursue Efficient, Low-Cost Operations and a Disciplined Approach to Capital Spending. We intend to be a low-cost contractor in the U.S. Gulf Coast drilling market. We believe that by being an efficient, low-cost contractor, we can maintain significant operating flexibility and maximize our earnings and cash flow over the entire business cycle. We believe that this operational flexibility will provide us with an important competitive advantage and allow us to compete effectively with competitors with higher specification fleets and higher cost structures than ours. We plan to pursue a disciplined approach to capital spending in increasing the size and upgrading the capabilities of our fleet.

Maintain High Operating Standards. We plan to continue to maintain a high level of quality service and safety. We have in place a comprehensive set of safety management systems, standards and procedures that we believe benefit our employees, our margins and our reputation.

Maintain a Conservative Capital Structure. We intend to maintain our conservative capital structure with a low percentage of debt. We believe this is a prudent financial strategy given that our industry is highly cyclical.

Drilling Rig Fleet

Our drilling rig fleet consists of jackup rigs, barge rigs, and other rigs, which include submersible rigs, a platform drilling rig, land drilling rigs and Lake Maracaibo barge rigs.

There are several factors that determine the type of rig most suitable for a particular drilling operation. The most significant factors are water depth and seabed conditions (in offshore and inland marine environments), whether drilling is being done over a platform or other structure, and the intended well depth. Our fleet allows us to meet a broad range of needs in the shallow water along the U.S. Gulf Coast. Most of our drilling equipment is suitable for both exploration and development drilling, and we are normally engaged in both types of drilling activity. All of our mobile offshore drilling units are designed for operations away from port for extended periods of time and most have living quarters for the crews, a helicopter landing deck and storage space for pipe and drilling supplies.

Following are brief descriptions of the types of rigs we operate. Rigs described in the following charts as *under contract* are operating under contract, including rigs being prepared or mobilized under contract. Rigs described as *warm stacked* are not under contract but are actively marketed and may require the hiring of additional crew (and, in some cases, an entire crew), but are generally ready for service with little or no capital expenditures. Rigs described as *shipyard* are not available and are in the shipyard being repaired or upgraded for future work. Rigs described as *cold stacked* are not actively marketed, generally cannot be ready for service immediately and normally require the hiring of an entire crew. Cold stacked rigs will also require a varying degree of maintenance and significant refurbishment before they can be operated as drilling rigs. We include information in the following charts for rated drilling depth, which means drilling depth stated by the manufacturer of the drilling equipment. A rig may not have the actual capacity to drill to the rated drilling depth.

Jackup Drilling Rigs (24)

Jackup rigs are mobile self-elevating drilling platforms equipped with legs that can be lowered to the ocean floor until a foundation is established to support the drilling platform. Once a foundation is established, the drilling platform is jacked further up the legs so that the platform is above the highest expected waves. The rig hull includes the drilling rig, jacking system, crew quarters, loading and unloading facilities, storage areas for bulk and liquid materials, helicopter landing deck and other related equipment.

Jackup rig legs may operate independently or have a lower hull referred to as a *mat* attached to the lower portion of the legs in order to provide a more stable foundation in soft bottom areas. Independent leg rigs are better suited for harder or uneven seabed conditions while mat rigs are better suited for soft bottom conditions. Some of our jackup rigs have a cantilever design, a feature that permits the drilling platform to be extended out from the hull, allowing it to perform drilling or workover operations over some types of preexisting platforms or structures. Our other jackup rigs have a slot-type design, permitting the rig to be configured for drilling operations to take place through a slot in the hull. Slot-type rigs are usually used for exploratory drilling, since it is difficult to position them over existing platforms or structures. Jackup rigs with the cantilever feature historically have achieved higher dayrates and utilization rates than slot type rigs.

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The following table contains information regarding our jackup rig fleet as of September 1, 2004:

Rig	Type ^(a)	Original Year Entered Service	Water Depth Capacity (in feet)	Rated Drilling Depth (in feet)	Location	Status
THE 110	MC	1982	100	20,000	Trinidad	Under Contract
THE 150	ILC	1979	150	20,000	U.S.	Under Contract
THE 152	MC	1980	150	20,000	U.S.	Under Contract
THE 153	MC	1980	150	20,000	U.S.	Cold Stacked
THE 155	ILC	1980	150	20,000	U.S.	Cold Stacked
THE 156	ILC	1983	150	20,000	Venezuela	Under Contract
THE 185	ILC	1982	120	20,000	U.S.	Cold Stacked
THE 191	MS	1978	160	20,000	U.S.	Cold Stacked
THE 200	MC	1979	200	20,000	U.S.	Under Contract
THE 201	MC	1981	200	20,000	U.S.	Under Contract
THE 202	MC	1982	200	20,000	U.S.	Under Contract
THE 203	MC	1981	200	20,000	U.S.	Under Contract
THE 204	MC	1981	200	20,000	U.S.	Under Contract
THE 205	MC	1979	200	20,000	Mexico	Under Contract
THE 206	MC	1980	200	20,000	Mexico	Under Contract
THE 207	MC	1981	200	20,000	U.S.	Under Contract
THE 208 ^(b)	MC	1980	200	20,000	Trinidad	Cold Stacked
THE 250	MS	1974	250	20,000	U.S.	Under Contract
THE 251	MS	1978	250	20,000	U.S.	Under Contract
THE 252	MS	1978	250	20,000	U.S.	Cold Stacked
THE 253	MS	1982	250	20,000	U.S.	Under Contract
THE 254	MS	1976	250	20,000	U.S.	Cold Stacked
THE 255 ^(c)	MS	1976	250	20,000	U.S.	Cold Stacked
THE 256 ^(c)	MS	1975	250	20,000	U.S.	Cold Stacked

(a) ILC means an independent leg cantilevered jackup rig. MC means a mat-supported cantilevered jackup rig. MS means a mat-supported slot-type jackup rig.

(b) This rig is currently unable to operate in the U.S. Gulf of Mexico due to regulatory restrictions.

(c) These rigs would require substantial refurbishment to be ready for service.

As of the last evaluation we conducted in early 2003, the estimated costs to prepare for service those rigs in the preceding table that (i) are noted as requiring substantial refurbishment in footnote (c) above, range from \$7.7 million to \$9.5 million per rig and (ii) are otherwise listed as cold stacked, range from \$1.0 million to \$3.5 million per rig. These estimated amounts will be subject to variables including further rig deterioration over time, the availability and cost of shipyard facilities, cost of equipment and materials and the actual extent of required repairs and maintenance. Actual amounts could vary substantially.

Barge Drilling Rigs (30)

Barge drilling rigs are mobile drilling platforms that are submersible and are built to work in eight to 20 feet of water. They are towed by tugboats to the drill site with the derrick lying down. The lower hull is then submerged by flooding compartments until it rests on the river or sea floor. The derrick is then raised and drilling operations are conducted with the barge resting on the bottom. Our barge drilling fleet consists of conventional and posted barge rigs. A posted barge is identical to a conventional barge except that the hull and

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superstructure are separated by 10- to 14-foot columns, which increases the water depth capabilities of the rig. Most of our barge drilling rigs are suitable for deep gas drilling.

The following table contains information regarding our barge drilling rig fleet as of September 1, 2004:

Rig	Type ^(a)	Original Year Entered Service	Horsepower Rating	Rated Drilling Depth (in feet)	Location	Status
1	Conv.	1980	2,000	20,000	U.S.	Cold Stacked
7	Posted	1981	2,000	25,000	U.S.	Cold Stacked
9	Posted	1975	2,000	25,000	U.S.	Under Contract
10	Posted	1981	2,000	25,000	U.S.	Cold Stacked
11	Conv.	1982	3,000	30,000	U.S.	Under Contract
15	Conv.	1981	2,000	25,000	U.S.	Under Contract
17	Posted	1981	3,000	30,000	U.S.	Under Contract
19	Conv.	1996	1,000	14,000	U.S.	Under Contract
20 ^{(b)(c)}	Conv.	1998	1,000	14,000	U.S.	Cold Stacked
21 ^(b)	Conv.	1982	1,500	15,000	U.S.	Cold Stacked
23	Conv.	1995	1,000	14,000	U.S.	Cold Stacked
27	Posted	1978	3,000	30,000	U.S.	Under Contract
28	Conv.	1979	3,000	30,000	U.S.	Cold Stacked
29	Conv.	1980	3,000	30,000	U.S.	Under Contract
30 ^(b)	Conv.	1981	3,000	30,000	U.S.	Cold Stacked
31 ^(b)	Conv.	1981	3,000	30,000	U.S.	Cold Stacked
32	Conv.	1982	3,000	30,000	U.S.	Cold Stacked
41	Posted	1981	3,000	30,000	U.S.	Under Contract
46	Posted	1981	3,000	30,000	U.S.	Under Contract
47 ^(b)	Posted	1982	3,000	30,000	U.S.	Cold Stacked
48	Posted	1982	3,000	30,000	U.S.	Under Contract
49	Posted	1980	3,000	30,000	U.S.	Cold Stacked
52	Posted	1981	2,000	25,000	U.S.	Under Contract
55	Posted	1981	3,000	30,000	U.S.	Under Contract
57	Posted	1978	2,000	25,000	U.S.	Under Contract
61 ^(b)	Posted	1978	3,000	30,000	U.S.	Cold Stacked
62 ^(d)	Posted	1978	3,000	30,000	U.S.	Cold Stacked
64	Posted	1979	3,000	30,000	U.S.	Shipyard
74 ^{(b)(e)}	Posted	1981	2,000	25,000	U.S.	Cold Stacked
75 ^{(b)(e)}	Posted	1979	3,000	30,000	U.S.	Cold Stacked

(a) Conv. means a conventional barge rig. Posted means a posted barge rig.

(b) These rigs would require substantial refurbishment to be ready for service.

(c) In September 2003, our inland barge Rig 20 experienced a fire while working in Louisiana inland waters. The incident resulted in the loss of drilling equipment and damage to the rig. The rig is no longer operating and will require substantial refurbishment to return to service. See Management's Discussion and Analysis of Financial Condition and Results of Operations Results of Continuing Operations Years Ended December 31, 2003 and 2002.

(d) In June 2003, our inland barge Rig 62 experienced a well control incident, commonly referred to as a blowout, while working in Texas inland waters. The rig is no longer operating and will require substantial refurbishment to return to service. See Management's

(footnotes continued on following page)

Discussion and Analysis of Financial Condition and Results of Operations Results of Continuing Operations Years Ended December 31, 2003 and 2002.

- (e) These rigs are not owned by us, but are bareboat chartered from a third party. Under these bareboat charters, we charter the rigs from a third party, operate, maintain and insure them and are obligated to return them at the end of the charter period in accordance with the terms of the charters, which generally require the rigs to be in the same condition as received, ordinary wear and tear excepted. Each charter expires in February 2005.

As of the last evaluation we conducted in early 2003, repair costs for rigs designated as cold stacked in the preceding table are estimated to be \$1.1 million per rig or less. Rigs requiring substantial refurbishment, as noted in footnotes (b), (c) and (d) above, are estimated to cost between \$2.4 million to \$4.5 million per rig to repair, except for *Rig 62* which is estimated to cost approximately \$7.0 million to repair. These estimated amounts will be subject to variables including further rig deterioration over time, the availability and cost of shipyard facilities, cost of equipment and materials and the actual extent of required repairs and maintenance. Actual amounts could vary substantially.

Other Drilling Rigs (16)

A submersible rig is a mobile drilling platform that is towed to the well site where it is submerged by flooding its superstructure until it rests on the sea floor, with the upper hull above the water surface. After completion of the drilling operation, the rig is refloated by pumping the water out of the lower hull, so that it can be towed to another location. Submersible rigs typically operate in water depths of 12 to 85 feet. Our three submersible rigs are suitable for deep gas drilling.

A platform drilling rig is placed on a production platform and is similar to a modular land rig. The production platform's crane is capable of lifting the modularized rig crane that subsequently sets the rig modules. The assembled rig has all the drilling, housing and support facilities necessary for drilling multiple production wells. Most platform drilling rig contracts are for multiple wells and extended periods of time on the same platform. Once work has been completed on a particular platform, the rig can be redeployed to another platform for further work. We have one platform drilling rig.

Our nine land drilling rigs are completely equipped to drill oil and gas wells. These rigs are designed to be transported by truck and assembled by crane. They require a firm, level area to be erected and sometimes require foundation work to be performed to support the drill floor and derrick.

Our three Lake Maracaibo barge rigs are designed to work in Lake Maracaibo, Venezuela, which requires operation in a floating mode in up to 150 feet of water. These rigs were modified by widening the hull to 100 feet, installing a mooring system and cantilevering the drill floor. As a result of these modifications, these rigs are generally not suitable for deployment to other locations. None of these rigs have operated since January 2000 and future prospects are uncertain. All three of these barge rigs would require substantial refurbishment to operate.

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The following table contains information regarding our other rigs as of September 1, 2004:

Rig	Type ^(a)	Original Year Entered Service/ Upgraded	Horsepower Rating	Rated Drilling Depth (in feet)	Location	Status
THE 75	Subm.	1983	N/A	25,000	U.S.	Under Contract
THE 77	Subm.	1983	N/A	30,000	U.S.	Cold Stacked
THE 78	Subm.	1983	N/A	30,000	U.S.	Cold Stacked
Rig 3 ^(b)	Plat.	1993/1998	N/A	25,000	Mexico	Under Contract
26 ^(c)	Land	1980/1998	750	6,500	Venezuela	Warm Stacked
27 ^(c)	Land	1981/1997	900	8,000	Venezuela	Warm Stacked
36	Land	1982	2,000	18,000	Venezuela	Warm Stacked
37	Land	1982	2,000	18,000	Venezuela	Warm Stacked
40	Land	1980	2,000	25,000	Venezuela	Under Contract
42	Land	1981	2,000	25,000	Venezuela	Warm Stacked
43	Land	1981	2,000	25,000	Venezuela	Warm Stacked
54	Land	1981	3,000	30,000	Venezuela	Under Contract
55	Land	1983	3,000	35,000	Venezuela	Under Contract
40	LMB	1980/1994	3,000	25,000	Venezuela	Cold Stacked
42	LMB	1982/1994	2,000	25,000	Venezuela	Cold Stacked
43	LMB	1982/1994	3,000	25,000	Venezuela	Cold Stacked

(a) Subm. means a submersible rig. Plat. means a platform drilling rig. LMB means a Lake Maracaibo barge rig.

(b) Our platform rig has been awarded a contract with PEMEX to begin working in Mexico in late-2004. The expected cost of upgrades to the platform rig necessary to comply with the contract specifications is approximately \$8 million to \$9 million.

(c) These rigs are owned by a joint venture in which we have a 66.7% ownership interest.

As of the last evaluation we conducted in early 2003, the estimated costs to prepare for service those rigs in the preceding table that are listed as cold stacked range from \$1.9 million to \$5.3 million per rig. These estimated amounts will be subject to variables including further rig deterioration over time, the availability and cost of shipyard facilities, cost of equipment and materials and the actual extent of required repairs and maintenance. Actual amounts could vary substantially.

Drilling Contracts

Our contracts to provide drilling services are individually negotiated and vary in their terms and provisions. We obtain most of our contracts through competitive bidding against other contractors. Drilling contracts generally provide for payment on a dayrate basis, with higher rates while the drilling unit is operating and lower rates for periods of mobilization or when drilling operations are interrupted or restricted by equipment breakdowns, adverse environmental conditions or other factors.

A dayrate drilling contract generally extends over a period of time covering the drilling of a single well or group of wells or covering a stated term. These contracts typically can be terminated by the customer under various circumstances such as the loss or destruction of the drilling unit or the suspension of drilling operations for a specified period of time as a result of a breakdown of major equipment. The contract term in some instances may be extended by the customer exercising options for the drilling of additional wells or for an additional term, or by exercising a right of first refusal.

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Historically, most of our drilling contracts have been short-term or on a well-to-well basis. From time to time, however, we enter into longer term drilling contracts. In the third quarter of 2003, we were awarded long term contracts with PEMEX, the Mexican national oil company, for two of our jackup rigs and a platform rig.

After upgrades to comply with contract specifications, one rig began operating on a 720-day contract in early November 2003 at a contract dayrate of approximately \$42,000. The other jackup rig began operating in early December 2003 on a 1,081-day contract at a contract dayrate of approximately \$39,000. The platform rig contract is 1,289 days in duration beginning in late-2004 at a contract dayrate of approximately \$29,000. We expect the upgrade to the platform rig necessary to comply with contract specifications to occur in 2004 and cost approximately \$8 million to \$9 million. Each of the contracts can be terminated by PEMEX on five days' notice, subject to certain conditions.

Customers

We engage in offshore and inland marine drilling primarily for independent oil and gas companies, although we also work for large international oil companies and government-controlled oil companies. One customer, Applied Drilling Technologies, Inc., accounted for 11% of our 2003 operating revenues. No other customers accounted for 10% or greater of our revenues in 2003, 2002 or 2001. Nonetheless, the loss of any significant customer could, at least in the short term, have a material adverse effect on our results of operations.

Competitors

The U.S. Gulf of Mexico shallow water and U.S. inland marine market segments in which we operate are highly competitive. In the U.S. inland marine market segment, our principal competitor is Parker Drilling Co. In the U.S. Gulf of Mexico shallow water market segment, we compete with numerous industry participants, none of which has a dominant market share. Drilling contracts are traditionally awarded on a competitive bid basis. Pricing is often the primary factor in determining which qualified contractor is awarded a job, although rig availability, safety record, crew quality and technical capability of service and equipment may also be considered. Many of our competitors in the U.S. Gulf of Mexico shallow water market segment have greater financial and other resources than we have and may be better able to make technological improvements to existing equipment or replace equipment that becomes obsolete.

Market

General

Most jackup and submersible rigs can be moved from one region to another, and in this sense the marine contract drilling market is a global market. Because the cost of a rig move is significant, there is limited availability of rig moving vessels and some rigs are designed to work in specific regions, the demand/supply balance for jackup and submersible rigs may vary somewhat from region to region. However, significant variations between regions tend not to exist on a long-term basis due to the ability to move rigs. Because many of our rigs were designed for drilling in the U.S. Gulf Coast, our ability to move our rigs to other regions in response to changes in market conditions is limited. In addition, in the master separation agreement, we agree not to compete with Transocean in specified geographic locations. See *Certain Relationships and Related Party Transactions*, *Relationship Between Us and Transocean*, *Master Separation Agreement*, *Noncompetition and Other Covenants*.

U.S. Inland Barge Market Segment

Our barge rig fleet operates in marshes, rivers, lakes and shallow bay and coastal water tidal areas that are known as the transition zone. Our primary barge market segment consists of the inland shallow water areas of the U.S. Gulf Coast, where jackup rigs are unable to operate. This area historically has been the world's largest market segment for barge rigs.

U.S. Gulf of Mexico Shallow Water Market Segment

The U.S. Gulf of Mexico shallow water market segment is serviced by our jackups and submersibles. This market segment begins at the outer limit of the transition zone and extends to water depths of about

350 feet. Oil and gas reserves in these water depths have been developed to a significantly greater degree than reserves in deeper water (beginning at water depths of 350 feet and extending to approximately 10,000 feet).

Other Assets

We have a 25% equity interest in Delta Towing, which operates a U.S. inland and shallow water marine support vessel business. Beta Marine Services, LLC owns the remaining 75% equity interest in Delta Towing. In connection with its formation, Delta Towing issued notes to us with principal amounts totaling \$144 million, secured by Delta Towing's assets described in the following paragraph. Immediately prior to the closing of the merger with Transocean, we valued these notes at \$80 million. Delta Towing has failed to make some of its scheduled quarterly interest and principal payments on these notes. See Management's Discussion and Analysis of Financial Condition and Results of Operations Related Party Transactions.

Delta Towing owns and operates towing vessels and barges used primarily to transport and store equipment and material to support jackup and barge rig drilling operations. Delta Towing utilizes rig moving tugs, utility barges, service tugs and crew boats in connection with its operations. Although these assets can be deployed for other uses, any continuation of the current downturn, or further significant downturn, in oil and gas activity in the transition zone would have a negative impact on Delta Towing's business that could not be fully offset by deployment of such assets to other markets. As of September 1, 2004, Delta Towing's operating assets consisted of 51 inland tugs, 26 offshore tugs, 36 crewboats, 35 deck barges, 17 shale barges, five spud barges and three offshore barges.

We also own additional offshore equipment that consists of five jackup rigs, three of which are mat-supported and two which are independent leg rigs, ranging in water depth capacity from 100 feet to 160 feet, that we do not anticipate returning to drilling service as we believe doing so would be cost prohibitive. In May 2003, we decided to market these units for non-drilling uses such as production platforms or accommodation units.

Regulation

Our operations are affected in varying degrees by governmental laws and regulations. The drilling industry is dependent on demand for services from the oil and gas industry and, accordingly, is also affected by changing tax and other laws relating to the energy business generally.

The transition zone and shallow water areas of the U.S. Gulf of Mexico are ecologically sensitive. Environmental issues have led to higher drilling costs, a more difficult and lengthy well permitting process and, in general, have adversely affected decisions of oil and gas companies to drill in these areas. In the United States, regulations applicable to our operations include regulations controlling the discharge of materials into the environment, requiring removal and cleanup of materials that may harm the environment or otherwise relating to the protection of the environment. For example, as an operator of mobile offshore drilling units in navigable U.S. waters and some offshore areas, we may be liable for damages and costs incurred in connection with oil spills or other unauthorized discharges of chemicals or wastes resulting from or related to those operations. Laws and regulations protecting the environment have become more stringent, and may in some cases impose strict liability, rendering a person liable for environmental damage without regard to negligence or fault on the part of such person. Some of these laws and regulations may expose us to liability for the conduct of or conditions caused by others or for acts which were in compliance with all applicable laws at the time they were performed. The application of these requirements or the adoption of new requirements could have a material adverse effect on our financial position or results of operations.

The U.S. Federal Water Pollution Control Act of 1972, commonly referred to as the Clean Water Act, prohibits the discharge of specified substances into the navigable waters of the United States without a permit. The regulations implementing the Clean Water Act require permits to be obtained by an operator before specified exploration activities occur. Offshore facilities must also prepare plans addressing spill prevention control and countermeasures. Violations of monitoring, reporting and permitting requirements can result in the imposition of civil and criminal penalties.

The U.S. Oil Pollution Act of 1990 (OPA) and related regulations impose a variety of requirements on responsible parties related to the prevention of oil spills and liability for damages resulting from such spills.

Few defenses exist to the liability imposed by OPA, and the liability could be substantial. Failure to comply with ongoing requirements or inadequate cooperation in the event of a spill could subject a responsible party to civil or criminal enforcement action.

The U.S. Outer Continental Shelf Lands Act authorizes regulations relating to safety and environmental protection applicable to lessees and permittees operating on the outer continental shelf. Included among these are regulations that require the preparation of spill contingency plans and establish air quality standards for certain pollutants, including particulate matter, volatile organic compounds, sulfur dioxide, carbon monoxide and nitrogen oxides. Specific design and operational standards may apply to outer continental shelf vessels, rigs, platforms, vehicles and structures. Violations of lease conditions or regulations related to the environment issued pursuant to the Outer Continental Shelf Lands Act can result in substantial civil and criminal penalties, as well as potential court injunctions curtailing operations and canceling leases. Such enforcement liabilities can result from either governmental or citizen prosecution.

The U.S. Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), also known as the Superfund law, imposes liability without regard to fault or the legality of the original conduct on some classes of persons that are considered to have contributed to the release of a hazardous substance into the environment. These persons include the owner or operator of a facility where a release occurred and companies that disposed or arranged for the disposal of the hazardous substances found at a particular site. Persons who are or were responsible for releases of hazardous substances under CERCLA may be subject to joint and several liability for the cost of cleaning up the hazardous substances that have been released into the environment and for damages to natural resources. We could be subject to liability under CERCLA principally in connection with our onshore activities. It is also not uncommon for third parties to file claims for personal injury and property damage allegedly caused by the hazardous substances released into the environment.

Our non-U.S. contract drilling operations are subject to various laws and regulations in countries in which we operate, including laws and regulations relating to the importation of and operation of drilling units, currency conversions and repatriation, oil and gas exploration and development, taxation of offshore earnings and earnings of expatriate personnel, the use of local employees and suppliers by foreign contractors and duties on the importation and exportation of drilling units and other equipment. Governments in some foreign countries have become increasingly active in regulating and controlling the ownership of concessions and companies holding concessions, the exploration for oil and gas and other aspects of the oil and gas industries in their countries. In some areas of the world, this governmental activity has adversely affected the amount of exploration and development work done by major oil and gas companies and may continue to do so. Operations in less developed countries can be subject to legal systems that are not as mature or predictable as those in more developed countries, which can lead to greater uncertainty in legal matters and proceedings.

Although significant capital expenditures may be required to comply with these governmental laws and regulations, such compliance has not materially adversely affected our earnings or competitive position.

Employees

As of September 1, 2004, we had approximately 1,950 employees. We require highly skilled personnel to operate and provide technical services and support for our drilling units. As a result, we conduct extensive personnel recruiting, training and safety programs.

As of September 1, 2004, approximately 223 (or 11%) of our employees worldwide were working under collective bargaining agreements, approximately 42 of whom were working in Trinidad and 181 of whom were working in Venezuela. Efforts have been made from time to time to unionize other portions of our workforce, including workers in the Gulf of Mexico.

Legal Proceedings

In October 2001, we were notified by the U.S. Environmental Protection Agency (EPA) that the EPA had identified one of our subsidiaries as a potentially responsible party in connection with the Palmer Barge Line superfund site located in Port Arthur, Jefferson County, Texas. Based upon the information provided by the EPA and our review of our internal records to date, we dispute our designation as a potentially responsible

party and do not expect that the ultimate outcome of this case will have a material adverse effect on our business or consolidated financial position. We continue to monitor this matter.

In December 2002, we received an assessment for corporate income taxes from SENIAT, the national Venezuelan tax authority, of approximately \$16 million (based on current exchange rates) relating to calendar years 1998 through 2001. In March 2003, we paid approximately \$2.6 million of the assessment, plus approximately \$0.3 million in interest, and are contesting the remainder of the assessment. After we made the partial assessment payment, we received a revised assessment in September 2003 of approximately \$18.8 million (based on current exchange rates and inclusive of penalties). The resolution of this assessment is not expected to impact us as Transocean is obligated to indemnify us against any payments so long as we cooperate and provide assistance to Transocean in the resolution of the assessment. See Certain Relationships and Related Party Transactions Relationship Between Us and Transocean Tax Sharing Agreement.

We recently learned that certain of our subsidiaries have been named, along with other defendants, in several complaints that have been filed in the Circuit Courts of the State of Mississippi involving over 700 persons that allege personal injury arising out of asbestos exposure in the course of their employment by some of these defendants between 1965 and 1986. The complaints also name as defendants certain of Transocean's subsidiaries to whom we may owe indemnity and other unaffiliated defendant companies, including companies that allegedly manufactured drilling related products containing asbestos that are the subject of the complaints. The number of unaffiliated defendant companies involved in each complaint ranges from approximately 20 to 70. The complaints allege that the defendant drilling contractors used those asbestos-containing products in offshore drilling operations, land based drilling operations and in drilling structures, drilling rigs, vessels and other equipment and assert claims based on, among other things, negligence and strict liability, and claims authorized under the Jones Act. The plaintiffs seek, among other things, awards of unspecified compensatory and punitive damages. Based on a recent decision of the Mississippi Supreme Court, we anticipate that the trial courts may grant motions requiring each plaintiff to name the specific defendant or defendants against whom such plaintiff makes a claim and the time period and location of asbestos exposure so that the cases may be properly severed. These complaints were only recently filed and we have not yet had an opportunity to conduct any discovery nor have we been able to determine the number of plaintiffs, if any, that were employed by our subsidiaries or Transocean's subsidiaries or otherwise have any connection with our or Transocean's drilling operations. We intend to defend ourselves vigorously and, based on the limited information available to us at this time, we do not expect the ultimate outcome of these lawsuits to have a material adverse effect on our business or consolidated financial position.

Due to the limited information available to us at this time, we have not yet made a determination whether we or Transocean are financially responsible under the terms of the master separation agreement for any losses we or Transocean may incur as a result of the legal proceedings described in the foregoing paragraph. See Certain Relationships and Related Party Transactions Relationship Between Us and Transocean Master Separation Agreement Indemnification and Release.

Under the master separation agreement, Transocean has agreed to indemnify us for any losses we incur as a result of the legal proceedings described in the following three paragraphs. See Certain Relationships and Related Party Transactions Relationship Between Us and Transocean Master Separation Agreement Indemnification and Release.

In March 1997, an action was filed by Mobil Exploration and Producing U.S. Inc. and affiliates, St. Mary Land & Exploration Company and affiliates and Samuel Geary and Associates Inc. against our subsidiary Cliffs Drilling, its underwriters at Lloyd's (the Underwriters) and its insurance broker in the 16th Judicial District Court of St. Mary Parish, Louisiana. The plaintiffs alleged damages in excess of \$50 million in connection with the drilling of a turnkey well in 1995 and 1996. The case was tried before a jury in January and February 2000, and the jury returned a verdict of approximately \$30 million in favor of the plaintiffs for excess drilling costs, loss of insurance proceeds, loss of hydrocarbons, expenses and interest. We and the Underwriters appealed such judgment, and the Louisiana Court of Appeals reduced the amount for which we may be responsible to less than \$10 million. The plaintiffs requested that the Supreme Court of Louisiana consider the matter and reinstate the original verdict. We and the Underwriters also appealed to the Supreme

Court of Louisiana requesting that the Court reduce the verdict or, in the case of the Underwriters, eliminate any liability for the verdict. Prior to the Supreme Court of Louisiana ruling on these petitions, we settled with the St. Mary group of plaintiffs and the State of Louisiana. Subsequently, the Supreme Court of Louisiana denied the applications of all remaining parties. We have settled with all remaining plaintiffs. We believe that any amounts, apart from a small deductible, paid in settlement are covered by relevant primary and excess liability insurance policies. However, the insurers and Underwriters have denied all coverage. We have instituted litigation against those insurers and Underwriters to enforce our rights under the relevant policies. One group of insurers has asserted a counterclaim against us claiming that they issued the policy as a result of a misrepresentation. The settlements did not have a material adverse effect on our business or consolidated financial position, and we do not expect that the ultimate outcome of the case involving the insurers and Underwriters will have a material adverse effect on our business or consolidated financial position.

In 1984, in connection with the financing of the corporate headquarters, at that time, for Reading & Bates Corporation (R&B), a predecessor to one of our subsidiaries, in Tulsa, Oklahoma, the Greater Southwestern Funding Corporation (Southwestern) issued and sold, among other instruments, Zero Coupon Series B Bonds due 1999-2009 with an aggregate \$189 million value at maturity. Paine Webber Incorporated purchased all of the Series B Bonds for resale and in 1985 acted as underwriter in the public offering of most of these bonds. The proceeds from the sale of the bonds were used to finance the acquisition and construction of the headquarters. R&B's rental obligation was the primary source for repayment of the bonds. In connection with the offering, R&B entered into an indemnification agreement indemnifying Southwestern and Paine Webber from loss caused by any untrue statement or alleged untrue statement of a material fact or the omission or alleged omission of a material fact contained or required to be contained in the prospectus or registration statement relating to that offering. Several years after the offering, R&B defaulted on its lease obligations, which led to a default by Southwestern. Several holders of Series B bonds filed an action in Tulsa, Oklahoma in 1997 against several parties, including Paine Webber, alleging fraud and misrepresentation in connection with the sale of the bonds. In response to a demand from Paine Webber in connection with that lawsuit and a related lawsuit, R&B agreed in 1997 to retain counsel for Paine Webber with respect to only that part of the referenced cases relating to any alleged material misstatement or omission relating to R&B made in certain sections of the prospectus or registration statement. The agreement to retain counsel did not amend any rights and obligations under the indemnification agreement. There has been only limited progress on the substantive allegations of the case. The trial court has denied class certification, and the plaintiffs' appeal of this denial to a higher court has been denied. The plaintiffs have further appealed that decision. We dispute that there are any matters requiring us to indemnify Paine Webber. In any event, we do not expect that the ultimate outcome of this matter will have a material adverse effect on our business or consolidated financial position.

In April 2003, Gryphon Exploration Company (Gryphon) filed suit against some of our subsidiaries, Transocean and other third parties in the United States District Court in Galveston, Texas claiming damages in excess of \$6 million. In its complaint, Gryphon alleges the defendants were responsible for well problems experienced by Gryphon with respect to a well in the Gulf of Mexico drilled by our subsidiaries in 2001. We dispute the allegations of Gryphon and intend to vigorously defend this claim. While we continue to investigate this matter, we do not currently expect the ultimate outcome of this matter to have a material adverse effect on our business or consolidated financial position.

We and our subsidiaries are involved in a number of other lawsuits, all of which have arisen in the ordinary course of our business. We do not believe that ultimate liability, if any, resulting from any such other pending litigation will have a material adverse effect on our business or consolidated financial position.

We cannot predict with certainty the outcome or effect of any of the litigation or regulatory matters specifically described above or of any other pending litigation. There can be no assurance that our beliefs or expectations as to the outcome or effect of any lawsuit or other litigation matter will prove correct and the eventual outcome of these matters could materially differ from management's current estimates.

MANAGEMENT

Directors and Executive Officers

The following table sets forth the names, ages and positions of our directors and executive officers as of September 1, 2004:

Name	Age	Position
Thomas N. Amonett	61	Director
R. Don Cash	62	Director
Gregory L. Cauthen	47	Director
Thomas M Hamilton	61	Director
Thomas R. Hix	57	Director
Arthur Lindenauer	67	Director
Robert L. Long	58	Director
J. Michael Talbert	57	Director and Chairman of the Board
Jan Rask	49	President, Chief Executive Officer and Director
T. Scott O Keefe	48	Senior Vice President and Chief Financial Officer
David J. Crowley	46	Vice President Marketing
Michael L. Kelley	46	Vice President Operations
Lloyd M. Pellegrin	56	Vice President Human Resources
Randall A. Stafford	48	Vice President, General Counsel and Corporate Secretary
Dale W. Wilhelm	41	Vice President and Controller

Thomas N. Amonett has served as a director since May 2004. He has been President and Chief Executive Officer of Champion Technologies, Inc., a manufacturer and distributor of specialty chemicals and related services since 1999. From November 1998 to June 1999, he was President, Chief Executive Officer and a director of American Residential Services, Inc., a company providing equipment and services relating to residential heating, ventilating, air conditioning, plumbing, electrical and indoor air quality systems and appliances. From July 1996 until June 1997, Mr. Amonett was Interim President and Chief Executive Officer of Weatherford Enterra, Inc., an energy services and manufacturing company. Mr. Amonett also serves as a director of Reunion Industries Inc., a specialty manufacturing company, and Stelmar Shipping Ltd., an international provider of petroleum product and crude oil transportation services.

R. Don Cash has served as a director since May 2004. He is a director of Questar Corporation, an integrated natural gas company. He served as the Chairman of the Board of Directors of Questar from May 1985 to May 2003; Chief Executive Officer from May 1984 to May 2002; and President from May 1984 to February 2001. Mr. Cash also serves as a director of National Fuel Gas Co., a diversified energy company, Aegis Mutual Insurance Services, a mutual insurance company, Zions Bancorporation, the Lubbock Symphony Board and The Texas Tech Foundation.

Gregory L. Cauthen has served as director since July 2002. He is Senior Vice President and Chief Financial Officer of Transocean. He was also Treasurer of Transocean until July 2003. Mr. Cauthen served as Vice President, Chief Financial Officer and Treasurer from December 2001 until he was elected Senior Vice President in July 2002. From March 2001 until December 2001, Mr. Cauthen served as Vice President, Finance of Transocean. Prior to joining Transocean, he served as President and Chief Executive Officer of WebCaskets.com, Inc., a provider of death care services, from June 2000 until February 2001. Prior to June 2000, he was employed at Service Corporation International, a provider of death care services, where he served as Senior Vice President, Financial Services from July 1998 to August 1999 and Vice President, Treasurer from July 1995 to July 1998, was assigned to various special projects from August 1999 to May 2000 and had been employed in various other positions since February 1991.

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Thomas M Hamilton has served as a director since May 2004. He served as the Chairman, President and Chief Executive Officer of EEX Corporation from January 1997 until his retirement in November 2002. From 1992 to 1997, Mr. Hamilton served as Executive Vice President of Pennzoil Company and as President of Pennzoil Exploration and Production Company. Mr. Hamilton was a director of BP Exploration, where he served as Chief Executive Officer of the Frontier and International Operating Company of BP Exploration from 1989 to 1991 and as the General Manager for East Asia/ Australia/ Latin America from 1988 to 1989. From 1985 to 1988, he held the position of Senior Vice President of Exploration at Standard Oil Company, prior to its being merged into BP. Mr. Hamilton is also a Director of FMC Technologies Inc.

Thomas R. Hix was appointed as a director in February 2004. He was senior Vice President and Chief Financial Officer of Cooper Cameron Corporation, a petroleum and industrial equipment and services company, from January 1995 until December 2002. Mr. Hix has been retired since January 2003. Previously, he was Senior Vice President of Finance, Treasurer and Chief Financial Officer of The Western Company of North America from September of 1993 to April 1995.

Arthur Lindenauer was appointed as a director in February 2004. He has been a director of Transocean since 1999. He became Chairman of the Board of Schlumberger Technology Corporation, the principal U.S. subsidiary of Schlumberger Limited, a global oilfield and information services company, in December 1998 and served in that position through February of 2004. He previously served as Executive Vice President Finance and Chief Financial Officer of Schlumberger from January 1980 to December 1998. Mr. Lindenauer was a partner with the accounting firm of Price Waterhouse from 1972 to 1980. Mr. Lindenauer is also a director of the New York Chapter of the Cystic Fibrosis Foundation, a Trustee of the American University in Cairo and a member of the Board of Overseers of the Tuck School of Business at Dartmouth College.

Robert L. Long has served as director since our merger transaction with Transocean in January 2001. He is President and Chief Executive Officer and a director of Transocean. Mr. Long served as Chief Financial Officer of Transocean from August 1996 until December 2001, at which time he assumed the position of President. Mr. Long also served as Chief Operating Officer from June 2002 until October 2002, when he assumed the additional position of Chief Executive Officer. Mr. Long served as Senior Vice President of Transocean from May 1990 until the time of Transocean's merger transaction with Sedco Forex, at which time he assumed the position of Executive Vice President. Mr. Long also served as Treasurer of Transocean from September 1997 until March 2001. Mr. Long has been employed by Transocean since 1976 and was elected Vice President in 1987.

J. Michael Talbert has served as our Chairman of the Board since July 2002. He is Chairman of the Board of Directors of Transocean. He has served as a member of the Board of Directors of Transocean since August 1994. Mr. Talbert served as Chief Executive Officer of Transocean from August 1994 until October 2002, at which time he became Chairman of the Board of Directors. Mr. Talbert also served as Chairman of the Board of Transocean from August 1994 until the time of Transocean's merger transaction with Sedco Forex and as President of Transocean from the time of such merger until December 2001. Prior to assuming his duties with Transocean, Mr. Talbert was President and Chief Executive Officer of Lone Star Gas Company, a natural gas distribution company and a division of Ensearch Corporation. He is also a director of El Paso Corporation, a diversified natural gas company.

Jan Rask has been our President and Chief Executive Officer and has served as a director since July 2002. Mr. Rask was Managing Director, Acquisitions and Special Projects, of Pride International, Inc., a contract drilling company, from September 2001 to July 2002, when he joined our company. From July 1996 to September 2001, Mr. Rask was President, Chief Executive Officer and a director of Marine Drilling Companies, Inc., a contract drilling company. Mr. Rask served as President and Chief Executive Officer of Arethusa (Off-Shore) Limited from May 1993 until the acquisition of Arethusa (Off-Shore) Limited by Diamond Offshore Drilling, Inc. in May 1996. Mr. Rask joined Arethusa (Off-Shore) Limited's principal operating subsidiary in 1990 as its President and Chief Executive Officer. Mr. Rask has been a director of Veritas DGC Inc., an integrated geophysical service company, since 1998.

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T. Scott O Keefe has been our Senior Vice President and Chief Financial Officer since July 2002. From April 2002 to July 2002, Mr. O Keefe was an independent financial consultant. Mr. O Keefe was Vice President of Pride International, Inc. from September 2001 until April 2002. Mr. O Keefe was Senior Vice President, Chief Financial Officer and Secretary of Marine Drilling Companies, Inc. from January 1998 until September 2001. From April 1996 to January 1998, Mr. O Keefe was a consultant to and Senior Vice President and Chief Financial Officer of Grey Wolf, Inc., a contract drilling company. From March 1995 to April 1996, Mr. O Keefe provided financial consulting services to various energy companies. From June 1980 to March 1995, Mr. O Keefe held various financial management positions with public and private oil and gas related companies. He began his professional career with Price Waterhouse & Co. in 1978.

David J. Crowley has been our Vice President Marketing since April 2003. Mr. Crowley was Director of Marketing at ENSCO International, Inc. from February 2001 to April 2003, when he joined our company. Mr. Crowley served as Manager of Marketing for the Schlumberger Integrated Project Management group from November 1999 to January 2001. From February 1997 to October 1999, Mr. Crowley served as Manager of Marketing for Schlumberger Oilfield Services UK Ltd. Prior to February 1997, Mr. Crowley held various management positions in operations, engineering and marketing spanning 17 years for Sedco Inc. and Sedco Forex in Europe, West Africa, Middle East, India and Southeast Asia.

Michael L. Kelley became our Vice President Domestic Operations in February 2004 and in April 2004 he became Vice President Operations. Mr. Kelley was Manager Operations at ENSCO Offshore Company, the domestic offshore drilling division of ENSCO International, Inc., from April 1999 to January 2004. From June 1982 to April 1999, Mr. Kelley served in various capacities at R&B Falcon Corporation, the latest of which was as Drilling Superintendent from July 1991 to April 1999. Prior to June 1982, Mr. Kelley held various positions with Tierra Drilling Company.

Lloyd M. Pellegrin has been our Vice President Human Resources since November 2002. Mr. Pellegrin was Region Human Resource Manager, Shallow and Inland Water Region of Transocean from February 2001 until November 2002. From January 1998 until January 2001, Mr. Pellegrin served as Vice President, Administration of R&B Falcon Drilling USA, Inc. Mr. Pellegrin also served as Vice President, Administration with Falcon Drilling Company, Inc. from November 1992 until January 1998. Prior to November 1992, Mr. Pellegrin worked for Atlantic Pacific Marine Corp. for 15 years, most recently as Vice President, Administration.

Randall A. Stafford became our Vice President, General Counsel and Corporate Secretary in January 2003. From January 2001 until January 2003, Mr. Stafford served as Associate General Counsel of Transocean. From January 2000 until January 2001, Mr. Stafford served as Counsel to R&B Falcon. From January 1990 until January 2000, Mr. Stafford was employed as Associate General Counsel of Pool Energy Services Company, an international oil and gas drilling and well servicing company that was acquired by Nabors Industries in November 1999.

Dale W. Wilhelm has been our Vice President and Controller since July 2003. From July 2002 to July 2003, Mr. Wilhelm was an independent financial consultant. Mr. Wilhelm was Vice President and Controller of Marine Drilling Companies, Inc., a contract drilling company, from May 1998 to July 2002. From August 1997 to May 1998, Mr. Wilhelm was Corporate Controller of Continental Emsco Company, an oilfield equipment manufacturer and distributor, and from September 1994 to August 1997, he was Corporate Controller of Serv-Tech, Inc., an industrial maintenance provider. Mr. Wilhelm was Assistant Corporate Controller for CRSS Inc., an engineering and construction company, from May 1990 to September 1994. Prior to May 1990, Mr. Wilhelm was with the public accounting firm of KPMG, LLP as Audit Manager. Mr. Wilhelm is a certified public accountant.

Board and Committee Activity and Structure

The audit committee, which consists of Messrs. Cauthen, Hix, Hamilton and Lindenauer (Chairman), reviews and reports to the board of directors the scope and results of audits by our outside auditor and our internal auditing function and review with the outside auditor the adequacy of our system of internal controls, with both Messrs. Hix and Lindenauer qualifying as financial experts. It reviews transactions between us

and our directors and officers, our policies regarding those transactions and compliance with our business ethics and conflict of interest policies. The audit committee also recommends to the board of directors a firm of certified public accountants to serve as our outside auditor for each fiscal year, review the audit and other professional services rendered by the outside auditor and periodically review the independence of the outside auditor. We expect Mr. Cauthen to resign from this committee within one year from the date of our IPO in order to satisfy the New York Stock Exchange and Securities and Exchange Commission requirements for independence of all members of audit committees.

The executive compensation committee, which consists of Messrs. Amonett, Cash, Hamilton and Long (Chairman), reviews and recommends to the board of directors the compensation and benefits of our executive officers, establishes and reviews general policies relating to our compensation and benefits and administers our stock plans.

The corporate governance committee, which consists of Messrs. Amonett, Cash, Hix and Talbert (Chairman), assists the Board in (1) identifying individuals qualified to become members of the Board consistent with criteria approved by the Board, (2) recommending to the Board the director nominees to fill vacancies and to stand for election at the next annual meeting of shareholders, (3) reviewing and recommending Board compensation, (4) developing and recommending to the Board a set of corporate governance principles applicable to us, (5) recommending committee assignment for directors to the Board and (6) overseeing an annual review of Board performance.

In addition to regularly scheduled board and committee meetings, our non-management directors meet in executive sessions without the presence of management in conjunction with regularly scheduled board meetings. These sessions are led by the Chairman of the Board of Directors, Mr. Talbert.

Beginning at the time Transocean ceases to own at least a majority of the voting power of our outstanding capital stock, our directors will be divided into three classes serving staggered three-year terms. At each annual meeting of stockholders, directors will be elected to succeed the class of directors whose terms have expired. This classification of our board of directors could have the effect of increasing the length of time necessary to change the composition of a majority of the board of directors. Following this classification of the board, in general, at least two annual meetings of stockholders will be necessary for stockholders to effect a change in a majority of the members of the board of directors. Prior to this classification of the board, each director will serve for a term ending on the next annual meeting date or until his or her successor has been duly elected and qualified or until his or her earlier death, resignation or removal.

Because we are considered to be controlled by Transocean under New York Stock Exchange Corporate Governance Rules, we are eligible for exemptions from provisions of these rules requiring a majority of independent directors, nominating/ corporate governance and compensation committees composed entirely of independent directors and written charters addressing specified matters. We have elected to take advantage of these exemptions. In the event that we cease to be a controlled company within the meaning of these rules, we will be required to comply with these provisions after the specified transition periods.

The master separation agreement provides Transocean with continuing rights to nominate board and committee members. See [Certain Relationships and Related Party Transactions](#) Relationship Between Us and Transocean Master Separation Agreement.

Summary Compensation Table

The following table shows the aggregate compensation paid to our chief executive officer and four other most highly compensated executive officers (the Named Executive Officers) during the years ended December 31, 2002 and 2003. All information set forth in this table reflects compensation earned by these individuals for the years ended December 31, 2002 and 2003.

Summary Compensation Table

Name and Principal Position	Year	Annual Compensation			Long-Term Compensation Awards		All Other Compensation (\$) ^(c)
		Salary(\$)	Bonus(\$) ^(a)	Other Annual Compensation(\$)	Restricted Stock Award(\$)	Securities Underlying Options/SARs ^(b)	
Jan Rask	2003	530,000	-0-				2,347
President and Chief Executive Officer	2002	242,917(d)	194,103				150
T. Scott O Keefe	2003	260,000	19,500				9,360
Senior Vice President and Chief Financial Officer	2002	118,333(d)	66,207				1,125
David J. Crowley	2003	129,026(d)	9,677	39,808(e)			3,709
Vice President Marketing	2002						
Rodney W. Meisetschlaeger	2003	178,861	-0-				8,566
Vice President Offshore Operations(f)	2002	174,580	36,941			10,500	8,068
Randall A. Stafford	2003	170,000	1,913				360
Vice President, General Counsel and Corporate Secretary	2002	145,000	23,849			6,500	360

(a) The amounts under Bonus for 2003 and 2002 represent amounts earned with respect to such year but paid during the following year.

(b) Represents options to purchase Transocean ordinary shares at fair market value on the date of the grants.

(c) The amounts shown as All Other Compensation represent:

	Year	Savings Plan Matching Contributions	Payments Under Life Insurance Program
Mr. Rask	2003	\$ 1,987	\$ 360
	2002		150
Mr. O Keefe	2003	9,000	360
	2002	975	150
Mr. Crowley	2003	3,469	240
	2002		
Mr. Meisetschlaeger	2003	8,100	466
	2002	7,856	212
Mr. Stafford	2003		360
	2002		360

(d) Mr. Rask, Mr. O Keefe and Mr. Crowley began their employment with us on July 16, 2002, July 18, 2002 and April 21, 2003, respectively. Their annual base salaries were \$530,000, \$260,000 and \$185,000, respectively.

(e) Represents moving expense reimbursements.

(f) Mr. Meisetschlaeger left our company in January 2004.

Grants and Exercises of Transocean Stock Options

There were no grants of options to acquire our common stock or Transocean ordinary shares to the executive officers named in the summary compensation table above, or exercises of such options by such executive officers, in the year ended December 31, 2003.

Employment Agreements and Change of Control Arrangements

We entered into an employment agreement with Mr. Jan Rask effective as of July 16, 2002, as amended on December 12, 2003, to serve as Chief Executive Officer and President of our company in exchange for specified compensation and benefits. The initial term of his employment agreement ends on January 16, 2007. Afterwards, the agreement automatically renews for an additional one-year term on each anniversary of the effective date of the agreement unless either party gives at least a six-month advance written notice of nonrenewal. Mr. Rask's employment agreement calls for a minimum base salary of \$530,000 per year, which will be reviewed at least annually and may be increased afterwards. The agreement also affords Mr. Rask the opportunity to receive an annual discretionary bonus that is tied to his achievement of specified performance objectives established by our board of directors. Mr. Rask's annual discretionary bonus is calculated by multiplying his percentage of attained objectives by his annual target bonus, which is a specified percentage of his base salary. For each year of the initial term of his employment agreement, Mr. Rask's annual target bonus will be no less than 70% of his base salary. Under the agreement, Mr. Rask also is eligible to receive stock option awards at the discretion of the board and is entitled to participate in our applicable incentive, savings, retirement and welfare plans and to receive specified perquisites.

Pursuant to his employment agreement, on the closing date of the IPO, Mr. Rask received a nonqualified stock option to purchase 1,200,000 shares of Class A common stock at an exercise price of \$12.00 per share. The option has a ten-year term (except in the case of Mr. Rask's termination) and one-half of the shares subject to the option became exercisable on February 10, 2004. The remaining shares subject to the option become exercisable on February 10, 2005 and 2006 in equal increments. In addition to the option, Mr. Rask received 156,496 of restricted shares of Class A common stock. The restricted shares vest on July 16, 2005. The option and restricted shares are subject to the other terms and conditions, consistent with the foregoing, of our incentive plan and applicable award agreement.

We entered into an employment agreement with Mr. T. Scott O'Keefe effective as of July 18, 2002, as amended on December 12, 2003, to serve as Chief Financial Officer and Senior Vice President of our company in exchange for specified compensation and benefits. The initial term of his employment agreement ends on January 18, 2006. Afterwards, the agreement automatically renews for an additional one-year term on each anniversary of the effective date of the agreement unless either party gives at least a six-month advance written notice of nonrenewal. Mr. O'Keefe's employment agreement calls for a minimum base salary of \$260,000 per year, which will be reviewed at least annually and may be increased afterwards. The agreement also affords Mr. O'Keefe the opportunity to receive an annual discretionary bonus that is tied to his achievement of specified performance objectives established by our board of directors. Mr. O'Keefe's annual discretionary bonus is calculated by multiplying his percentage of attained objectives by his annual target bonus, which is a specified percentage of his base salary. For each year of the initial term of his employment agreement, Mr. O'Keefe's annual target bonus will be no less than 50% of his base salary. Under the agreement, Mr. O'Keefe also is eligible to receive stock option awards at the discretion of the board and is entitled to participate in our applicable incentive, savings, retirement and welfare plans and to receive specified perquisites.

Pursuant to his employment agreement, on the closing date of the IPO, Mr. O'Keefe received a nonqualified stock option to purchase 210,000 shares of Class A common stock at an exercise price of \$12.00 per share. The option has a 10-year term (except in the case of Mr. O'Keefe's termination) and one-half of the shares subject to the option became exercisable on February 10, 2004. The remaining shares subject to the option become exercisable on February 10, 2005 and 2006 in equal increments. The option is subject to the other terms and conditions, consistent with the foregoing, of our incentive plan and applicable award agreement.

We entered into an employment agreement with Mr. David J. Crowley effective as of April 21, 2003, to serve as Vice President - Marketing of our company in exchange for specified compensation and benefits. The initial term of his employment ends on April 21, 2005. Afterwards, the agreement automatically renews for an additional one-year term on each anniversary of the effective date of the agreement unless either party gives at least a six-month advance written notice of nonrenewal. Mr. Crowley's employment agreement calls for a

minimum base salary of \$185,000 per year, which will be reviewed at least annually and may be increased afterwards. The agreement also affords Mr. Crowley the opportunity to receive an annual discretionary bonus that is tied to his achievement of specified performance objectives established by our board of directors. Mr. Crowley's annual discretionary bonus is calculated by multiplying his percentage of attained objectives by his annual target bonus, which is a specified percentage of his base salary. For the term of his employment agreement, Mr. Crowley's annual bonus target will be no less than 50% of his base salary. Mr. Crowley is also eligible to receive stock option awards at the discretion of the board and is entitled to participate in our applicable incentive, savings, retirement and welfare plans and to receive specified perquisites.

Pursuant to his employment agreement, on the closing date of the IPO, Mr. Crowley received a nonqualified stock option to purchase 100,000 shares of Class A common stock at an exercise price of \$12.00 per share. The option has a 10-year term (except in the case of Mr. Crowley's termination) and one-third of the shares subject to the option become exercisable on each of February 10, 2005, 2006, and 2007. The option is subject to the other terms and conditions, consistent with the foregoing, of our incentive plan and applicable award agreement.

Under these employment agreements, if any of Mr. Rask, Mr. O'Keefe or Mr. Crowley voluntarily terminates his employment (other than in connection with a change in control as defined in the agreements) with 90 days' advance written notice or if his employment is terminated due to death or disability, he will receive his unpaid base salary through his termination date, any bonus payable for the relevant year and any other benefits to which he has a vested right. Additionally, in the event of a termination due to death or disability, the option and restricted shares awarded to him, if any, will fully vest and the option will remain exercisable for its full term.

Upon termination of his employment by us (except under limited circumstances defined as for cause in the agreements), the officer will receive (1) his unpaid base salary for his remaining employment term (which includes the initial term and any renewals), (2) any bonus payable for the relevant year, (3) full vesting of the option awarded to him, if any, and exercisability through its full term, (4) full vesting of restricted shares awarded to him, if any, and (5) any other benefits to which he has a vested right.

In the event of a termination of his employment by us (except under limited circumstances defined as for cause in the agreements) or by the officer for specified reasons, such as his removal from the position of Chief Executive Officer and President in the case of Mr. Rask, the position of Chief Financial Officer and Senior Vice President, in the case of Mr. O'Keefe, or the position of Vice President - Marketing in the case of Mr. Crowley, or the assignment to him of duties materially inconsistent with his position with us (for good reason), within the 18-month period immediately following a change in control as defined in the agreement (a change in control termination), the officer will be entitled to receive (1) three times, in the case of Mr. Rask, two and one-half times in the case of Mr. O'Keefe, and two times in the case of Mr. Crowley, his annual compensation for the year of termination (which is the sum of his base salary and his annual target bonus, or, if greater, the highest bonus paid to him under the agreement during the most recent 36-month period), (2) any bonus payable for the relevant year, (3) continuation of specified welfare benefits for three years, (4) full vesting of the option awarded to him, if any, and exercisability through its full term, and (5) full vesting of restricted shares awarded to him, if any.

The employment agreements also provide for covenants limiting competition with us, or any of our affiliates, and limiting solicitation for employment of any of our employees, or any of our affiliates, for 18 months following a change in control termination or for one year following any other termination of employment and a covenant to keep specified nonpublic information relating to us, or any of our affiliates, confidential. With respect to any payment or distribution to Mr. Rask, Mr. O'Keefe or Mr. Crowley, the agreements provide for a tax gross-up payment designed to keep him whole with respect to any taxes imposed by Section 4999 of the Internal Revenue Code of 1986, as amended.

Severance Policy and Change of Control Arrangements

Our board of directors has adopted a Severance Policy for specified employees who are not entitled to change of control benefits under a written employment agreement. The benefits under this policy are not

available to Messrs. Rask, O Keefe or Crowley because each of those officers is already entitled to change of control benefits under an employment agreement with us, as described above in Employment Agreements and Change of Control Arrangements. The benefits are available to our other officers, including Mr. Stafford. In the event of a termination of the employment of Mr. Stafford by us or by him for specified reasons, such as receipt of notification of salary reduction, reduction in job title, significant reduction of responsibilities or relocation of employment, within the one-year period immediately following a change of control as defined in the policy, he will be entitled to receive an amount equal to his annual compensation for the year of termination (the sum of his base salary and his annual target bonus).

Director Compensation

Directors who are also full-time officers or employees of our company or officers or employees of Transocean receive no additional compensation for serving as directors. All other directors receive an annual retainer of \$25,000. The audit committee chairman receives an additional \$15,000 annual retainer. The compensation committee chairman and corporate governance committee chairman do not currently receive an additional annual retainer since they are currently officers of Transocean. Nonemployee directors also receive a fee of \$1,500 for each board or board committee meeting attended in person or by telephone, plus incurred expenses where appropriate.

Each outside director is granted 5,000 restricted shares of our Class A common stock when elected or appointed to the Board. Following this restricted stock grant, if the outside director remains in office, the director will be granted an option to purchase 5,000 shares of Class A common stock after each annual meeting of stockholders at the fair market value of those shares on the date of grant. Since the Company did not hold an annual meeting of stockholders after becoming a public company in 2004, the 2004 option grant was made effective as of the Company's Board of Directors meeting in May 2004. Because awards to outside directors are not specified in our Long-Term Incentive Plan, the board will have authority to determine the awards made to outside directors under the plan from time to time without the prior approval of our stockholders.

Compensation Committee Interlocks and Insider Participation

None of our executive officers have served as members of a compensation committee (or if no committee performs that function, the board of directors) of any other entity that has an executive officer serving as a member of our board of directors.

Securities Authorized for Issuance under Equity Compensation Plan

The following table provides information with respect to compensation plans (including individual compensation arrangements) under which our equity securities are authorized for issuance to employees or non-employees (such as directors, consultants, advisors, vendors, customers, suppliers or lenders), as of September 1, 2004:

Plan Category	Number of Securities to Be Issued upon Exercise of Outstanding Options, Warrants and Rights	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders	1,658,617	\$ 12.03/share	1,038,493
Equity compensation plans not approved by security holders			
Total	1,658,617	\$ 12.03/share	1,038,493

Security Ownership of Directors and Executive Officers of TODCO Shares

The following table sets forth certain information known to the Company as of September 1, 2004 with respect to the beneficial ownership of our common stock by (i) each stockholder known by us to own beneficially more than 5% of the outstanding shares of any class of common stock, (ii) each director, (iii) the Chief Executive Officer and Named Executive Officers, and (iv) all directors and executive officers as a group.

Name or Identity of Group and Address	Class A Common Stock		Class B Common Stock	
	Number of Shares Beneficially Owned	Percent	Number of Shares Beneficially Owned	Percent
Directors and Named Officers:				
Thomas N. Amonett ^(a)	10,000	*	0	*
R. Don Cash ^(a)	11,000	*	0	*
Gregory L. Cauthen	0	*	0	*
Thomas M Hamilton	10,000	*	0	*
Thomas R. Hix ^(a)	10,000	*	0	*
Arthur Lindenauer ^(a)	10,000	*	0	*
Robert L. Long	0	*	0	*
J. Michael Talbert	0	*	0	*
Jan Rask ^(a)	756,496	5.4%	0	*
T. Scott O Keefe ^(b)	105,000	*	0	*
David J. Crowley	0	*	0	*
Michael L. Kelley	0	*	0	*
Lloyd M. Pellegrin	1,831	*	0	*
Randall A. Stafford	2,394	*	0	*
Dale W. Wilhelm	0	*	0	*
All Directors and Officers as a Group (15 persons) ^(a)	916,721	6.5%	0	*
Other Principal Stockholders:				
Transocean 4 Greenway Plaza Houston, TX 77046	46,200,000 ^(b)	76.6%	46,200,000	100%

(a) Includes the following number of shares of our Class A common stock which the named party has the right to acquire upon exercise of stock options that are (i) currently exercisable or (ii) exercisable within 60 days of the date hereof: Mr. Amonett 5,000; Mr. Cash 5,000; Mr. Hix 5,000; Mr. Lindenauer 5,000; Mr. Rask 600,000; Mr. O Keefe 105,000 and all executive officers and directors as a group 725,000.

(b) Includes 46,200,000 of our Class B common stock held by Transocean which may be converted to our Class A common stock.

* Less than 1%

Security Ownership of Directors and Executive Officers of Transocean Shares

The following table sets forth information as of September 1, 2004 with respect to the beneficial ownership of Transocean ordinary shares by each of our directors and Named Executive Officers, and all of our directors and executive officers as a group. Except as otherwise indicated in the footnotes, each individual has sole voting and investment power with respect to the shares set forth in the following table. Each director and officer and the directors and officers as a group beneficially own less than 1% of Transocean's ordinary shares.

Name of Beneficial Owner ^(a)	Shares Owned Beneficially ^{(b)(c)}
Jan Rask	
T. Scott O Keefe	
David J. Crowley	
Michael L. Kelley	
Lloyd M. Pellegrin ^(d)	37,734
Randall A. Stafford	29,640
Dale W. Wilhelm	1,250
Thomas R. Hix	
Arthur Lindenauer	25,121
Gregory L. Cauthen ^(d)	56,666
Robert L. Long ^{(d)(e)}	252,439
J. Michael Talbert ^{(d)(f)}	763,028
Thomas N. Amonett	
R. Don Cash	
Thomas M Hamilton	
All directors and executive officers as a group ^(d)	1,169,878

- (a) The business address of each director and executive officer is c/o TODCO, 2000 W. Sam Houston Parkway South, Suite 800, Houston, Texas 77042.
- (b) Beneficial ownership means the sole or shared power to vote, or to direct the voting of, Transocean ordinary shares, or investment power with respect to Transocean ordinary shares, or any combination of the foregoing.
- (c) Includes options exercisable within 60 days held by Messrs. Pellegrin (25,640), Stafford (29,640), Cauthen (56,666), Lindenauer (20,000), Long (244,333) and Talbert (760,733).
- (d) Includes:

	Mr. Pellegrin	Mr. Cauthen	Mr. Long	Mr. Talbert	All Directors and Executive Officers as a Group
Shares held by Trustee under 401(k) plan	1,870		3,646	2,295	7,811
Shares held in Employee Stock Purchase Plan		1,351	4,461		5,812

- (e) Includes 34,322 shares held in a joint account with his wife.
- (f) Includes 78,536 shares held in a joint account with his wife.

CERTAIN RELATIONSHIPS AND RELATED PARTY TRANSACTIONS

Merger with Transocean

We were incorporated in Delaware on July 7, 1997. On January 31, 2001, we completed a merger transaction with Transocean in which an indirect subsidiary of Transocean, TSF Delaware Inc., merged with and into our company, which was then named R&B Falcon Corporation. On December 13, 2002, R&B Falcon changed its name to TODCO.

Asset Transfers to Transocean

For a description of the risks related to the transactions with Transocean described below, see Risk Factors Risks Related to Our Principal Stockholder Transocean. The terms of our separation from Transocean, the related agreements and other transactions with Transocean were determined in the context of a parent-subsidary relationship and thus may be less favorable to us than the terms we could have obtained from an unaffiliated third party.

The following describes transfers of our assets to Transocean between the date of our acquisition by Transocean and the closing of the IPO. None of the drilling rigs transferred to Transocean are currently involved in the business activities that fall within the TODCO business as defined in the master separation agreement. See Relationship Between Us and Transocean Master Separation Agreement.

In August 2001, we sold, in separate transactions, the drilling units *Jack Bates*, *Deepwater Millennium*, *Deepwater Expedition*, *Peregrine I*, *Deepwater Horizon*, *C. Kirk Rhein*, *Falcon 100*, *Deepwater Navigator* and *Deepwater Discovery* to Transocean for net proceeds of \$1,615.0 million. The sale prices for these units were determined by Transocean based on appraisals by R.S. Platou (U.S.A.) Inc., a third party valuation firm. In consideration for the sales of these drilling units, \$1,190.0 million of debt we owed to Transocean was cancelled. We incurred this debt in connection with the retirement of some of our then-outstanding public debt. In addition, Transocean delivered to us promissory notes due August 17, 2011 bearing interest at 5.72% payable annually in an aggregate principal amount of \$425.0 million. In December 2002, Transocean repaid to us the \$425.0 million aggregate principal amount of promissory notes plus accrued and unpaid interest. At the time of the sales, each of the drilling units was being utilized under a drilling contract between one of our subsidiaries and a customer. These contracts were not transferred and we secured the continued use of the drilling units for the purpose of performing these contracts through charters or other arrangements. These charters or other arrangements were terminated or transferred to Transocean prior to the closing of the IPO.

In April 2002, we sold, in separate transactions, the drilling units *Harvey H. Ward* and *Roger W. Mowell* to Transocean for an aggregate net price of \$93.0 million. The sale prices for these units were determined by Transocean based on appraisals by R.S. Platou (U.S.A.) Inc., a third party valuation firm. In consideration for the sales of these drilling units, Transocean delivered to us promissory notes due April 3, 2012 bearing interest at 5.5% payable annually in an aggregate principal amount of \$93.0 million. The notes can be prepaid at any time at Transocean's option, without penalty. In December 2002, Transocean repaid to us the \$93.0 million aggregate principal amount of promissory notes plus accrued and unpaid interest.

In July 2002, we distributed as an in-kind dividend for no consideration, in separate transactions, the drilling units *W.D. Kent*, *Charley Graves* and *J.W. McLean* to Transocean. Simultaneous with the distributions, we entered into a demise party charter agreement with Transocean for each rig whereby Transocean chartered the drilling units to us at a fixed daily rate aggregating \$49,800. Additionally, we entered into a master brokerage agreement with Transocean for each drilling unit whereby we marketed that drilling unit in exchange for a fee equal to 2% of the payment due Transocean under the demise charter. Both the master brokerage agreements and the demise party charters were terminated on September 30, 2002.

Also in July 2002, we sold, in separate transactions, the following subsidiaries to Transocean, in exchange for total cash consideration of approximately \$1.1 million: (1) RB Mediterranean Ltd., which holds oil and gas interests outside the United States, (2) RB Anton Ltd., which holds oil and gas interests outside the United States, (3) RB Astrid Ltd., which holds oil and gas interests outside the United States, and (4) PT

RBF Offshore Drilling, which has drilling operations in Indonesia. The sale prices for RB Mediterranean Ltd. and PT RBF Offshore Drilling were determined by Transocean based on internal valuations. The sale prices for RB Anton Ltd. and RB Astrid Ltd. were determined by Transocean based on recommendations by Argonauta Exploration & Production Services, a third party consulting firm that manages the assets held by those entities.

Effective August 1, 2002, Transocean assumed sponsorship of specified employee benefits plans, as more fully described in Relationship Between Us and Transocean Employee Matters Agreement.

In September 2002, we distributed as an in-kind dividend for no consideration, in separate transactions, the stock of the following subsidiaries to Transocean: (1) R&B Falcon Canada Co., which has drilling operations in Canada, (2) Shore Services, LLC, which has shore base operations in Italy, (3) R&B Falcon Inc., LLC, which has a branch in Saudi Arabia, (4) R&B Falcon (M) Sdn. Bhd., which has drilling operations in Malaysia, (5) R&B Falcon International Energy Services BV, which has drilling operations outside the United States, (6) R&B Falcon BV, which has operations outside the United States, (7) Transocean Offshore Drilling Services LLC, which owns the drilling unit *J.T. Angel*, and (8) RBF Rig Corporation LLC, which owns the drilling unit *C.E. Thornton*. Additionally, in September 2002, we distributed as an in-kind dividend for no consideration, in separate transactions, the drilling units *F.G. McClintock*, *Peregrine III* and *Land Rig 34* as well as certain surplus equipment to Transocean.

Also in September 2002, we sold the stock of R&B Falcon (Ireland) Limited, which has drilling operations outside the United States, to Transocean for cash consideration of approximately \$1.4 million. The sale price was determined by Transocean based on internal valuations.

In October 2002, we assigned our leasehold interest in the drilling unit *M.G. Hulme, Jr.* to Transocean for no consideration. Additionally, we assigned the drilling contract for the drilling unit *Deepwater Horizon* to Transocean for no consideration in the same month.

In November 2002, we distributed as an in-kind dividend for no consideration the drilling unit *Randolph Yost* to Transocean. Additionally, we assigned the drilling contract for the drilling unit *Deepwater Discovery* to Transocean for no consideration in the same month.

In December 2002, we distributed to Transocean as an in-kind dividend for no consideration the stock of the following subsidiaries: (1) Falcon Atlantic Ltd., which has operations outside the United States; and (2) R&B Falcon Drilling do Brasil, Ltda., which has shore base operations in Brazil. Also in December 2002, we transferred the drilling units *D.R. Stewart* and *George H. Galloway* to Transocean for no consideration and we assigned our rights and obligations under a rig sharing agreement for the drilling unit *Deepwater Millennium* to Transocean for no consideration.

Also in December 2002, we assigned the drilling contracts for the drilling units *Deepwater Navigator* and *Peregrine I* to Transocean for no consideration.

In January 2003, we assigned to Transocean for no consideration a 12.5% undivided interest in an aircraft at net book value of \$1.0 million. The transaction was recorded as a decrease to additional paid-in capital.

Also in January 2003, we distributed to Transocean as an in-kind dividend for no consideration some accounts receivable balances from related parties in the amount of \$200.9 million. The transaction was recorded as a decrease to additional paid-in capital.

In February 2003, we distributed to Transocean for no consideration the stock of our subsidiaries R&B Falcon (A) Pty. Ltd., which owns the drilling unit *Ron Tappmeyer* and Cliffs Drilling do Brasil Servicos de Petroleo S/C Ltda., a dormant Brazilian entity. The aggregate net book value of \$44.6 million for these transfers was recorded as a decrease to additional paid-in capital.

In March 2003, we sold to Transocean the stock of Arcade Drilling AS, a subsidiary that owns and operates the *Paul B. Loyd, Jr.* and owns the *Henry Goodrich*, for net proceeds of \$264.1 million and recorded a net pre-tax loss of \$11.0 million. The sales price was determined based on an appraisal by Professor Terje Hansen of the Norwegian School of Economics and Business Administration, taking into account the values

of the drilling units provided by R.S. Platou (U.S.A.) Inc. In consideration for the sale of the subsidiary, Transocean cancelled \$233.3 million principal amount of our 6.95% notes due April 2008. The market value attributed to the notes, 113.21% of the principal amount, was determined by Transocean based on available market information.

In March 2003, we assigned the drilling contract for the *Deepwater Frontier* to Transocean for no consideration. Additionally, in March 2003, we distributed to Transocean miscellaneous deepwater assets with a value of \$1.4 million for no consideration. The transactions were recorded as a decrease to additional paid-in capital.

In May 2003, we sold to Transocean *Cliffs Platform Rig 1* in consideration for the cancellation of \$13.9 million principal amount of the 6.95% Senior Notes held by Transocean. The sales price was determined based on an appraisal by R.S. Platou (U.S.A.) Inc. We recorded the excess of the sales price over the net book value of the rig of \$1.6 million as an increase to additional paid-in capital and a pre-tax loss on the retirement of debt of \$1.5 million.

In May 2003, we sold to Transocean our 50% interest in Deepwater Drilling L.L.C. (DD LLC), which leases the drilling unit *Deepwater Pathfinder*, and our 60% interest in Deepwater Drilling II L.L.C. (DDII LLC), which leases the *Deepwater Frontier*, in consideration for the cancellation of \$43.7 million principal amount of our debt held by Transocean. The value of our interests in DD LLC and DDII LLC was determined by Transocean based on a similar third party transaction. We recorded the excess of the sales price over the net book value of the membership interests of \$21.6 million as an increase to additional paid-in capital paid the year ended December 31, 2003.

In June 2003, we sold to Transocean our membership interests in our wholly owned subsidiary, R&B Falcon Drilling (International & Deepwater) Inc. LLC, which owns the following assets: (1) the drilling unit *Jim Cunningham*, (2) all of the stock of R&B Falcon Deepwater (UK) Ltd., which has specified charter rights with respect to the drilling unit *Deepwater Nautilus*, (3) all of the stock of RBF Exploration LLC, which is the issuer of the Class A1 Notes due May 2005 and the Class A2 Notes, repurchased and retired in May 2003, related to the drilling unit *Deepwater Nautilus*, (4) several dormant or near dormant subsidiaries, and (5) other miscellaneous assets. As consideration for the stock sold, Transocean cancelled \$238.8 million of our outstanding debt held by Transocean. The sales transaction was based on a valuation by Transocean which takes into account the valuations of the drilling units provided by R.S. Platou (U.S.A.) Inc. We recorded the excess of the net book value over the sales price of our membership interests of \$60.9 million as a loss on sale of assets and a pre-tax loss on the retirement of debt of \$48.0 million for the year ended December 31, 2003.

At the time of the transactions, some of the drilling units discussed above were being utilized in connection with drilling contracts between our subsidiaries and customers. These contracts were not transferred and we secured the use of the drilling units for the purpose of performing these contracts through charters or other arrangements. The costs of these charters or other arrangements are included in discontinued operations and totaled \$0.8 million, \$233.8 million and \$96.8 million for the years ended December 31, 2003 and 2002 and the eleven months ended December 31, 2001, respectively.

In August 2003, Transocean made a payment to us of \$11.4 million in order for us to have the amount of cash and cash equivalents agreed to between us and Transocean, as more fully described in Relationship Between Us and Transocean Master Separation Agreement Transfer of Assets and Assignment of Liabilities.

In December 2003, Transocean made an equity contribution to us of \$84.7 million in return for intercompany payable balances we owed to Transocean.

In February 2004, prior to the IPO, the Company exchanged \$45,784,000, \$152,463,000 and \$289,793,000 in principal amount of its outstanding 7.375%, 6.750% and 9.500% notes, respectively, held by Transocean for 3,940,406 shares of the Company's Class B common stock. Immediately following this exchange, the Company declared a dividend of 11.1447508 shares of its Class B common stock with respect to each share of its Class B common stock outstanding immediately following the exchange. As a result,

60,000,000 shares of the Company's Class B common stock were issued and outstanding immediately prior to the IPO. Transocean currently holds 46,200,000 shares of the Company's Class B common stock. The Class B common stock is convertible at any time into shares of the Company's Class A common stock on a share per share basis at the sole option of Transocean. The stock for debt exchange was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933.

Prior to the closing of the IPO, we completed the following transactions:

We assigned to Transocean for no consideration any other agreements relating to drilling units and other assets not owned by us or our subsidiaries upon the closing of the IPO.

We assigned to Transocean the rights to any receivables outstanding upon the closing of the IPO which were not related to the TODCO business as that term is used in the master separation agreement. We will remit the proceeds from those receivables as they are collected.

We transferred to Transocean any remaining miscellaneous equipment and other assets that did not relate to our business following the closing of the IPO.

To the extent the transfer of legal title to any of the above assets could not be completed prior to the closing of the IPO, beneficial ownership of such assets was transferred to Transocean, and we or our applicable subsidiary held such assets as agent for the other party until such time as legal title could be transferred. See Relationship Between Us and Transocean Master Separation Agreement Transfer of Assets and Assignment of Liabilities.

Debt Retirement and Debt Exchange Offers

In March 2002, in conjunction with Transocean, we completed exchange offers and consent solicitations for our 6.50% notes due 2003, 6.75% notes due 2005, 6.95% notes due 2008, 7.375% notes due 2018, 9.125% notes due 2003 and 9.50% notes due 2008. As a result of these exchange offers and consent solicitations, Transocean exchanged approximately \$234.5 million, \$342.3 million, \$247.8 million, \$246.5 million, \$76.9 million and \$289.8 million principal amount of our outstanding 6.50%, 6.75%, 6.95%, 7.375%, 9.125% and 9.50% notes, respectively, for newly issued 6.50%, 6.75%, 6.95%, 7.375%, 9.125% and 9.50% notes of Transocean having the same principal amount, interest rate, redemption terms and payment and maturity dates. Approximately \$38.8 million principal amount of notes were not exchanged in the exchange offers and \$33.8 million principal amount of the notes remains outstanding. Because the holders of a majority in principal amount of each of these series of notes consented to amendments to the indentures under which the notes were issued, some covenants, restrictions and events of default were eliminated from the indentures with respect to these series of notes. In connection with the exchange offers, we made an aggregate of \$8.3 million in consent payments to holders of our notes. At December 31, 2003 and December 31, 2002, \$488.1 million and \$936.6 million principal amount of the notes, respectively, was outstanding to Transocean. Interest expense related to these notes was \$3.1 million for the six months ended June 30, 2004, \$42.7 million for the year ended December 31, 2003 and \$77.9 million for the year ended December 31, 2002.

In December 2002, we repurchased all of the approximately \$234.5 million and \$76.9 million principal amount of the 6.50% and 9.125% notes payable to Transocean, respectively, and approximately \$189.8 million of the principal amount of the 6.75% notes payable to Transocean plus accrued and unpaid interest. We recorded a net after-tax loss of \$12.2 million in conjunction with the repurchase of these notes. We funded the repurchase from cash received from Transocean's repurchase of approximately \$518.0 million aggregate principal amount of the notes receivable plus accrued and unpaid interest.

In March 2003, we acquired approximately \$233.3 million principal amount of the 6.95% notes due April 2008 in exchange for the stock of Arcade. See Asset Transfers to Transocean.

In April 2003, we repaid all of the \$5.0 million principal amount of the 6.50% notes, plus accrued and unpaid interest, in accordance with their scheduled maturities. We funded the repayment from a capital contribution received from Transocean.

In May 2003, we repurchased and retired the entire \$50.0 million principal amount of the 9.41% Nautilus Class A2 Notes due May 2005. We recorded a pre-tax loss on retirement of debt of approximately \$5.5 million. We funded the repurchases from a capital contribution received from Transocean as well as cash on hand.

In May 2003, we acquired \$13.9 million principal amount of the 6.95% notes in exchange for the sale of *Cliffs Platform Rig 1* to Transocean. We recorded a pre-tax loss on retirement of debt of approximately \$1.5 million. See [Asset Transfers to Transocean](#).

In May 2003, we acquired \$43.7 million principal amount of the 2.76% fixed rate promissory note issued by us to Transocean, scheduled to mature on April 6, 2005 in exchange for the sale of our 50% interest in DD LLC and our 60% interest in DDII LLC to Transocean. See [Asset Transfers to Transocean](#).

In June 2003, we acquired \$200.7 million principal amount of the 7.375% notes, the remaining \$37.5 million principal amount of the 2.76% fixed rate promissory note and \$0.6 million principal amount of the 6.95% notes in exchange for the sale to Transocean of our wholly owned subsidiary R&B Falcon Drilling (International & Deepwater) Inc. LLC, which owns the following assets: (1) the drilling unit *Jim Cunningham*, (2) all of the stock of R&B Falcon Deepwater (UK) Ltd., which has specified charter rights with respect to the drilling unit *Deepwater Nautilus*, (3) all of the stock of RBF Exploration LLC, which is the issuer of the Class A1 Notes due May 2005 and the Class A2 Notes repurchased and retired in May 2003, related to the drilling unit *Deepwater Nautilus*, (4) several dormant or near dormant subsidiaries, and (5) other miscellaneous assets. We recorded a pre-tax loss on retirement of debt of approximately \$48.0 million. See [Asset Transfers to Transocean](#).

As described above, Transocean exchanged a portion of the notes it acquired in the exchange offer as consideration for the asset transfers described in [Asset Transfers to Transocean](#). Prior to the closing of the IPO, Transocean exchanged the balance of the notes for newly issued shares of our Class B common stock. The determination of the number of shares issued was based on a method that took into account the initial public offering price. Prior to these retirement transactions, our outstanding common stock was reclassified into shares of Class B common stock. Following the reclassification, the retirement transactions and a stock split, Transocean held an aggregate of 60,000,000 shares of Class B common stock prior to the closing of the IPO. A portion of these shares of Class B common stock was sold and converted into shares of Class A common stock in the IPO.

Revolving Credit Agreement

We were a party to a \$1.8 billion two-year revolving credit agreement with Transocean, dated April 6, 2001. Amounts outstanding under the revolver bore interest payable quarterly at LIBOR plus 0.575% to 1.300% depending on our senior unsecured public debt rating. In April 2001 we borrowed approximately \$1.3 billion under this credit agreement to retire some of our then-outstanding public debt. For a description of the debt retirements, see [Third Party Debt Redeemed and Repurchased Debt](#) in Note 6 to our consolidated financial statements for the year ended December 31, 2003 included elsewhere in this prospectus. This line of credit expired April 6, 2003 and, as of that date, the approximately \$81.2 million then outstanding under the line was converted into the 2.76% fixed rate promissory note. This note was cancelled in connection with the sale of some of the Transocean Assets to Transocean, as described in [Asset Transfers to Transocean](#) above.

Administrative Support Services

Prior to June 30, 2003, Transocean provided administrative support services to us. Transocean charged us a proportional share of its administrative costs based on estimates of the percentage of work the relevant Transocean departments performed for us. This arrangement was terminated prior to June 30, 2003. Specified administrative support services are now provided by Transocean to us under the transition services agreement. See [Relationship Between Us and Transocean Transition Services Agreement](#).

Purchase of Minority Interests in Reading & Bates Development Co.

In January 2001, prior to our merger transaction with Transocean, we purchased for \$34.7 million the minority interest of approximately 13.6% in Reading & Bates Development Co. (Devco), which was owned by our former directors and employees and directors and employees of Devco (including our former directors Paul B. Loyd, Jr., a current director of Transocean, and Charles A. Donabedian, a former director of Transocean). In connection with the purchase, a \$300,000 bonus was paid to our former director Richard A. Pattarozzi, a current director of Transocean. The purchase price was based on a valuation by a third party advisor.

Relationship Between Us and Transocean

We have provided below a summary description of the material terms and conditions of a master separation agreement and several other important related agreements between Transocean and us. We encourage you to read the full text of these agreements which have been filed with the SEC as exhibits to the registration statement of which this prospectus is a part.

Master Separation Agreement

The master separation agreement between Transocean and us provides for the completion of the separation of our assets and businesses from those of Transocean. In addition, it contains several agreements governing the relationship between us and Transocean following the IPO and specifies the ancillary agreements that we and Transocean signed.

TODCO Business

The master separation agreement defines the TODCO business to mean the following businesses and activities:

contract drilling, workover, production and similar services for oil and gas wells using jackup, submersible, barge (including workover) and platform drilling rigs in the U.S. Gulf of Mexico and U.S. inland waters, including maintenance and mobilization activities to the extent related to rigs providing these services,

contract drilling, workover, production and similar services for oil and gas wells in and offshore Mexico, Trinidad, Colombia and Venezuela (including the turnkey drilling services formerly provided by our subsidiaries in Venezuela), including maintenance and mobilization activities to the extent related to rigs providing these services,

construction activities (including construction activities involving an upgrade to, or modification of, a rig) in connection with rigs owned by us or our subsidiaries after the closing of the IPO,

office or yard facilities owned or used by us and our subsidiaries to the extent related to the services and activities described in this definition,

our joint venture interest in Delta Towing Holdings, LLC, the operation of the business transferred to Delta Towing prior to that transfer and the notes issued in connection with that transfer,

our investment in Energy Virtual Partners, Inc. and Energy Virtual Partners, LP (which have been liquidated),

activities that were related primarily to the above activities at the time those activities ceased, and

any business conducted by TODCO or any of its subsidiaries after the closing of the IPO.

The following businesses and activities are excluded from the definition of the TODCO business to the extent they were conducted prior to the closing of the IPO:

contract drilling, workover, production or similar services for oil and gas wells using semisubmersibles and drillships in the U.S. Gulf of Mexico, including maintenance and mobilization activities to the extent related to rigs providing these services,

contract drilling, workover, production or similar services for oil and gas wells in geographic regions outside of the U.S. Gulf of Mexico, U.S. inland waters, Mexico, Colombia, Trinidad and Venezuela, including maintenance and mobilization activities to the extent related to rigs providing these services and such services using land rigs,

construction activities (including construction activities involving an upgrade to, or modification of, a rig) in connection with rigs or other assets owned by (1) Transocean or its subsidiaries (excluding us) after the closing of the IPO or (2) neither Transocean nor us after the closing of the IPO,

oil and gas exploration and production activities (but not including our ownership interest in Energy Virtual Partners),

coal production activities, and

the turnkey drilling business that we formerly operated in the U.S. Gulf of Mexico and offshore Mexico, except that contract drilling services provided to that business which otherwise fall within the definition of TODCO business are not excluded.

Transfer of Assets and Assignment of Liabilities

We have transferred the stock of various subsidiaries and other assets to Transocean and Transocean has assumed liabilities associated with the transferred assets and businesses. See Asset Transfers to Transocean. The master separation agreement provides for any additional transfers of assets and assumptions of liabilities necessary to effect the separation of the TODCO business from the business of Transocean. The master separation agreement provides that assets or liabilities that could not legally be transferred or assumed prior to the closing of the IPO would be transferred or assumed as soon as practicable following receipt of all necessary consents of third parties and regulatory approvals. In any such case, the master separation agreement provides that the party retaining the assets or liabilities will hold the assets in trust for the use and benefit of, or retain the liabilities for the account of, the party entitled to the assets or liabilities (at the expense of that party), until the transfer or assumption can be completed. The party retaining these assets or liabilities will also take any action reasonably requested by the other party in order to place the other party in the same position as would have existed if the transfer or assumption had been completed. We refer to all of these transfers of assets and assumptions of liabilities together as the separation.

Except as set forth in the master separation agreement, no party is making any representation or warranty as to the assets or liabilities transferred or assumed as a part of the separation and all assets were and will be transferred on an as is, where is basis. As a result, we and Transocean each have agreed to bear the economic and legal risks that any conveyances of assets are insufficient to vest good and marketable title to such assets in the party who should have title under the master separation agreement.

The parties also agreed that for a period of one year following the IPO, if Transocean determines in its good faith judgment that:

any assets owned by us or our subsidiaries were used primarily during the prior 12 months in Transocean's business, we will transfer those assets to Transocean without additional consideration, or

any assets owned by Transocean were used primarily during the prior 12 months in our business, Transocean will transfer those assets to us without additional consideration.

All of the rigs listed in Business Drilling Rig Fleet are deemed to have been used primarily in our business during the 12 months prior to the closing of the IPO.

Working Capital

The master separation agreement contains an acknowledgement that our cash and cash equivalents as of June 30, 2003 were \$25.0 million after giving effect to a subsequent payment by Transocean to us of \$11.4 million. The amount paid to us by Transocean equals the difference between \$25.0 million and the amount of our cash and cash equivalents as of June 30, 2003 prior to giving effect to the payment by Transocean. The master separation agreement provides that we will retain all cash and cash equivalents generated by our business following June 30, 2003. Transocean will not be required to make any additional payments to us for our working capital needs under the master separation agreement.

Letters of Credit and Guarantees

The master separation agreement requires that we and Transocean use our reasonable best efforts to terminate (or have us or one of our subsidiaries substituted for Transocean, or Transocean or one of its subsidiaries substituted for us, as applicable) all existing guarantees by one party of obligations relating to the business of the other party, including financial, performance and other guarantee obligations. We have also agreed with Transocean that each party will use its reasonable best efforts to have the other party substituted under letters of credit or other surety instruments issued by third parties for the account of either party or any of its subsidiaries issued on behalf of the other party's business.

Indemnification and Release

The master separation agreement provides for cross-indemnities that will generally place financial responsibility on us and our subsidiaries for all liabilities associated with the businesses and operations falling within the definition of TODCO business, and that will generally place financial responsibility for liabilities associated with all of Transocean's businesses and operations with Transocean and its subsidiaries, regardless of the time those liabilities arise. The master separation agreement also contains indemnification provisions under which we and Transocean each indemnify the other with respect to breaches of the master separation agreement or any ancillary agreements. We have also agreed to indemnify Transocean against liabilities arising from misstatements or omissions in this prospectus or the registration statement of which it is a part, except for misstatements or omissions relating to information regarding Transocean provided by Transocean in writing for inclusion in this prospectus or the registration statement.

In connection with our separation from Transocean, the allocation of liabilities related to taxes and employment matters will be governed separately in a tax sharing agreement and an employee matters agreement. See Tax Sharing Agreement and Employee Matters Agreement.

Under the master separation agreement, we generally released Transocean and its affiliates, agents, successors and assigns, and Transocean generally released us and our affiliates, agents, successors and assigns, from any liabilities between us or our subsidiaries on the one hand, and Transocean or its subsidiaries on the other hand, arising from acts or events occurring on or before the closing of the IPO, including acts or events occurring in connection with the separation or the IPO. The general release does not apply to obligations under the master separation agreement or any ancillary agreement or to specified debt and other ongoing contractual arrangements.

Under the master separation agreement, we will be strictly liable to Transocean for any misstatements or omissions in information supplied to Transocean in connection with SEC filings and other public disclosures.

Noncompetition and Other Covenants

The master separation agreement includes provisions that restrict us from competing with Transocean in specified business activities. These provisions do not restrict us from engaging in any contract drilling, workover, production or similar services for oil and gas wells using jackup, barge, platform or land rigs in the following geographic locations: U.S. onshore, U.S. inland water, U.S. Gulf of Mexico and offshore or onshore Mexico, Trinidad, Venezuela or Colombia. However, except for the activities described in the foregoing sentence, we are restricted from engaging in any contract drilling, workover, production or similar services for

oil and gas wells using any type of drilling unit in the following geographic locations: offshore North America, offshore South America, offshore Europe, offshore Africa, offshore Middle East, offshore India, offshore Southeast Asia, offshore Asia, offshore Australia, the Gulf of Mexico, the North Sea, the Mediterranean Sea, the Red Sea, the Persian Gulf and the Caspian Sea. These provisions remain in effect so long as Transocean beneficially owns at least a majority of the voting power of our outstanding voting stock.

The master separation agreement required us to use reasonable commercial efforts to satisfy the conditions precedent for the closing of the IPO. The master separation agreement also includes provisions relating to a tax-free distribution by Transocean of the remainder of our common stock it owns, but does not obligate Transocean to effect such a distribution. If Transocean chooses to conduct a tax-free distribution, we have agreed to take all action reasonably requested by Transocean to facilitate that transaction at our own expense. See *Description of Capital Stock* *Common Stock Conversion*.

The master separation agreement also contains provisions relating to the exchange of information, provision of information for financial reporting purposes, the preservation of legal privileges, dispute resolution, and provision of corporate records.

Some of the rights granted to Transocean in the master separation agreement would apply to and be binding upon any entity that acquires control of us.

Insurance

The master separation agreement provides that we will continue to be covered under substantially all current insurance policies of Transocean (other than employee welfare or benefit plan policies, which are addressed in the employee matters agreement) and future insurance policies determined jointly by us and Transocean. We have agreed to reimburse Transocean for premium expenses related to those insurance policies. Transocean has agreed not to terminate our coverage under the insurance policies unless it provides us prior notice. However, we will cease to have coverage under Transocean's insurance policies when Transocean ceases to own at least a majority of the voting power of our outstanding voting stock, and no prior notice will be required in that case. In no event will Transocean be liable to us in the event of the termination of any insurance policy (unless in the case of termination by Transocean, Transocean failed to provide us the notice required by the master separation agreement), the failure of insurance policies to cover our liabilities or the nonrenewal of insurance policies beyond their expiration dates as of the date of the master separation agreement.

Corporate Governance

The master separation agreement also contains several provisions regarding our corporate governance that apply as long as Transocean owns specified percentages of our common stock. As long as Transocean owns shares representing a majority of the voting power of our outstanding voting stock, Transocean will have the right to:

nominate for designation by our board of directors, or a nominating committee of the board, a majority of the members of the board, as well as the chairman of the board, and

designate at least a majority of the members of any committee of our board of directors.

If Transocean's beneficial ownership of our common stock is reduced to a level of at least 10% but less than a majority of the voting power of our outstanding voting stock, Transocean will have the right to:

designate for nomination a number of directors proportionate to its voting power, and

designate one member of any committee of our board of directors.

In the master separation agreement, we have also agreed to use our best efforts to cause Transocean's nominees to be elected.

The master separation agreement specified the form of our amended and restated certificate of incorporation and bylaws to be in effect at the time of the IPO. It also provides that for so long as Transocean

beneficially owns shares representing at least 15% of the voting power of our outstanding voting stock, we will not, without the prior consent of Transocean, adopt any amendments to our amended and restated certificate of incorporation or bylaws or take any action to recommend to our stockholders certain actions which would, among other things, limit the legal rights of Transocean, or deny any benefit to Transocean or any of its subsidiaries as our stockholders in a manner not applicable to our stockholders generally.

We have also agreed that for so long as Transocean and its subsidiaries own 50% or more of the voting power of our outstanding voting stock, we will maintain the same accounting principles and practices as Transocean, and we will not select a different accounting firm than Transocean's, which is currently Ernst & Young LLP, to serve as our independent certified public accountants.

We have also agreed that for so long as Transocean owns at least a majority of the voting power of all the outstanding shares of voting stock, we will not take any action or enter into any commitment or agreement that could result in a contravention or default by us or any of our affiliates, of or under any provisions of applicable law, any provision of Transocean's memorandum of association or articles of association or any credit agreement or other material agreement by which Transocean is bound. Also, for so long as Transocean owns at least a majority of the voting power of our outstanding voting stock, we will not enter into any commitment or agreement that contains provisions triggering a default or material payment when Transocean exercises its right to convert its shares of our Class B common stock into shares of our Class A common stock or otherwise disposes of its shares of our Class B common stock.

We have agreed to grant to Transocean a continuing right to purchase from us, at the times set forth in the master separation agreement,

such number of shares of our voting stock as is necessary to allow Transocean to maintain its then-current percentage following the IPO, and

80% of the shares of each other class of capital stock that we issue.

These rights terminate if at any time Transocean owns less than 80% of the voting power of our outstanding voting stock.

Expenses

Transocean has agreed to pay all out-of-pocket costs and expenses incurred in connection with the separation, the IPO, the master separation agreement and the ancillary agreements, except as otherwise provided in the master separation agreement, the ancillary agreements or any other agreement between us and Transocean relating to the separation and the IPO. Transocean has also agreed to pay out-of-pocket costs and expenses incurred in connection with this offering.

Tax Sharing Agreement

Until the closing of our IPO, we were included in Transocean Holdings' consolidated group for U.S. federal income tax purposes. As of the closing of the IPO, we are not included in Transocean Holdings' U.S. federal consolidated group because no U.S. subsidiary of Transocean owns at least 80% of the aggregate voting power and value of our outstanding stock.

We have entered into a tax sharing agreement with Transocean Holdings which governs Transocean Holdings' and our respective rights, responsibilities and obligations with respect to taxes and tax benefits. References in this summary description of the tax sharing agreement to the terms "tax" or "taxes" mean taxes and any interest, penalties, additions to tax or additional amounts in respect of such taxes. The general principles of the tax sharing agreement include the following:

Except for special tax items discussed in the bullet below, all U.S. federal, state, local and foreign income taxes and income tax benefits (including income taxes and income tax benefits attributable to the TODCO business) that accrued on or before the closing of the IPO generally will be for the account of Transocean Holdings. Accordingly, we generally will not be liable for any income taxes accruing on or before the closing of the IPO, but we generally must pay Transocean Holdings for the

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amount of any income tax benefits, calculated as described below, created on or before the closing of the IPO (pre-closing tax benefits) that we use or absorb on a return with respect to a period after the closing of the IPO. We will have no obligation to pay Transocean Holdings for any pre-closing tax benefits arising out of or relating to the alternative minimum tax provisions of Sections 55 through 59 of the U.S. Internal Revenue Code, but we will be required to pay Transocean Holdings for any pre-closing tax benefits we use that are alternative minimum tax credits described in Section 53 of the Internal Revenue Code. Our obligation to pay Transocean Holdings for the use of pre-closing tax benefits and our potential obligation to pay alternative minimum tax to the Internal Revenue Service may result in our paying more, in the aggregate, to the Internal Revenue Service and to Transocean Holdings than we would otherwise have paid if we had utilized no pre-closing tax benefits. For purposes of the tax sharing agreement, deferred tax liabilities reflected in our financial statements, which represent the anticipated future tax effects of temporary differences between the financial statement basis and the tax basis of our assets and liabilities, are not considered to constitute income tax liabilities accrued on or before the closing of the IPO. As of June 30, 2004, we had approximately \$485 million of income tax benefits subject to our obligation to reimburse Transocean Holdings. See Note 10 to our condensed consolidated financial statements for the period ended June 30, 2004 included in this prospectus. The amount of these tax benefits will be calculated as follows:

(1) in the case of a deduction used or absorbed, by multiplying the deduction by the highest applicable statutory tax rate in effect, and

(2) in the case of a credit used or absorbed, by allowing 100% of the credit.

However, if the use or absorption of a pre-closing tax benefit defers or precludes our use or absorption of any income tax benefit created after the closing of the IPO (post-closing tax benefit), our payment obligation with respect to the pre-closing tax benefit generally will be deferred until we actually use or absorb such post-closing tax benefit. This payment deferral will not apply with respect to, and we will have to pay currently for the use or absorption of pre-closing tax benefits to the extent of:

(1) up to 20% of any deferred or precluded post-closing tax benefit arising out of our payment of foreign income taxes, and

(2) 100% of any deferred or precluded post-closing tax benefit arising out of a carryback from a subsequent year.

If any person other than Transocean or its subsidiaries becomes the beneficial owner of greater than 50% of the aggregate voting power of our outstanding voting stock, we will be deemed to have used or absorbed all pre-closing tax benefits, and we generally will be required to pay Transocean Holdings an amount for the deemed use or absorption of these pre-closing tax benefits. The amount paid for the deemed use of these tax benefits will be calculated by:

(1) in the case of a deduction (including, for these purposes, all pre-closing income taxes, whether claimed as a deduction or credit), multiplying the deduction by the highest applicable statutory tax rate in effect,

(2) in the case of a credit other than a pre-closing foreign tax credit, allowing 100% of such credit, and

(3) multiplying the amounts by a specified discount factor.

The specified discount factor will vary depending on the year in which another person becomes the beneficial owner of greater than 50% of the voting power of our stock: if in 2004, 2007 or 2008, then the factor is 0.80; if in 2005 or 2006, then the factor is 0.70; if in 2009, then the factor is 0.85; if in 2010, then the factor is 0.90; if in 2011 or 2012, then the factor is 0.95; and if in 2013 or a later year, then the factor is 1.00). Moreover, if any of our subsidiaries that join with us in the filing of consolidated returns ceases to join in the filing of such returns, we will be deemed to have used that portion of the pre-closing tax benefits attributable to that subsidiary following the cessation, and we generally will be required to pay Transocean Holdings the amount of this deemed tax benefit,

calculated as described above with regard to an acquisition of beneficial ownership, at the time such subsidiary ceases to join in the filing of such returns. In the case of any of our payments to Transocean Holdings resulting from another person becoming the owner of greater than 50% of our voting stock or a subsidiary ceasing to join in the filing of a consolidated return with us, the payment will in no case be deferred, regardless of whether the existence of the related pre-closing tax benefit would or could defer or preclude our use or absorption of any post-closing tax benefit. Moreover, the payment will not be subsequently adjusted for any difference between the tax benefits that we are deemed to use or absorb in such case and the tax benefits that we actually use or absorb, and the difference between those amounts could be substantial. Among other considerations, applicable tax laws may, as a result of another person becoming the owner of greater than 50% of our voting power, significantly limit our use of such tax benefits, and these limitations are not taken into account in determining the amount of the payment to Transocean Holdings. A substantial portion of the pre-closing tax benefits are net operating losses, most or all of which should be eligible to be carried forward at least fourteen more years.

We are responsible for all special tax items accruing on or after the date on which we issued shares of our common stock to Transocean in repayment of our notes, as described in Debt Retirement and Debt Exchange Offers. For this purpose, special tax items means taxes with respect to items specified in U.S. Treasury regulation section 1.1502-76(b)(2)(ii)(C) (generally referring to transactions outside the ordinary course of our business). However, special tax items do not include taxes with respect to transactions to effect the separation of the TODCO business from the business of Transocean. See Master Separation Agreement. Moreover, there were no special tax items that accrued during the period beginning on the date of issuance of such shares to Transocean and ending on the date of the closing of the IPO.

We and Transocean Holdings are not currently members of a U.S. federal consolidated group or state, local or foreign combined group. If we and Transocean Holdings (or any affiliate of Transocean Holdings other than us) were to become members of a U.S. federal consolidated group or state, local or foreign combined group for any period after the closing of the IPO, we would be responsible for all income taxes attributable to us for that period, determined as if we had filed separate U.S. federal, state, local or foreign income tax returns. We would be entitled to reimbursement by Transocean Holdings for any income tax benefits realized by Transocean Holdings or any of its affiliates as a result of our being a member of any such consolidated or combined group.

We must pay Transocean Holdings for any tax benefits attributable to us resulting from (1) the payment by Transocean Holdings, after the closing of the IPO, of any additional taxes of the TODCO business that are not U.S. federal income taxes or (2) the delivery by Transocean or its subsidiaries, after the closing of the IPO, of stock of Transocean to an employee of ours in connection with the exercise of an employee stock option. We will generally be required to pay the deemed value of these tax benefits within 30 days of the payment of such additional taxes or the delivery of Transocean stock, whether or not we ever actually use or absorb such tax benefits. However, items in excess of \$1.0 million will be subject to the same rules as discussed above for pre-closing tax benefits, and therefore the payment of these items may be deferred in some circumstances.

Apart from (1) income taxes and income tax benefits that accrued on or before the closing of the IPO and (2) tax benefits resulting from Transocean Holdings payment of our taxes that are not U.S. federal income taxes or delivery of stock to our employees, described above, Transocean Holdings will be responsible for all income taxes, and will be entitled to all income tax benefits, attributable to Transocean Holdings or its affiliates (other than us), and we will be responsible for all income taxes, and will be entitled to all income tax benefits, attributable to us.

Our ability to obtain a refund from a carryback to a year in which we and Transocean Holdings joined in a consolidated or combined return will be at the discretion of Transocean Holdings. Moreover, any refund that we may obtain will be net of any increase in taxes resulting from the carryback that are otherwise for the account of Transocean Holdings.

We will have the right to be notified of tax matters for which we are responsible under the terms of the tax sharing agreement, although Transocean Holdings will have sole authority to respond to and conduct all tax proceedings, including tax audits, relating to any Transocean Holdings consolidated, or Transocean combined, income tax returns in which we are included.

Transocean Holdings will have substantial control over our filing of tax returns with respect to (1) any period in which Transocean or Transocean Holdings possess greater than 50% of the voting power of all of our outstanding stock or (2) any period after the closing of the IPO so long as there remains a present or potential obligation for us to pay Transocean Holdings for pre-closing tax benefits.

We will also be responsible for all taxes, other than income taxes, attributable to the TODCO business, whether accruing before, on or after the closing of the IPO.

We generally will be required to pay Transocean Holdings for the amount of pre-closing tax benefits that we use in determining the amount of any installment of estimated taxes we pay to Transocean Holdings or any tax authority within thirty days after the installment of estimated taxes is or would have been paid. If, after any installment payment of estimated taxes or after the relevant return is due (with or without any extensions), the estimated amount of pre-closing tax benefits for which we have previously paid differs from the most recent estimate or actual amount of pre-closing tax benefits that we use or absorb on that return, we and Transocean Holdings must make appropriate true-up payments between us. However, under some circumstances, payments by us for the use of pre-closing tax benefits, whether estimated or actual, may be deferred (subject to an interest charge) under a subordination agreement between us and Transocean in favor of our third-party lenders.

The tax sharing agreement further provides for cooperation between Transocean Holdings and us with respect to tax matters, the exchange of information and the retention of records that may affect the income tax liability of the parties to the agreement. However, if we fail to cooperate with Transocean Holdings in any tax contest with respect to taxes that are otherwise for the account of Transocean Holdings, any additional taxes resulting from such tax contest will be for our account, notwithstanding any other provision in the tax sharing agreement.

Notwithstanding the tax sharing agreement, under U.S. treasury regulations, each member of a consolidated group is severally liable for the U.S. federal income tax liability of each other member of the consolidated group. Accordingly, with respect to periods in which we have been included in Transocean Holdings consolidated group, we could be liable to the U.S. government for any U.S. federal income tax liability incurred, but not discharged, by any other member of Transocean Holdings consolidated group. However, if any such liability were imposed, we would generally be entitled to be indemnified by Transocean Holdings for tax liabilities allocated to Transocean Holdings under the tax sharing agreement.

Registration Rights Agreement

Because our shares of common stock held by Transocean are deemed restricted securities as defined in Rule 144, Transocean may only sell a limited number of shares of our common stock into the public markets without registration under the Securities Act. We entered into a registration rights agreement with Transocean under which, at the request of Transocean, we would use our best efforts to register shares of our common stock that were held by Transocean after the closing of the IPO, or were subsequently acquired, for public sale under the Securities Act. As long as Transocean owns a majority of the voting power of our outstanding common stock, there is no limit to the number of registrations that it may request. Once Transocean owns less than a majority of the voting power of our outstanding common stock, it can request a total of three additional registrations. If Transocean sells more than 10% of our outstanding shares of common stock to a transferee, Transocean may transfer all or a portion of its rights under the agreement, except that a transferee that acquires a majority of our outstanding common stock can only request two additional registrations after it owns less than a majority of our outstanding common stock, and a transferee of less than a majority of our outstanding common stock can only request either one or two registrations, depending on the percentage of our outstanding common stock it acquires. The transfer of rights under the agreement to a transferee does not limit the number of registrations Transocean may request. We also provide Transocean and its permitted

transferees with piggy-back rights to include its shares in future registrations of our common stock under the Securities Act. There is no limit on the number of these piggy-back registrations in which Transocean may request its shares be included. These rights will terminate once Transocean or a permitted transferee is able to dispose of all of its shares of our common stock within a three-month period pursuant to the exemption from registration provided under Rule 144 of the Securities Act. We have agreed to cooperate in these registrations and related offerings. We and Transocean have agreed to restrictions on the ability of each party to sell securities following registrations requested by either party.

The registration rights agreement provides that we will pay all out-of-pocket expenses incurred in connection with any registration pursuant to the agreement. However, Transocean has agreed to pay such expenses in connection with this offering.

Transition Services Agreement

We entered into a transition services agreement with Transocean under which Transocean provides specified administrative support during the transitional period following the closing of the IPO. Transocean may provide specified information technology and systems, financial reporting, accounting, human resources, treasury and claims administration services to us in exchange for agreed fees based on Transocean's actual costs. We are required to use specific services so long as Transocean owns at least 50% of the voting power of our outstanding shares of voting stock. However, we expect to replace the computerized accounting system provided by Transocean with our own system by January 1, 2005. Only in limited circumstances will Transocean be liable to us with respect to the provision of services under the transition services agreement.

Employee Matters Agreement

We entered into an agreement with Transocean and Transocean Holdings to allocate specified assets, liabilities, and responsibilities relating to our current and former employees and their participation in Transocean's benefit plans.

Benefits under our U.S. pension plan ceased to accrue as of July 1, 1999. As of August 1, 2001, our employees' existing accrued benefits under that plan were fully vested. Sponsorship of that plan has been assumed by Transocean Holdings effective August 1, 2002. Effective as of the date that we no longer are a part of a controlled group of companies with Transocean for U.S. federal income tax purposes, affected employees will be entitled to take a distribution from that plan, subject to the provisions of the plan and to taxation and possible early withdrawal penalties. We do not expect to establish a new pension plan for our employees.

Our employees became eligible to participate in our U.S. savings plan effective November 1, 2002. Our employees may make pre-tax contributions to that plan. Employees who are not considered highly compensated for tax purposes may also make post-tax contributions. We provide matching contributions of up to 100% of the first 3% of participant contributions, plus 50% of the next 3% of participant contributions for a total 4.5% in matching contributions. Additionally, the plan allows for a discretionary annual contribution allocable to all eligible employees, subject to a two-year vesting requirement. We have agreed that we will make an annual contribution of 1.5% of compensation for all eligible employees (as defined in the plan) for so long as we are part of a controlled group of companies with Transocean for U.S. federal income tax purposes. Annual contributions were made in 2002 and 2003. On or about January 1, 2003, liabilities for our employees' accounts under the Transocean U.S. Savings Plan, and assets associated with those liabilities, were transferred to our U.S. savings plan. Our employees who have invested in Transocean ordinary shares under the Transocean U.S. Savings Plan may retain that investment, if they choose to do so, until December 31, 2005, but will not be eligible to acquire additional Transocean ordinary shares under our U.S. savings plan.

Under the terms of the Transocean stock option awards granted prior to the closing of the IPO, our employees will continue to retain outstanding options to acquire Transocean ordinary shares for the duration of their original term.

With some exceptions, we have agreed to indemnify Transocean for employment liabilities arising from any acts of our employees or from claims by our employees against Transocean and for liabilities relating to benefits for our employees. Transocean has agreed to similarly indemnify us.

Service and Secondment Agreement

We have entered into an agreement with Transocean under which we provide to Transocean specified administrative services and seconded personnel in connection with a drilling contract Transocean has for drilling oil and gas wells offshore Trinidad and Tobago for a fee of \$2,750 per day for an expected duration of 60 days. In connection with the provision of these services, we have agreed to indemnify Transocean for liabilities pertaining to our employees (excluding the seconded personnel), and Transocean has agreed to indemnify us for liabilities pertaining to its employees (including the seconded personnel).

PRINCIPAL AND SELLING STOCKHOLDERS

We are a majority-owned subsidiary of Transocean Inc, one of the selling stockholders in this offering. Transocean Holdings Inc., the other selling stockholder in this offering, is a wholly owned subsidiary of Transocean Inc. Transocean Inc. and Transocean Holdings Inc. currently own an aggregate of 46,200,000 shares of Class B common stock. Upon the closing of this offering, Transocean Inc. will own 30,600,000 shares of Class B common stock, representing all of the outstanding shares of our Class B common stock and 51% of all of the outstanding shares of our common stock and giving it 84% of the combined voting power of our outstanding common stock. The foregoing percentages relating to the percentage owned and combined voting power of all of the outstanding shares of common stock would be reduced to 47% and 82% if the underwriters exercise their over-allotment option in full. Under Delaware corporate law and our charter documents, Transocean will be able, acting alone, to elect our entire board of directors and to approve any action requiring the approval of our stockholders. Please read *Management Board Structure and Compensation of Directors* and *Security Ownership of Directors and Executive Officers* for a description of the ownership of TODCO common stock and Transocean ordinary shares by our directors and executive officers and for information about options to purchase Class A common stock and restricted shares of Class A common stock granted to our directors and executive officers. Transocean's principal executive office in the United States is located at 4 Greenway Plaza, Houston, Texas 77046.

DESCRIPTION OF CAPITAL STOCK

General

The following descriptions are summaries of material terms of our common stock, preferred stock, amended and restated certificate of incorporation and amended and restated bylaws. These summaries are qualified by reference to our amended and restated certificate of incorporation and amended and restated bylaws, copies of which have been filed as exhibits to the registration statement of which this prospectus is a part, and by applicable law.

Our authorized capital stock consists of (1) 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 (2) 50,000,000 shares of preferred stock, par value \$.01 per share. We refer to our Class A common stock and Class B common stock collectively as our common stock. Of the 500,000,000 authorized shares of Class A common stock, 15,600,000 shares are being offered in this offering (or 17,940,000 shares if the underwriters exercise their over-allotment option in full). Of the 50,000,000 shares of preferred stock, 760,000 shares have been designated Series A preferred stock. Immediately following this offering, 29,702,890 shares of Class A common stock and 30,600,000 shares of Class B common stock will be outstanding and there will be no outstanding shares of preferred stock.

Our Class A common stock is listed on the New York Stock Exchange under the symbol THE.

Common Stock

Voting Rights

The holders of Class A common stock and Class B common stock generally have identical rights, except that holders of Class A common stock are entitled to one vote per share while holders of Class B common stock are entitled to five votes per share on all matters on which stockholders are permitted to vote. There are no cumulative voting rights. Accordingly, holders of a majority of the total votes entitled to vote in an election of directors will be able to elect all of the directors standing for election. Generally, all matters to be voted on by stockholders must be approved by a majority of the votes entitled to be cast by the holders of the Class A common stock and Class B common stock present in person or represented by proxy, voting together as a single class, subject to any voting rights granted to holders of any preferred stock. However, amendments to our amended and restated certificate of incorporation that would alter or change the powers, preferences or special rights of the Class A common stock or Class B common stock so as to affect them adversely also must be approved by a majority of the votes entitled to be cast by the holders of the shares affected by the amendment, voting as a separate class. Holders of Class A common stock are not entitled to vote on any alteration or change in the powers, preferences or special rights of the Class B common stock that would not adversely affect the rights of holders of the Class A common stock. For purposes of the foregoing provisions, any provision for the voluntary, mandatory or other conversion or exchange of the Class B common stock into or for Class A common stock on a one-for-one basis will be deemed not to adversely affect the rights of the Class A common stock. Notwithstanding the foregoing and subject to the rights of any class of preferred stock, any amendment to our amended and restated certificate of incorporation to increase the number of authorized shares of any class of our capital stock requires the approval only of a majority of the votes entitled to be cast by the holders of the Class A common stock and Class B common stock, voting together as a single class.

Dividends

Subject to preferences that may be applicable to any outstanding preferred stock, the holders of Class A common stock and Class B common stock will share equally on a per share basis any dividends when, as and if declared by the board of directors out of funds legally available for that purpose. Dividends payable in shares of common stock may be paid only as follows:

shares of Class A common stock may be paid only to holders of Class A common stock, and shares of Class B common stock may be paid only to holders of Class B common stock, and

the number of shares so paid will be equal on a per share basis with respect to each outstanding share of Class A common stock and Class B common stock. We may not reclassify, subdivide or combine shares of either class without at the same time proportionally reclassifying, subdividing or combining shares of the other class.

Conversion

Each share of Class B common stock is convertible while held by Transocean at the option of Transocean into one share of Class A common stock. Following any distribution of Class B common stock to security holders of Transocean in a transaction (including any distribution in exchange for Transocean shares or securities) intended to qualify as a tax-free distribution under Section 355 of the U.S. Internal Revenue Code of 1986, as amended, or any corresponding provision of any successor statute (a Tax-Free Spin-Off), shares of Class B common stock will no longer be convertible into shares of Class A common stock.

Prior to a Tax-Free Spin-Off, each share of Class B common stock transferred to a person other than Transocean or any of its affiliates (excluding us) will automatically be converted into a share of Class A common stock upon such transfer. Shares of Class B common stock transferred to shareholders of Transocean in a Tax-Free Spin-Off will not be converted into shares of Class A common stock and, following a Tax-Free Spin-Off, shares of Class B common stock will be transferable as Class B common stock, subject to applicable law.

If a Tax-Free Spin-Off has not occurred, all shares of Class B common stock will automatically be converted into shares of Class A common stock on the later of:

the date on which the voting power of the voting stock owned by Transocean falls below 80% of the voting power of our outstanding voting stock, and

the two-year anniversary of the closing date of this offering.

All conversions will be effected on a share-for-share basis.

Other Rights

If we are liquidated, dissolved or wound up, all holders of our common stock, regardless of class, will be entitled to a ratable share of any distribution to stockholders, after satisfaction of all of our liabilities and of the prior rights of any outstanding class of our preferred stock. Other than the conversion rights of the Class B common stock described above or the subscription rights granted to Transocean under the master separation agreement, our common stock has no preemptive or conversion rights or other subscription rights. There are no redemption or sinking fund provisions applicable to our common stock. All outstanding shares of our common stock are fully paid and nonassessable.

Preferred Stock

General

Our board of directors has the authority, without stockholder approval, to issue shares of preferred stock from time to time in one or more series, and to fix the number of shares and terms of each such series. The board may determine the designation and other terms of each series, including the following:

dividend rates,

whether dividends will be cumulative or non-cumulative,

redemption rights,

liquidation rights,

sinking fund provisions,

conversion or exchange rights, or

voting rights.

The issuance of preferred stock, while providing us with flexibility in connection with possible acquisitions and other transactions, could adversely affect the voting power of holders of our common stock. It could also affect the likelihood that holders of our common stock will receive dividend payments and payments upon liquidation. We have no present plans to issue any preferred stock.

The issuance of shares of preferred stock, or the issuance of rights to purchase shares of preferred stock, could be used to discourage an attempt to obtain control of our company. For example, if, in the exercise of its fiduciary obligations, our board of directors were to determine that a takeover proposal was not in the best interest of our shareholders, the board could authorize the issuance of a series of preferred stock containing class voting rights that would enable the holder or holders of this series to prevent a change of control transaction or make it more difficult. Alternatively, a change of control transaction deemed by the board to be in the best interest of our shareholders could be facilitated by issuing a series of preferred stock having sufficient voting rights to provide a required percentage vote of the stockholders.

Series A Junior Participating Preferred Stock

For purposes of the stockholders' rights plan described below, our board of directors has designated 760,000 shares of Series A Junior Participating Preferred Stock, par value \$.001 per share. See Stockholder Rights Plan. Each share of Series A preferred stock will be entitled to a minimum preferential quarterly dividend payment of \$20 but will be entitled to an aggregate dividend of 1,000 times the dividend declared per share of Class A common stock. In the event of liquidation, the holders of Series A preferred stock will be entitled to a minimum preferential liquidation payment of \$1,000 per share but will be entitled to an aggregate payment of 1,000 times the liquidation payment made per share of Class A common stock. Each share of Series A preferred stock will have 1,000 votes voting together with the Class A common stock and Class B common stock. In the event of any merger, consolidation or other transaction in which shares of Class A common stock are exchanged, each share of Series A preferred stock will be entitled to receive 1,000 times the amount received per share of Class A common stock. Each share of Series A preferred stock is redeemable in whole or in part for cash in a per share amount equal to 1,000 times the current market price (determined in accordance with the certificate of designation for the Series A preferred stock) of a share of Class A common stock on the date of the mailing of the redemption notice. The value of the Series A preferred stock is protected by antidilution provisions.

Due to the nature of the Series A preferred stock's dividend, redemption, liquidation and voting rights, the value of one one-thousandth of a share of Series A preferred stock purchasable upon exercise of each right should approximate the value of one share of Class A common stock.

For a complete description of the terms of our Series A preferred stock, we encourage you to read our certificate of designations relating to the Series A preferred stock, which we have filed as an exhibit to the registration statement of which this prospectus is a part.

Stockholder Rights Plan

General

Each share of Class A common stock and Class B common stock includes one right (the Class A rights and the Class B rights, respectively, which are together referred to as the rights). Each Class A right and each Class B right entitles the holder to purchase from us a unit consisting of one-thousandth of a share of our Series A preferred stock at a purchase price of \$50.00 per unit, subject to specified adjustments. The rights are issued pursuant to a rights agreement between us and The Bank of New York as rights agent. Until a right is exercised, the holder of a right, as such, will have no rights to vote or receive dividends or any other stockholder rights.

The rights may have antitakeover effects. The rights will cause substantial dilution to any person or group that attempts to acquire us without the approval of our board of directors. As a result, the overall effect of the rights may be to render more difficult or discourage any attempt to acquire us. Because our board of directors can approve a redemption of the rights or a permitted offer, the rights should not interfere with a merger or other business combination approved by our board of directors. The adoption of the rights agreement was approved by Transocean Holdings Inc., our sole stockholder prior to this offering.

We have summarized the material terms and conditions of the rights agreement and the rights below. For a complete description of the rights, we encourage you to read the rights agreement, which we have filed as an exhibit to the registration statement of which this prospectus is a part.

Detachment of Rights; Exercisability

The rights are attached to all certificates representing our currently outstanding common stock and will attach to all common stock certificates we issue prior to the rights distribution date that we describe below. The rights are not exercisable until after the rights distribution date and will expire at the close of business on the tenth anniversary date of the adoption of the plan, unless we redeem or exchange them earlier as we describe below. The rights will separate from the common stock and a rights distribution date would occur, subject to specified exceptions, on the earlier of the following two dates:

10 days following a public announcement that a person or group of affiliated or associated persons (collectively, an acquiring person) has acquired or obtained the right to acquire beneficial ownership of (1) 20% or more of the outstanding shares of our Class A common stock, (2) 15% or more of the outstanding shares of our Class B common stock or (3) any combination of Class A common stock and Class B common stock representing 15% or more of the votes of all shares entitled to vote in the election of directors, or

10 business days following the start of a tender or exchange offer that would result, if closed, in a person s becoming an acquiring person.

Transocean is excluded from the definition of acquiring person for purposes of the rights and therefore its ownership cannot trigger the rights. In addition, any person that acquires from Transocean shares of common stock that would otherwise result in that person becoming an acquiring person will not become an acquiring person due to that acquisition. Specified inadvertent owners that would otherwise become an acquiring person, including those who would have this designation as a result of the conversion of Class B common stock into Class A common stock, or repurchases of common stock by us, will also not become acquiring persons as a result of those transactions.

Our board of directors may defer the rights distribution date in some circumstances, and some inadvertent acquisitions will not result in a person becoming an acquiring person if the person promptly divests itself of a sufficient number of shares of common stock.

Until the rights distribution date:

Class A common stock and Class B common stock certificates will evidence the rights, and the rights will be transferable only with those certificates,

any new common stock will be issued with rights and new certificates will contain a notation incorporating the rights agreement by reference, and

the surrender for transfer of any Class A common stock and Class B common stock certificate will also constitute the transfer of the rights associated with the stock that certificate represents.

As soon as practicable after the rights distribution date, the rights agent will mail certificates representing the Class A rights and Class B rights to holders of record of Class A common stock and Class B common stock, respectively, at the close of business on that date. After the rights distribution date, only separate rights certificates will represent the rights.

We will not issue rights with any shares of common stock we issue after the rights distribution date, except:

as our board of directors may otherwise determine, and

together with shares of common stock we issue as a result of previously established incentive plans or convertible securities.

Flip-In Event

A flip-in event will occur under the rights agreement when a person becomes an acquiring person otherwise than pursuant to a permitted offer. The rights agreement generally defines permitted offer to mean a tender or exchange offer for all outstanding shares of common stock at a price and on terms that a majority of the members of our board of directors who are independent from the acquiring person or the person making the offer determines to be fair to and otherwise in the best interests of our company and our stockholders.

If a flip-in event occurs and we do not redeem the rights as described under Redemption of Rights below, each Class A right and Class B right, other than any right that has become void as we describe below, will become exercisable at the time it is no longer redeemable to receive the number of shares of Class A common stock and Class B common stock, or, in some cases, cash, property or other of our securities, having a current market price equal to two times the exercise price of the Class A right or Class B right, respectively.

When a flip-in event occurs, all rights that then are, or in some circumstances that were, beneficially owned by or transferred to an acquiring person or specified related parties will become void in the circumstances the rights agreement specifies.

Flip-Over Event

A flip-over event will occur under the rights agreement when, at any time after a person has become an acquiring person:

we are acquired in a merger or other business combination transaction, other than specified mergers that follow a permitted offer of the type we describe above, or

50% or more of our assets, cash flow or earning power is sold or transferred.

If a flip-over event occurs, each holder of a Class A right or Class B right, other than any right that has become void as we describe under Flip-In Event, will have the right to receive the number of shares of common stock of the acquiring company which has a current market price equal to two times the exercise price of the Class A right or Class B right, respectively.

Antidilution

The number of outstanding Class A rights or Class B rights associated with a share of Class A or Class B common stock, respectively, the number of fractional shares of Series A preferred stock issuable on exercise of a right and the exercise price of the rights are subject to adjustment for any stock split, stock dividend or subdivision, combination or reclassification of the Class A or Class B common stock, respectively, occurring prior to the rights distribution date. The exercise price of the rights and the number of fractional shares of Series A preferred stock or other securities or property issuable on exercise of the rights also are subject to adjustment to prevent dilution in the event of specified types of transactions affecting the Series A preferred stock.

With some exceptions, the rights agreement will not require us to adjust the exercise price of the rights until cumulative adjustments amount to at least 1% of the exercise price. It also will not require us to issue fractional shares of Series A preferred stock that are not integral multiples of one one-hundredth of a share, and, instead we may make a cash adjustment based on the market price of the Series A preferred stock on the last trading date prior to the date of exercise. The rights agreement reserves to us the right to require prior to

the occurrence of any flip-in event or flip-over event that, on any exercise of rights, a number of rights must be exercised so that we will issue only whole shares of Series A preferred stock.

Redemption of Rights

At any time until 10 days after the date on which the occurrence of a flip-in event is first publicly announced, we may redeem the rights in whole, but not in part, at a redemption price of \$.01 per right. The redemption price is subject to adjustment for any stock split, stock dividend or similar transaction occurring before the date of redemption. At our option, we may pay that redemption price in cash, shares of common stock or any other consideration our board of directors may select. The rights are not exercisable after a flip-in event until they are no longer redeemable. If our board of directors timely orders the redemption of the rights, the rights will terminate on the effectiveness of that action.

Exchange of Rights

We may, at our option, exchange the rights (other than rights owned by an acquiring person or an affiliate or an associate of an acquiring person, which have become void), in whole or in part. The exchange will be at an exchange ratio of one share of Class A or Class B common stock (and/or other equity securities we deem to have the same value as one share of Class A or Class B common stock, respectively), per Class A right or Class B right, respectively, subject to specified adjustments at any time after the occurrence of a flip-in event and prior to:

any person other than Transocean becoming the beneficial owner of common stock with voting power equal to 50% or more of the total voting power of all shares of common stock entitled to vote in the election of directors, or

the occurrence of a flip-over event.

Amendment of Terms of Rights

During the time the rights are redeemable, we may amend any of the provisions of the rights agreement, other than by decreasing the redemption price. Once the rights cease to be redeemable, we generally may amend the provisions of the rights agreement, other than to decrease the redemption price, only as follows:

to cure any ambiguity, defect or inconsistency,

to make changes that do not materially adversely affect the interests of holders of rights, excluding the interests of any acquiring person, or

to shorten or lengthen any time period under the rights agreement, except that we cannot lengthen the time period governing redemption or lengthen any time period that protects, enhances or clarifies the benefits of holders of rights other than an acquiring person.

We have agreed, in the master separation agreement with Transocean, not to amend or modify the terms of the rights agreement without the consent of Transocean for so long as Transocean continues to own at least 15% of the voting power of our outstanding voting stock.

Charter and Bylaw Provisions

Election and Removal of Directors

Our board of directors will be comprised of between one and 12 directors, excluding any directors elected by holders of preferred stock pursuant to provisions applicable in the case of defaults. The exact number of directors will be fixed from time to time by resolution of the board. Beginning at the time Transocean ceases to own, directly or indirectly, at least a majority of the voting power of our outstanding voting stock, our directors will be divided into three classes serving staggered three-year terms. Beginning at that time, at each annual meeting of stockholders, directors will be elected to succeed the class of directors whose terms have expired. Please read Management Board Structure and Compensation of Directors above.

This system of electing and removing directors may discourage a third party from making a tender offer or otherwise attempting to obtain control of us, because it generally makes it more difficult for stockholders to replace a majority of the directors. In addition, beginning at the time Transocean ceases to own, directly or indirectly, at least a majority of the voting power of our outstanding common stock, no director may be removed except for cause, and directors may be removed for cause by an affirmative vote of shares representing a majority of the voting power then entitled to vote at an election of directors. Any vacancy occurring on the board of directors and any newly created directorship may only be filled by a majority of the remaining directors in office. As long as Transocean owns, directly or indirectly, at least a majority of the voting power of our outstanding voting stock, directors may be removed with or without cause by holders of a majority of the voting power of the outstanding voting stock and directors will generally be elected annually.

Stockholder Meetings

Our amended and restated certificate of incorporation and our bylaws provide that special meetings of our stockholders may be called only by the chairman of our board of directors, our chief executive officer, a majority of the directors or Transocean, if it is a stockholder. Our amended and restated certificate of incorporation and our bylaws specifically deny any power of any other person to call a special meeting.

Stockholder Action by Written Consent

Our amended and restated certificate of incorporation and our bylaws provide that beginning at the time Transocean ceases to own, directly or indirectly, at least a majority of the voting power of our outstanding voting stock, holders of our common stock will not be able to act by written consent without a meeting. Prior to that time, stockholders will therefore be entitled to act by written consent without a meeting or notice and Transocean will be able to take any action requiring approval of our stockholders by written consent and without the affirmative vote of our other stockholders.

Amendment of Amended and Restated Certificate of Incorporation

Beginning at the time Transocean ceases to own, directly or indirectly, at least a majority of the voting power of our outstanding voting stock, the provisions of our amended and restated certificate of incorporation described below under Transactions and Corporate Opportunities may be amended only by the affirmative vote of holders of at least 80% of the voting power of our outstanding shares of voting stock, voting together as a single class, and the provisions of our amended and restated certificate of incorporation described above under Election and Removal of Directors, Stockholder Meetings and Stockholder Action by Written Consent may be amended only by the affirmative vote of holders of at least 66 2/3% of the voting power of our outstanding shares of voting stock, voting together as a single class. The affirmative vote of holders of at least a majority of the voting power of our outstanding shares of stock is generally required to amend other provisions of our amended and restated certificate of incorporation.

Amendment of Bylaws

Our bylaws may generally be altered, amended or repealed, and new bylaws may be adopted, with:

the affirmative vote of a majority of directors present at any regular or special meeting of the board of directors called for that purpose, or

the affirmative vote of holders of at least a majority of the voting power of our outstanding shares of voting stock, voting together as a single class.

Any alteration, amendment or repeal of, or adoption of any bylaw inconsistent with specified provisions of the bylaws, including those related to special and annual meetings of stockholders, action of stockholders by written consent, classification of the board of directors, nomination of directors, special meetings of directors, removal of directors and committees of the board of directors requires:

the affirmative vote of at least 80% of all directors in office at any regular or special meeting of the board of directors called for that purpose, or

the affirmative vote of holders of at least 80% of the voting power of our outstanding shares of voting stock, voting together as a single class.

Other Limitations on Stockholder Actions

Our bylaws also impose some procedural requirements on stockholders who wish to:

make nominations in the election of directors,

propose that a director be removed,

propose any repeal or change in our bylaws, or

propose any other business to be brought before an annual or special meeting of stockholders.

Under these procedural requirements, in order to bring a proposal before a meeting of stockholders, a stockholder must deliver timely notice of a proposal pertaining to a proper subject for presentation at the meeting to our corporate secretary along with the following:

a description of the business or nomination to be brought before the meeting and the reasons for conducting such business at the meeting,

the stockholder's name and address,

the number of shares beneficially owned by the stockholder and evidence of such ownership, and

the names and addresses of all persons with whom the stockholder is acting in concert and a description of all arrangements and understandings with those persons, and the number of shares such persons beneficially own.

To be timely, a stockholder must generally deliver notice:

in connection with an annual meeting of stockholders, not less than 120 nor more than 180 days prior to the date on which the annual meeting of stockholders was held in the immediately preceding year, but in the event that the date of the annual meeting is more than 30 days before or more than 60 days after the anniversary date of the preceding annual meeting of stockholders, a stockholder notice will be timely if received by us not later than the close of business on the later of (1) the 120th day prior to the annual meeting and (2) the 10th day following the day on which we first publicly announce the date of the annual meeting, or

in connection with the election of a director at a special meeting of stockholders, not less than 40 nor more than 60 days prior to the date of the special meeting, but in the event that less than 55 days' notice or prior public disclosure of the date of the special meeting of the stockholders is given or made to the stockholders, a stockholder notice will be timely if received by us not later than the close of business on the 10th day following the day on which a notice of the date of the special meeting was mailed to the stockholders or the public disclosure of that date was made.

In order to submit a nomination for our board of directors, a stockholder must also submit any information with respect to the nominee that we would be required to include in a proxy statement, as well as some other information. If a stockholder fails to follow the required procedures, the stockholder's proposal or nominee will be ineligible and will not be voted on by our stockholders.

We have agreed, in the master separation agreement, that for so long as Transocean owns at least 15% of the voting power of our outstanding shares of our voting stock, we will not, without the consent of Transocean, adopt any amendments to our amended and restated certificate of incorporation or bylaws or take or recommend any action to our stockholders that would:

impose limits on the legal rights of Transocean,

involve the issuance of specified warrants, rights, capital stock or other securities, excluding the rights described under Preferred Stock Stockholder Rights Plan,

deny any benefit to Transocean proportionately as holders of any class of voting securities generally, or

alter voting or other rights of holders of any class of voting securities so that those rights are determined with reference to the amount of voting securities held by Transocean.

Limitation on Liability of Directors

Our amended and restated certificate of incorporation provides that no director will be personally liable to us or our stockholders for monetary damages for breach of fiduciary duties as a director, except as required by applicable law, as in effect from time to time. Currently, Delaware law requires that liability be imposed for the following:

any breach of the director's duty of loyalty to our company or our stockholders,

any act or omission not in good faith or which involved intentional misconduct or a knowing violation of law,

unlawful payments of dividends or unlawful stock repurchases or redemptions as provided in Section 174 of the Delaware General Corporation Law, and

any transaction from which the director derived an improper personal benefit.

Our bylaws provide that, to the fullest extent permitted by law, we will indemnify any officer or director of our company against all damages, claims and liabilities arising out of the fact that the person is or was our director or officer, or served any other enterprise at our request as a director, officer, employee, agent or fiduciary. We will reimburse the expenses, including attorneys' fees, incurred by a person indemnified by this provision when we receive an undertaking to repay such amounts if it is ultimately determined that the person is not entitled to be indemnified by us. Amending this provision will not reduce our indemnification obligations relating to actions taken before an amendment.

Anti-Takeover Effects of Some Provisions

Some provisions of our amended and restated certificate of incorporation and bylaws could make the following more difficult:

acquisition of control of us by means of a proxy contest or otherwise, or

removal of our incumbent officers and directors.

These provisions, as well as our stockholder rights plan and our ability to issue preferred stock, are designed to discourage coercive takeover practices and inadequate takeover bids. These provisions are also designed to encourage persons seeking to acquire control of us to first negotiate with our board of directors. We believe that the benefits of increased protection give us the potential ability to negotiate with the proponent of an unfriendly or unsolicited proposal to acquire or restructure us, and that the benefits of this increased protection outweigh the disadvantages of discouraging those proposals, because negotiation of those proposals could result in an improvement of their terms.

Transactions and Corporate Opportunities

Our amended and restated certificate of incorporation includes provisions that regulate and define the conduct of specified aspects of the business and affairs of our company. These provisions serve to determine and delineate the respective rights and duties of our company, Transocean and some of our directors and officers in anticipation of the following:

directors, officers and/or employees of Transocean serving as our directors and/or officers,

Transocean engaging in lines of business that are the same as, or similar to, our lines of business,

Transocean having an interest in the same areas of corporate opportunity as we have, and

we and Transocean engaging in material business transactions, including transactions pursuant to the various agreements related to our separation from Transocean described elsewhere in this prospectus.

We may enter into agreements with Transocean to engage in any transaction. We may also enter into agreements with Transocean to compete or not to compete with each other, including agreements to allocate, or to cause our and its respective directors, officers and employees to allocate, opportunities between Transocean and us and have done so in the master separation agreement. Our amended and restated certificate of incorporation provides that no such agreement will be considered contrary to any fiduciary duty of Transocean, as the controlling stockholder of our company, or of a director, officer or employee of our company or Transocean. Neither Transocean nor any of our directors, officers or employees who are also directors, officers or employees of Transocean are under any fiduciary duty to us to refrain from acting on our behalf or on behalf of Transocean in respect of any such agreement or transaction. These provisions are generally subject to the corporate opportunity obligations described below with which Transocean and our officers and directors who are also Transocean's directors, officers or employees must comply.

Under our amended and restated certificate of incorporation, Transocean has no duty to refrain from engaging in activities or lines of business similar to ours or from doing business with any of our clients, customers or vendors and, except as discussed in the above paragraph, neither Transocean nor any of its officers, directors or employees will be liable to us or our stockholders for breach of any fiduciary duty as a stockholder by reason of any of these activities. In addition, if Transocean or a director or officer of our company who is also a director, officer or employee of Transocean acquires knowledge of a potential transaction or matter which may be a corporate opportunity for both our company and Transocean, then neither Transocean nor any such person will have a duty to communicate or offer this corporate opportunity to us and will not be liable to us or our stockholders for breach of any fiduciary duty by reason of the fact that Transocean pursues or acquires the corporate opportunity for itself, directs the corporate opportunity to another person or does not communicate information regarding the corporate opportunity to us, so long as Transocean or a director or officer of Transocean, as the case may be, acts in a manner consistent with the following policy: A corporate opportunity offered to Transocean or to any person who is an officer or director of our company and who is also an officer, director or employee of Transocean will belong to Transocean, unless the opportunity was expressly offered in writing to Transocean solely in its capacity as a stockholder of our company or to that person solely in his or her capacity as a director or officer of our company.

By becoming a stockholder in our company, you will be deemed to have notice of and consented to these provisions of our amended and restated certificate of incorporation. Beginning at the time that Transocean ceases to own at least a majority of the voting power of our outstanding voting stock, these provisions may not be amended or repealed except by the vote of the holders of 80% of the voting power of our outstanding shares of voting stock.

Delaware Business Combination Statute

We have expressly elected not to be subject to Section 203 of the Delaware General Corporation Law, which is described below. However, our stockholders can amend our amended and restated certificate of incorporation and bylaws to elect to be subject to Section 203. Our amended and restated certificate of incorporation provides that as long as Transocean owns, directly or indirectly, a majority of the voting power of our outstanding common stock, Transocean may act by written consent in lieu of a meeting. Thus, Transocean, as a controlling stockholder, may cause such an election without a meeting of stockholders.

Section 203 provides that, subject to specified exceptions, an interested stockholder of a Delaware corporation is not permitted to engage in any business combination, including mergers or consolidations or acquisitions of additional shares of the corporation, with the corporation for a three-year period following the time that stockholder became an interested stockholder, unless one of the following conditions is met:

prior to the time the stockholder became an interested stockholder, the board of directors approved either the business combination or the transaction which resulted in the stockholder becoming an interested stockholder,

upon consummation of the transaction which resulted in the stockholder becoming an interested stockholder, the interested stockholder owned at least 85% of the voting stock of the corporation outstanding at the time the transaction commenced, other than statutorily excluded shares, or

on or subsequent to the time the stockholder became an interested stockholder, the business combination is approved by the board of directors and authorized at an annual or special meeting of stockholders by the affirmative vote of at least 66 2/3% of the outstanding voting stock which is not owned by the interested stockholder.

Except as otherwise set forth in Section 203, interested stockholder means:

any person that is the owner of 15% or more of the outstanding voting stock of the corporation, or is an affiliate or associate of the corporation and was the owner of 15% or more of the outstanding voting stock of the corporation at any time within three years immediately prior to the date of determination, and

the affiliates and associates of any such person.

If we ever become subject to Section 203, it may be more difficult for a person who is an interested stockholder to effect various business combinations with us for the applicable three-year period. Section 203, if it becomes applicable, also may have the effect of preventing changes in our management. It is possible that Section 203, if it becomes applicable, could make it more difficult to accomplish transactions which our stockholders may otherwise deem to be in their best interests. The provisions of Section 203, if it becomes applicable, may cause persons interested in acquiring us to negotiate in advance with our board of directors. The restrictions on business combinations set forth in Section 203 are not applicable to Transocean so long as Transocean holds 15% or more of our common stock. Our board has also, to the extent allowed by law, approved in advance any transfer of shares by Transocean which would result in a direct transferee otherwise becoming an interested person under the statute. Because we are not currently subject to Section 203, Transocean, as a controlling stockholder, may find it easier to sell its controlling interest to a third party because Section 203 would not apply to the third party.

Listing of Class A Common Stock

Our Class A common stock is listed on the New York Stock Exchange under the symbol THE.

Transfer Agent and Registrar

The transfer agent and registrar for our common stock is The Bank of New York.

SHARES ELIGIBLE FOR FUTURE SALE

After this offering, we will have 29,702,890 shares of our Class A common stock and 30,600,000 shares of our Class B common stock outstanding. All of the shares of our Class A common stock sold in this offering will be freely tradable without restriction under the Securities Act, except for any shares that may be acquired by any of our affiliates, as that term is defined in Rule 144 under the Securities Act. Affiliates are individuals or entities that directly, or indirectly through one or more intermediaries, control, are controlled by, or are under common control with, us and may include our directors and officers as well as our significant stockholders, if any. We, Transocean, Mr. Rask, Mr. O Keefe and our directors have agreed with the underwriters not to offer or sell any shares of our common stock for a period of time after the date of this prospectus, 90 days in the case of us and Transocean and 25 days in the case of Mr. Rask, Mr. O Keefe and our directors, without the prior written consent of the underwriters, except for issuances described under Underwriters.

The shares of our common stock held by Transocean following this offering are deemed restricted securities as defined in Rule 144, and may not be sold other than through registration under the Securities Act or under an exemption from registration, such as the one provided by Rule 144.

In general, a stockholder subject to Rule 144 who has owned common stock of an issuer for at least one year may, within any three-month period, sell up to the greater of:

1% of the total number of shares of common stock then outstanding, and

the average weekly trading volume of the common stock during the four weeks before the stockholder files a notice of sale with the SEC.

Rule 144 requires stockholders to aggregate their sales with other affiliated stockholders for purposes of complying with this volume limitation. A stockholder who has owned common stock for at least two years, and who has not been an affiliate of the issuer for at least 90 days, may sell common stock free from the volume limitation and notice requirements of Rule 144.

We have granted Transocean registration rights with respect to our shares it will hold after this offering. See Relationship Between Us and Transocean Registration Rights Agreement.

Transocean has advised us that its current long term intent is to dispose of our common stock owned by it following this offering. Transocean could elect to dispose of our common stock in a number of different types of transactions, including additional public offerings of our common stock, open market sales of our common stock, sales of our common stock to one or more third parties, spin-off distributions of our common stock to Transocean's shareholders, split-off offerings to Transocean's shareholders that would allow for the opportunity to exchange Transocean shares for shares of our common stock or a combination of these transactions. However, the determination whether, and if so, when, to proceed with any of these transactions is entirely within the discretion of Transocean. Transocean has also advised us that its current preference would be to receive cash in any transaction disposing of our common stock owned by it following this offering.

MATERIAL U.S. FEDERAL INCOME TAX

CONSIDERATIONS FOR NON-U.S. HOLDERS

General

The following general discussion sets forth the opinion, insofar as concerns conclusions of law, of Baker Botts L.L.P. with respect to the expected material U.S. federal income and estate tax consequences of the ownership and disposition of our Class A common stock by a Non-U.S. Holder. Generally, for purposes of this discussion a Non-U.S. Holder is a beneficial owner of our Class A common stock that is, for U.S. federal income tax purposes, a non-resident alien individual, a foreign corporation, or a foreign estate or trust. In general, an individual is a non-resident alien individual with respect to a particular calendar year if he or she (1) is not a U.S. citizen, (2) has at no time during that calendar year been a permanent U.S. resident and (3) is not present in the United States a specified number of days in the current year and the prior two years or, if he or she is present in the United States for the requisite number of days, other specified conditions do not exist. A foreign estate or a foreign trust is an estate or trust that, in either case, is not subject to U.S. federal income tax on a net income basis on income or gain from Class A common stock. Different rules apply for U.S. federal estate tax purposes. See *Federal Estate Taxes* below.

The following discussion is based on current provisions of the U.S. Internal Revenue Code of 1986, as amended (the *Code*), existing, proposed and temporary U.S. Treasury regulations promulgated under the Code and administrative and judicial interpretations, all of which are subject to change, possibly on a retroactive basis. The following discussion does not address aspects of U.S. federal taxation other than income and estate taxation, and does not address all aspects of U.S. federal income and estate taxation. The discussion does not consider any specific facts or circumstances that might apply to a particular Non-U.S. Holder and does not address all aspects of U.S. federal income and estate tax law that might be relevant to a Non-U.S. Holder subject to special treatment under the Code, for example, insurance companies, tax-exempt organizations, financial institutions or broker-dealers, or a person whose functional currency is not the U.S. dollar. This discussion does not address the tax treatment of partnerships or persons who hold their interests through a partnership or another pass-through entity. In addition, this discussion does not address state, local or non-U.S. tax consequences that might be relevant to a Non-U.S. Holder and does not address the applicability or effect of any specific tax treaty.

The opinion of Baker Botts L.L.P. is not binding on the U.S. Internal Revenue Service (the *IRS*) or the courts, and no rulings will be sought from the IRS on any of the issues discussed in this section. Prospective purchasers of our Class A common stock are urged to consult their tax advisors regarding the U.S. federal, state and local tax consequences, as well as non-U.S. tax consequences, of acquiring, holding and disposing of shares of our Class A common stock.

Dividends

In general, if we were to make distributions with respect to our Class A common stock, such distributions would be treated as dividends to the extent of our current or accumulated earnings and profits as determined under the Code. Any distribution that exceeds our current or accumulated earnings and profits will first be applied in reduction of the Non-U.S. Holder's basis in our Class A common stock, and to the extent the distribution exceeds the Non-U.S. Holder's basis, the excess will be treated as gain from the disposition of our Class A common stock.

Subject to the discussion below, dividends paid to a Non-U.S. Holder generally will be subject to withholding of U.S. federal income tax at a 30% rate. A lower rate may apply if the Non-U.S. Holder is a qualified tax resident of a country with which the United States has an income tax treaty and if the Non-U.S. Holder satisfies specified procedural requirements. A Non-U.S. Holder generally must provide IRS Form W-8BEN or a successor form to the payor of dividends in order to be eligible to claim the benefits of a U.S. income tax treaty obligation. In the case of dividend payments outside the United States to an offshore account, as specified by applicable U.S. Treasury regulations (generally, an account maintained by you at an office or branch of a bank or other financial institution at any location outside the United States), the

Non-U.S. Holder will be eligible, unless the withholding agent actually knows or has reason to know otherwise, to claim treaty benefits by providing other specified documentary evidence instead of IRS Form W-8BEN. However, this other specified documentary evidence will be acceptable only as long as our Class A common stock is actively traded on an established financial market, as specified by applicable U.S. Treasury regulations (for example, the NYSE).

Withholding generally will not apply in respect of dividends if the dividends are effectively connected with the conduct of a trade or business of the Non-U.S. Holder within the United States and, in the case of dividends to which an income tax treaty applies (and which so requires as a condition for subjecting a Non-U.S. Holder to U.S. taxation on a net income basis), the dividends are also attributable to a permanent establishment (or a fixed base through which specified personal services are performed) maintained by the Non-U.S. Holder in the United States. To claim relief from withholding on this basis, a Non-U.S. Holder generally must provide IRS Form W-8ECI or a successor form to the payor of dividends. Any such dividends received by a Non-U.S. Holder are subject to U.S. federal income tax on a net income basis (that is, after any applicable deductions) at applicable graduated individual or corporate rates. A Non-U.S. Holder that is a corporation may be subject to an additional branch profits tax at a 30% rate or such lower rate as may be specified by an applicable income tax treaty.

A Non-U.S. Holder eligible for a reduced rate of withholding of U.S. federal income tax may obtain a refund of any excess amounts withheld by timely filing an appropriate claim for refund with the IRS.

Gain on Disposition of Common Stock

A Non-U.S. Holder generally will not be subject to U.S. federal income tax with respect to gain recognized on a sale, exchange or other disposition of our Class A common stock (including a redemption of our Class A common stock treated as a sale for U.S. federal income tax purposes), except in the following circumstances:

the gain is effectively connected with the conduct of a U.S. trade or business of the Non-U.S. Holder,

the Non-U.S. Holder is an individual who holds our common stock as a capital asset, is present in the United States for 183 or more days in the taxable year of the sale, exchange or other disposition, and either the individual has a tax home in the United States or the sale is attributable to an office or other fixed place of business maintained by the individual in the United States (the 183-day rule),

the Non-U.S. Holder is subject to tax under U.S. tax law provisions applicable to some U.S. expatriates (including former citizens or residents of the United States), or

we are or have been a United States real property holding corporation within the meaning of Section 897(c)(2) of the Code.

The 183-day rule summarized above applies only in limited circumstances because generally an individual present in the United States for 183 days or more in the taxable year of the sale, exchange or other disposition will be treated as a U.S. resident for U.S. federal income tax purposes and therefore will be subject to U.S. federal income tax at graduated rates applicable to individuals who are U.S. residents. If the 183-day rule applies, the Non-U.S. Holder will be subject to U.S. federal income tax at a rate of 30% on the gain realized, although the gain may be offset by specified U.S. source capital losses realized during the same taxable year. The rules regarding taxation of gain of taxpayers to whom the 183-day rule applies are complicated, and Non-U.S. Holders should consult their tax advisers with regard to any potential application of this rule.

Generally, a corporation is a U.S. real property holding corporation if the fair market value of its U.S. real property interests, as defined in the Code and applicable regulations, equals or exceeds 50% of the aggregate fair market value of its worldwide real property interests and its other assets used or held for use in a trade or business. We do not believe that we are currently a U.S. real property holding corporation or that we will become one in the future. If we nevertheless did become a U.S. real property holding corporation then, among other circumstances, an exemption would generally apply to a Non-U.S. holder who at no time actually or

constructively owned more than 5% of the outstanding Class A common stock, assuming the Class A common stock is at all times regularly traded on an established securities market, as prescribed by regulations.

Gains that are effectively connected with a Non-U.S. Holder's conduct of a trade or business within the United States are subject to U.S. federal income tax on a net income basis (that is, after any applicable deductions) at applicable graduated individual or corporate rates. However, if under an applicable income tax treaty such gains are not attributable to a permanent establishment (or a fixed base through which specified personal services are performed) maintained by the Non-U.S. Holder in the United States, the gains may be exempt from tax under the treaty. A Non-U.S. Holder that is a corporation may be subject to an additional branch profits tax at a 30% rate or such lower rate as may be specified by an applicable income tax treaty.

Backup Withholding and Information Reporting

Non-U.S. Holders are generally exempt from backup withholding and information reporting requirements with respect to:

dividend payments, and

the payment of the proceeds from the sale of common stock effected at a U.S. office of a broker,

if one of the following two conditions is satisfied:

the payor or broker does not have actual knowledge or a reason to know that a Non-U.S. Holder is a United States person and such Non-U.S. Holder has furnished to the payor or broker a valid Internal Revenue Service Form W-8BEN or an acceptable substitute form certifying, under penalties of perjury, the holder's status as a non-United States person, or

a Non-U.S. Holder otherwise establishes an exemption.

However, we and other payors are required to report the entire amount of any distribution made with respect to our Class A common stock (regardless of whether the distribution is treated as a dividend) on IRS Form 1042-S even if the payments are not otherwise subject to information reporting requirements. This information may also be made available to tax authorities in the Non-U.S. Holder's country of residence.

Payment of the proceeds from the sale of common stock effected at a foreign office of a broker generally will not be subject to information reporting or backup withholding. For this purpose, a sale of common stock will not be considered effected at a foreign office of a broker if:

the proceeds are transferred to an account maintained in the United States,

the payment of proceeds or the confirmation of the sale is mailed to a United States address, or

the sale has some other specified connection with the United States, as provided in U.S. Treasury regulations.

However, a sale of common stock will be subject to information reporting (and possibly backup withholding) if it is effected at a foreign office of a broker that is:

a United States person,

a controlled foreign corporation for U.S. tax purposes,

a foreign person 50% or more of whose gross income is effectively connected with the conduct of a U.S. trade or business for a specified three-year period, or

a foreign partnership, if at any time during its tax year:

one or more of its partners are U.S. persons, as defined in U.S. Treasury regulations, who in the aggregate hold more than 50% of the income or capital interest in the partnership, or

it is engaged in the conduct of a U.S. trade or business,

unless the broker does not have actual knowledge or a reason to know that a Non-U.S. Holder is a United States person and specified documentation requirements are met or a Non-U.S. Holder otherwise establishes an exemption. Backup withholding will apply if the sale is subject to information reporting and the broker has actual knowledge that a Non-U.S. Holder is a United States person.

Any amounts withheld under the backup withholding rules from a payment to a Non-U.S. Holder will be allowed as a refund or a credit against that Non-U.S. Holder's U.S. federal income tax liability if the requisite procedures are followed.

Federal Estate Taxes

An individual Non-U.S. Holder who is treated as the owner of Class A common stock at the time of his or her death generally will be required to include the value of the common stock in his or her gross estate for U.S. federal estate tax purposes and may be subject to U.S. federal estate tax on that value, unless an applicable tax treaty provides otherwise. For U.S. federal estate tax purposes, a Non-U.S. Holder is an individual who is neither a citizen nor a domiciliary of the United States. In general, an individual acquires a domicile in the United States for U.S. estate tax purposes by living in the United States, for even a brief period of time, with the intention of remaining in the United States indefinitely.

Legislation enacted in 2001 reduces the maximum federal estate tax rate over an eight-year period beginning in 2002 and eliminates the tax for estates of decedents dying after December 31, 2009. In the absence of renewal legislation, these amendments will expire and the federal estate tax provisions in effect prior to 2002 will be restored for estates of decedents dying after December 31, 2010.

UNDERWRITERS

Under the terms and subject to the conditions contained in an underwriting agreement dated the date of this prospectus, the underwriters named below, for whom Morgan Stanley & Co. Incorporated, Citigroup Global Markets Inc., Goldman, Sachs & Co. and UBS Securities LLC are acting as representatives, have severally agreed to purchase, and the selling stockholders have agreed to sell to them, severally, the number of shares of Class A common stock indicated below:

Name	Number of Shares
Morgan Stanley & Co. Incorporated	5,460,000
Citigroup Global Markets Inc.	5,460,000
Goldman, Sachs & Co.	2,067,000
UBS Securities LLC	2,067,000
Natexis Bleichroeder Inc.	156,000
A.G. Edwards & Sons, Inc.	156,000
Johnson Rice & Company L.L.C.	117,000
Sanders Morris Harris Inc.	117,000
	<hr/>
Total	15,600,000
	<hr/>

The underwriters are offering the shares of Class A common stock subject to their acceptance of the shares from us and subject to prior sale. The underwriting agreement provides that the obligations of the several underwriters to pay for and accept delivery of the shares of Class A common stock offered by this prospectus are subject to the approval of customary legal matters by their counsel and to customary other conditions. The underwriters are obligated to take and pay for all of the shares of Class A common stock offered by this prospectus, other than those shares covered by the over-allotment option described below, if any shares are taken.

The underwriters initially propose to offer part of the shares of Class A common stock directly to the public at the offering price listed on the cover page of this prospectus and part to dealers at a price that represents a concession not in excess of \$0.40 a share under the offering price. After the offering of the shares of Class A common stock, the offering price and other selling terms may from time to time be varied by the representatives.

Transocean has granted to the underwriters an option, exercisable for 30 days from the date of this prospectus, to purchase up to an aggregate of 2,340,000 additional shares of Class A common stock at the offering price listed on the cover page of this prospectus, less underwriting discounts and commissions. The underwriters may exercise this option solely for the purpose of covering over-allotments, if any, made in connection with the offering of the shares of Class A common stock offered by this prospectus. To the extent this option is exercised, each underwriter will become obligated, subject to specified conditions, to purchase approximately the same percentage of the additional shares of Class A common stock as the number listed next to the underwriter's name in the preceding table bears to the total number of shares of Class A common stock listed next to the names of all underwriters in the preceding table. If the underwriters' option is exercised in full, the total price to public would be \$282,555,000, the total underwriters' discounts and commissions would be \$12,009,036 and total proceeds to the selling stockholders would be \$270,545,964.

We estimate expenses payable by Transocean in connection with this offering, other than the underwriting discounts and commissions referred to above, will be approximately \$600,000.

The underwriters have informed us that they do not intend sales to discretionary accounts to exceed 5% of the total number of shares offered by them.

Our Class A common stock is listed on the New York Stock Exchange under the symbol THE.

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We, Mr. Rask, Mr. O Keefe and our directors, as well as Transocean and Transocean Holdings, have agreed that we and they will not, without the prior written consent of Morgan Stanley & Co. Incorporated and Citigroup Global Markets Inc. on behalf of the underwriters, during a period of time after the date of this prospectus, 90 days in the case of us, Transocean and Transocean Holdings, and 25 days in the case of Mr. Rask, Mr. O Keefe and our directors:

offer, pledge, sell, contract to sell, sell any option or contract to purchase, purchase any option or contract to sell, grant any option, right or warrant to purchase, lend, or otherwise transfer or dispose of directly or indirectly, any shares of Class A common stock or any securities convertible into or exercisable or exchangeable for shares of Class A common stock, or

enter into any swap or other arrangement that transfers to another, in whole or in part, any of the economic consequences of ownership of the Class A common stock,

whether any such transaction described above is to be settled by delivery of shares of Class A common stock or other securities, in cash or otherwise.

The restrictions described in the paragraph above do not apply to:

the sale of any shares of Class A common stock to the underwriters pursuant to the underwriting agreement,

any distribution of shares of our common stock by Transocean to the holders of its ordinary shares by means of a distribution or exchange offer in a transaction intended to qualify as a tax-free distribution under Section 355 of the Internal Revenue Code,

any issuance of our common stock or other securities pursuant to Transocean's subscription rights described in this prospectus,

any private sales by Transocean of our common stock or other securities, or transfers as bona fide gifts or by will or intestacy by Mr. Rask, Mr. O Keefe and our directors, in which the purchaser agrees to be bound by the restrictions described in the paragraph above,

transactions relating to shares of Class A common stock or other securities acquired in this offering or in open market transactions after the closing of this offering, and

grants pursuant to the employee benefit plans described in this prospectus.

In order to facilitate this offering, the underwriters may engage in transactions that stabilize, maintain or otherwise affect the price of the Class A common stock. Specifically, the underwriters may sell more shares than they are obligated to purchase under the underwriting agreement, creating a short position. A short sale is covered if the short position is no greater than the number of shares available for purchase by the underwriters under the over-allotment option. The underwriters can close out a covered short sale by exercising the over-allotment option or purchasing shares in the open market. In determining the source of shares to close out a covered short sale, the underwriters will consider, among other things, the open market price of shares compared to the price available under the over-allotment option. The underwriters may also sell shares in excess of the over-allotment option, creating a naked short position. The underwriters must close out any naked short position by purchasing shares in the open market. A naked short position is more likely to be created if the underwriters are concerned that there may be downward pressure on the price of the Class A common stock in the open market after pricing that could adversely affect investors who purchase in this offering. As an additional means of facilitating the offering, the underwriters may bid for, and purchase, shares of Class A common stock in the open market to stabilize the price of the Class A common stock. The underwriting syndicate may also reclaim selling concessions allowed to an underwriter or a dealer for distributing the Class A common stock in this offering, if the syndicate repurchases previously distributed Class A common stock to cover syndicate short positions or to stabilize the price of the Class A common stock. Any of these activities may stabilize or maintain the market price of the Class A common stock above independent market levels or retard a decline in the market price of the Class A common stock. The underwriters are not required to engage in these activities, and may end any of these activities at any time.

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Affiliates of Morgan Stanley & Co. Incorporated, Citigroup Global Markets Inc. and UBS Securities LLC participate in our revolving credit facility and receive customary compensation. From time to time, some of the underwriters have provided, and continue to provide, investment banking and other services to us and the selling stockholders for which they receive customary fees and commissions. Affiliates of some of the underwriters are creditors of either or both of the selling stockholders under existing credit facilities or pursuant to other extensions of credit. Proceeds received by the selling stockholders in this offering may be used to repay, in whole or in part, amounts owing to those creditors.

The underwriters and we have agreed to indemnify each other against certain liabilities, including liabilities under the Securities Act.

VALIDITY OF CLASS A COMMON STOCK

The validity of the Class A common stock offered by this prospectus will be passed on for us by Baker Botts L.L.P., Houston, Texas and for the underwriters by Sullivan & Cromwell LLP, New York, New York.

EXPERTS

The consolidated financial statements and schedule of TODCO at December 31, 2003 and 2002, and for each of the two years in the period ended December 31, 2003, for the period from February 1, 2001 to December 31, 2001, and for the period from January 1, 2001 to January 31, 2001, appearing in this prospectus and registration statement have been audited by Ernst & Young LLP, independent registered public accounting firm, as set forth in their report thereon appearing elsewhere herein, and are included in reliance upon such report given on the authority of such firm as experts in accounting and auditing.

WHERE YOU CAN FIND MORE INFORMATION

We have filed with the Securities and Exchange Commission a registration statement on Form S-1 under the Securities Act, with respect to the securities offered by this prospectus. In this prospectus we refer to that registration statement, together with all amendments, exhibits and schedules to that registration statement, as the registration statement.

As is permitted by the rules and regulations of the SEC, this prospectus, which is part of the registration statement, omits some information, exhibits, schedules and undertakings set forth in the registration statement. For further information with respect to us, and the securities offered by this prospectus, please refer to the registration statement.

We file current reports, quarterly reports, annual reports, proxy statements and other information with the SEC. You may read and copy those reports, proxy statements and other information at the public reference facility maintained by the SEC at 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of this material may also be obtained from the Public Reference Room of the SEC at 450 Fifth Street, N.W. Washington, D.C. 20549 at prescribed rates. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1 (800) 732-0330. The SEC maintains a website at www.sec.gov that contains reports, proxy and information statements and other information regarding registrants that make electronic filings with the SEC using its EDGAR system. You can also obtain information about us at the offices of the New York Stock Exchange, 20 Broad Street, New York, New York 10005.

You may request a copy of our filings, which we will provide at no cost, by writing to the Corporate Secretary of TODCO at the following address:

TODCO
2000 W. Sam Houston Parkway South
Houston, Texas 77042
Attn: Corporate Secretary

TODCO AND SUBSIDIARIES

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors

TODCO

We have audited the accompanying Post-Transocean Merger consolidated balance sheets of TODCO and Subsidiaries as of December 31, 2003 and 2002 and the related Post-Transocean Merger consolidated statements of operations, comprehensive loss, equity and cash flows for each of the two years in the period ended December 31, 2003, and the period from February 1, 2001 to December 31, 2001, and the related Pre-Transocean Merger consolidated statements of operations, comprehensive loss, equity and cash flows for the period from January 1, 2001 to January 31, 2001. Our audits also included the financial statement schedule listed in Item 15(a) of this Form 10-K. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and 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 audit 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 Post-Transocean Merger consolidated financial position of TODCO and Subsidiaries at December 31, 2003 and 2002, and the Post-Transocean Merger consolidated results of their operations and their cash flows for each of the two years in the period ended December 31, 2003, and the period from February 1, 2001 to December 31, 2001, and the Pre-Transocean Merger consolidated results of their operations and their cash flows for the period from January 1, 2001 to January 31, 2001, in conformity with U.S. generally accepted accounting principles. 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 Notes 1 and 4 to the consolidated financial statements, effective January 31, 2001, the Company completed a merger transaction resulting in a change of control and a new basis of accounting. As discussed in Note 2 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards (SFAS) 142 effective January 1, 2002, SFAS 123 effective January 1, 2003 and Financial Accounting Standards Board Interpretation No. 46 effective December 31, 2003.

/s/ ERNST & YOUNG LLP

Houston, Texas
February 4, 2004

TODCO AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	Post-Transocean Merger	
	December 31,	
	2003	2002
	(In millions, except share data)	
ASSETS		
Cash and cash equivalents	\$ 20.0	\$
Accounts receivable		
Trade	52.3	40.8
Related party	0.9	345.7
Other	4.6	13.4
Interest receivable related party		1.7
Materials and supplies	4.5	4.9
Other current assets	3.2	17.5
Current assets related to discontinued operations	0.1	152.9
	85.6	576.9
Property and equipment	924.9	871.6
Less accumulated depreciation	264.0	165.2
	660.9	706.4
Investments in and advances to joint ventures	0.1	79.7
Other assets	31.6	21.6
Non-current assets related to discontinued operations		842.6
	\$ 778.2	\$ 2,227.2
	\$ 778.2	\$ 2,227.2
LIABILITIES AND SHAREHOLDER S EQUITY		
Accounts payable		
Trade	\$ 24.7	\$ 11.6
Related party		70.1
Accrued income taxes	11.1	22.5
Debt due within one year	1.2	15.5
Debt due within one year related party	3.0	100.0
Interest payable related party	4.3	5.7
Other current liabilities	43.4	49.8
Current liabilities related to discontinued operations	0.5	102.6
	88.2	377.8
Long-term debt	25.6	25.2
Long-term debt related party	522.0	980.1
Deferred income taxes		67.1
Other long-term liabilities	4.7	5.0

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Non-current liabilities related to discontinued operations	210.1	
Total long-term liabilities	552.3	1,287.5
Commitments and contingencies		
Common stock, Class A, \$0.01 par value, 500,000,000 shares authorized, none outstanding at December 31, 2003 and 2002		
Common stock, Class B, \$0.01 par value, 260,000,000 shares authorized, 12,144,751 shares issued and outstanding at		
December 31, 2003 and 2002	0.1	0.1
Additional paid-in capital	6,136.3	6,276.3
Accumulated other comprehensive loss		(2.0)
Retained deficit	(5,998.7)	(5,712.5)
Total shareholder s equity	137.7	561.9
Total liabilities and shareholder s equity	\$ 778.2	\$ 2,227.2

See accompanying notes.

TODCO AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	Post-Transocean Merger			Pre-Transocean Merger
	Year Ended December 31, 2003	Year Ended December 31, 2002	Eleven Months Ended December 31, 2001	One Month Ended January 31, 2001
	(In millions, except per share amounts)			
Operating Revenues	\$ 227.7	\$ 187.8	\$ 441.0	\$ 48.5
Costs and Expenses				
Operating and maintenance	215.7	176.6	260.9	23.2
Operating and maintenance related party	11.7	9.1	9.1	
Depreciation	92.2	91.9	96.5	6.3
Goodwill amortization			42.9	0.2
General and administrative	14.9	19.2	17.4	60.8
General and administrative related party	1.4	9.7	2.0	
Impairment loss on long-lived assets	11.3	399.4	1.1	64.0
Gain on disposal of assets, net	(0.8)	(1.0)	(3.3)	(0.4)
	346.4	704.9	426.6	154.1
Operating Income (Loss)	(118.7)	(517.1)	14.4	(105.6)
Other Income (Expense), net				
Equity in loss of joint ventures	(6.6)	(2.7)	(0.9)	
Interest income	0.6	3.0	4.9	1.4
Interest income related party	3.3	33.6	16.2	0.2
Interest expense, net of amounts capitalized	(3.0)	(22.4)	(88.2)	(19.8)
Interest expense related party	(43.5)	(79.7)	(36.8)	
Loss on retirement of debt	(79.5)	(18.8)	(27.5)	
Impairment of investment in and advance to joint venture	(21.3)			
Other, net	(2.8)	0.3	(0.4)	0.3
	(152.8)	(86.7)	(132.7)	(17.9)
Loss from Continuing Operations before Income Taxes, Minority Interest and Cumulative Effect of a Change in Accounting Principle	(271.5)	(603.8)	(118.3)	(123.5)
Income tax benefit	(50.1)	(74.6)	(21.6)	(33.4)
Minority interest	0.6	(0.1)		
	(222.0)	(529.1)	(96.7)	(90.1)
Loss from Continuing Operations before Cumulative Effect of a Change in Accounting Principle	(222.0)	(529.1)	(96.7)	(90.1)
Discontinued Operations:				
(Loss) income from operations of discontinued segment	(43.9)	(480.8)	(12.1)	2.7
Income tax expense	19.9	27.6	44.6	1.2
Minority interest	1.2	3.7	0.7	0.7
	(65.0)	(512.1)	(57.4)	0.8
Net (loss) income from discontinued operations before cumulative effect of a change in accounting principle	(287.0)	(1,041.2)	(154.1)	(89.3)

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Loss before Cumulative Effect of a Change in Accounting Principle

Cumulative effect of a change in accounting principle continuing operations	0.8	(1,363.7)		
Cumulative effect of a change in accounting principle discontinued operations		(3,153.3)		

Net Loss	<u>\$ (286.2)</u>	<u>\$ (5,558.2)</u>	<u>\$ (154.1)</u>	<u>\$ (89.3)</u>
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Net Loss Per Common Share Basic and Diluted

Continuing operations	\$ (18.28)	\$ (43.57)	\$ (7.96)	\$ (0.43)
Discontinued operations	(5.35)	(42.16)	(4.73)	0.01
Cumulative effect of a change in accounting principle	0.07	(371.92)		

Net loss per common share basic and diluted	<u>\$ (23.56)</u>	<u>\$ (457.65)</u>	<u>\$ (12.69)</u>	<u>\$ (0.42)</u>
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Weighted Average Common Shares Outstanding:

Basic and diluted	<u>12.1</u>	<u>12.1</u>	<u>12.1</u>	<u>211.3</u>
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See accompanying notes.

TODCO AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

	Post-Transocean Merger			Pre-Transocean Merger
	Year Ended December 31, 2003	Year Ended December 31, 2002	Eleven Months Ended December 31, 2001	One Month Ended January 31, 2001
	(In millions)			
Net loss	\$(286.2)	\$(5,558.2)	\$(154.1)	\$(89.3)
Other comprehensive income (loss)				
Change in share of unrealized income (loss) in unconsolidated joint ventures accumulated other comprehensive loss (net of tax (expense) benefit of \$(1.1), \$(0.1), and \$1.2 for each of the years ended December 31, 2003 and 2002 and the eleven months ended December 31, 2001, respectively)	2.0	0.3	(2.3)	
Change in unrealized (loss) on securities held for sale, net of tax			(0.2)	(0.1)
Other comprehensive income (loss)		0.3	(2.5)	(0.1)
Total comprehensive loss	\$(284.2)	\$(5,557.9)	\$(156.6)	\$(89.4)

See accompanying notes.

TODCO AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EQUITY

	Common Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Deficit)	Unearned Compensation	Total Equity
	Shares	Amount					
(In millions)							
Pre-Transocean Merger							
Balance at December 31, 2000	212.0	\$ 2.1	\$ 1,458.1	\$ 0.3	\$ (82.9)	\$ (4.1)	\$ 1,373.5
Net loss					(89.3)		(89.3)
Activity in stock plans	0.1		6.3			4.1	10.4
Change in unrealized gain on securities held for sale				(0.1)			(0.1)
Contribution to employee savings plans			0.6				0.6
Balance at January 31, 2001	212.1	2.1	1,465.0	0.2	(172.2)		1,295.1
Post-Transocean Merger							
Net loss					(154.1)		(154.1)
Merger with Transocean	(200.0)	(2.0)	5,178.8		172.2		5,349.0
Tax benefit from options exercised			9.0				9.0
Other comprehensive loss related to unconsolidated joint venture				(2.3)			(2.3)
Change in unrealized gain on securities held for sale				(0.2)			(0.2)
Balance at December 31, 2001	12.1	0.1	6,652.8	(2.3)	(154.1)		6,496.5
Net loss					(5,558.2)		(5,558.2)
Net distributions to parent			(376.8)				(376.8)
Tax benefit from options exercised			0.3				0.3
Change in other comprehensive loss related to unconsolidated joint venture				0.3			0.3
Other					(0.2)		(0.2)
Balance at December 31, 2002	12.1	0.1	6,276.3	(2.0)	(5,712.5)		561.9
Net loss					(286.2)		(286.2)
Net distributions to parent			(224.6)				(224.6)
Equity contribution from parent			84.6				84.6
Change in other comprehensive loss related to unconsolidated joint venture				2.0			2.0
Balance at December 31, 2003	12.1	\$ 0.1	\$ 6,136.3	\$	\$ (5,998.7)	\$	\$ 137.7

See accompanying notes.

TODCO AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Post-Transocean Merger			Pre-Transocean Merger
	Year Ended December 31, 2003	Year Ended December 31, 2002	Eleven Months Ended December 31, 2001	One Month Ended January 31, 2001
(In millions)				
Cash Flows from Operating Activities Continuing Operations and Discontinued Operations				
Net loss	\$ (286.2)	\$ (5,558.2)	\$ (154.1)	\$ (89.3)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:				
Cumulative effect of a change in accounting principle	(0.8)	4,517.0		
Depreciation	102.5	169.3	209.6	17.7
Goodwill amortization			128.2	0.2
Impairment loss on goodwill		932.2		
Deferred income taxes	(34.9)	(56.5)	1.3	(33.3)
Equity in earnings of joint ventures	1.1	(3.6)	(11.5)	(0.4)
Net loss from disposal of assets	9.1	2.9	32.2	
Impairment loss on long-lived assets	11.3	55.4	27.8	64.0
Amortization of debt fair value adjustments	(3.0)	(10.6)	(19.9)	
Deferred compensation				9.8
Deferred income, net	(5.5)	(2.9)	6.3	(1.0)
Deferred expenses, net	(15.3)	0.7	(13.7)	1.5
Loss from retirement of debt	79.5	18.8	27.5	
Impairment of investment in and advance to joint venture	21.3			
Changes in operating assets and liabilities, net of effects from the Transocean Merger				
Accounts receivable, net	41.2	106.0	37.8	(20.1)
Accounts payable and other current liabilities	(20.3)	(45.5)	(121.7)	(14.3)
Accounts receivable/payable to related party, net	202.9	(116.8)	(64.8)	
Income taxes receivable/payable, net	(4.2)	(7.9)	(3.9)	2.9
Other, net	4.4	13.8	17.6	26.6
Net cash provided by (used in) operating activities	103.1	14.1	98.7	(35.7)
Cash Flows from Investing Activities Continuing Operations and Discontinued Operations				
Capital expenditures	(16.1)	(17.7)	(216.3)	(16.5)
Proceeds from settlement of notes receivable from related party		518.0		
Proceeds from disposal of assets, net	75.0	53.4	90.6	0.2
Proceeds from sale of subsidiary, net			85.6	
Purchase of minority interest in subsidiary				(34.7)
Joint ventures and other investments, net	0.6	2.1	13.6	(1.9)
Net cash provided by (used in) investing activities	59.5	555.8	(26.5)	(52.9)

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	_____	_____	_____	_____
Cash Flows from Financing Activities				
Continuing Operations and Discontinued Operations				
Net proceeds from long-term debt with related party	(54.0)	47.3	1,245.0	
Repayments on other debt instruments	(89.1)	(38.6)	(1,516.3)	(8.1)
Repayments on other debt instruments to related party		(529.2)		
Decrease in cash dedicated to debt service			3.7	2.7
Cash of subsidiaries at disposition to affiliates	(103.9)	(10.4)		
Exchange offer consent payments		(8.3)		
Other, net	1.5	3.7	(1.1)	1.0
	_____	_____	_____	_____
Net cash used in financing activities	(245.5)	(535.5)	(268.7)	(4.4)
	_____	_____	_____	_____
Net (decrease) increase in cash and cash equivalents	(82.9)	34.4	(196.5)	(93.0)
Cash and cash equivalents at beginning of period continuing operations and discontinued operations	102.9	68.5	265.0	358.0
	_____	_____	_____	_____
Cash and cash equivalents at end of period continuing operations and discontinued operations	\$ 20.0	\$ 102.9	\$ 68.5	\$ 265.0
	_____	_____	_____	_____

See accompanying notes.

TODCO AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 Nature of Business and Principles of Consolidation

TODCO (formerly known as R&B Falcon Corporation), together with its subsidiaries and predecessors, unless the context requires otherwise, the Company, we or our) is a leading provider of offshore and inland marine contract oil and gas drilling services. At December 31, 2003, the Company owned, had partial ownership interests in or operated 70 drilling rigs. As of this date, the Company's active fleet of drilling rigs consisted of 24 jackup rigs, 30 barge rigs, three submersible rigs and one platform rig as well as nine land rigs and three lake barge rigs in Venezuela. The Company contracts its drilling rigs, related equipment and work crews primarily on a dayrate basis to drill oil and natural gas wells. The Company wound up its turnkey operations in the second quarter of 2001 and no longer provides turnkey services.

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 for investments in joint ventures where the Company's ownership is between 20 percent and 50 percent and for investments in joint ventures owned more than 50 percent where 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 2).

Effective January 31, 2001, the merger transaction between the Company and Transocean Inc. (Transocean, formerly known as Transocean Sedco Forex Inc.) was completed (the Transocean Merger). A change of control occurred and the Company became an indirect wholly owned subsidiary of Transocean. See Note 4. The merger was accounted for as a purchase with Transocean as the accounting acquirer. Accordingly, the purchase price was allocated to the assets and liabilities of the Company based on estimated fair values as of January 31, 2001 with the excess accounted for as goodwill. The purchase price adjustments were pushed down to the consolidated financial statements of the Company, which affects the comparability of the consolidated financial statements for periods before and after the Transocean Merger. The accompanying financial statements for the periods ended on January 31, 2001 were prepared using the Company's historical basis of accounting and are designated as Pre-Transocean Merger. The accompanying consolidated financial statements for the periods subsequent to January 31, 2001 include the effects of the Transocean Merger and are designated as Post-Transocean Merger.

In July 2002, 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. Accordingly, the Transocean Assets and related operations have been reflected as discontinued operations in the Company's historical financial statements and the notes thereto. The Company's historical financial statements and the notes thereto have been restated for the effect of discontinued operations for all periods presented, except for the statement of cash flows and related Note 11 for which restatement is not required. See Note 23.

In February 2004, the Company completed its initial public offering of 13,800,000 shares of its Class A common stock (IPO), see Notes 14 and 24.

Note 2 Summary of Significant Accounting Policies

Accounting Estimates The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States (U.S.) requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and disclosure of contingent assets and liabilities. On an ongoing basis, the Company evaluates its estimates, including those

TODCO AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

related to bad debts, materials and supplies obsolescence, investments, intangible assets and goodwill, property and equipment and other long-lived assets, income taxes, workers' insurance, pensions and other post-retirement and 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.

Segments As a result of the IPO and the resulting change in the Company's chief operating decision maker as defined by the Financial Accounting Standards Board's (FASB) Statement of Financial Accounting Standards (SFAS) 131, *Disclosures about Segments of an Enterprise and Related Information*, the Company has redefined its reportable segments on a basis representative of how the Company evaluates its operating performance and makes resource allocation decisions (see Note 24). Accordingly, the Company's operations have been aggregated into three reportable business segments, which correspond to the Company's principal geographic regions in which we operate:

U.S. Inland Barge Segment The Company's barge rig fleet currently operating in this market segment consists of 12 conventional and 18 posted barge rigs. These units operate in marshes, rivers, lakes and shallow bay or coastal waterways that are known as the transition zone. This area along the U.S. Gulf Coast, where jackup rigs are unable to operate, is the world's largest market for this type of equipment.

U.S. Gulf of Mexico Segment The Company currently operates 19 jackup and three submersible rigs in the U.S. Gulf of Mexico shallow water market segment which begins at the outer limit of the transition zone and extends to water depths of about 350 feet. The Company's jackup rigs in this market segment consist of independent leg cantilever type units, mat-supported cantilever type rigs and mat-supported slot type jackup rigs that can operate in water depths up to 250 feet.

Other International Segment The Company's other operations are currently conducted in Mexico, Trinidad and Venezuela. In Mexico, the Company operates two jackup rigs and is preparing a platform rig to operate for PEMEX, the Mexican national oil company. Additionally, the Company has two jackup rigs in Trinidad and one in Venezuela, where the Company also has nine land rigs and three Lake Maracaibo barges.

The Company's historical presentation of reportable business segments for the year ended December 31, 2002, the eleven months ended December 31, 2001 and the one month ended January 31, 2001 have been restated to reflect the current presentation. See Note 19.

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. Generally, the maturity date of the Company's cash equivalent investments is the next business day.

Accounts and Notes Receivable 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 chargeable and collectibility is reasonably assured. Notes receivable, included in investments in and advances to joint ventures, are carried at their historical carrying amount net of write-offs and allowance for loan loss. Interest income on notes receivable, which is included in interest receivable-related party, is accrued and recognized as interest income monthly on the unimpaired loan balance. The Company's notes receivable do not have any associated premiums or discounts. Uncollectible loans and accounts receivable trade are written off when a settlement is reached for an amount that is less than the outstanding historical balance. As a result of the Company's consolidation of Delta Towing Holdings, LLC (Delta Towing), a joint venture formed to own and operate the Company's U.S. marine support vessel business, the Company's notes receivable and

TODCO AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

related interest receivable have been eliminated in the Company's consolidated balance sheet at December 31, 2003 (see New Accounting Pronouncements and Note 17).

Allowance for Doubtful Accounts 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 \$5.0 million and \$6.7 million at December 31, 2003 and 2002, respectively. An allowance for loan loss is established when events or circumstances indicate that both the contractual interest and principal for a note receivable are not fully collectible. A loan is considered delinquent when principal and/or interest payments have not been made in accordance with the payment terms of the loan. Collectibility is determined based on estimated future cash flows discounted at the respective loan's effective interest rate with the excess of the loan's total contractual interest and principal over the estimated discounted future cash flows recorded as an allowance for loan loss. During the year ended December 31, 2003, the Company recorded an allowance for loan loss of \$21.3 million related to its notes receivable from Delta Towing, see Note 18. As a result of the consolidation of Delta Towing, the allowance, together with the note receivable were eliminated from the Company's consolidated balance sheet at December 31, 2003.

Materials and Supplies Materials and supplies are carried at the lower of average cost or market less an allowance for obsolescence. Such allowance was \$0.3 million at December 31, 2003. There was no allowance for obsolescence at December 31, 2002.

Property and Equipment Property and equipment, consisting primarily of offshore drilling rigs and related equipment, represented approximately 85 percent of the Company's total assets at December 31, 2003. The carrying values of these assets are based on estimates, assumptions and judgments relative to capitalized costs, useful lives and salvage values of the Company's rigs. These estimates, assumptions and judgments reflect both historical experience and expectations regarding future industry conditions and operations. The Company provides for depreciation using the straight-line method after allowing for salvage values. Expenditures for renewals, replacements and improvements are capitalized. Maintenance and repairs are charged to operating expense as incurred. Upon sale or other disposition to third parties, the applicable amounts of asset cost and accumulated depreciation are removed from the accounts and the net amount, less proceeds from disposal, is charged or credited to income.

As a result of the Transocean Merger, property and equipment were adjusted to fair value and the Company conformed its policies relating to estimated rig lives and salvage values to Transocean's policies. Estimated useful lives of drilling units now range from 10 to 15 years for the majority of our drilling units, compared to 12 to 18 years prior to the Transocean Merger. Depreciation expense for the eleven months ended December 31, 2001 increased approximately \$36.9 million as a result of conforming these policies, primarily due to a decrease in the useful lives of the inland barges.

Assets Held for Sale Assets are classified as held for sale when the Company has a plan for disposal of certain assets and those assets meet the held for sale criteria of SFAS 144, *Accounting for Impairment or Disposal of Long-Lived Assets*. Prior to the Company's adoption of SFAS 144 (see New Accounting Pronouncements), certain assets were classified as held for sale under SFAS 121, *Accounting for Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of*. Effective with the Transocean Merger, the Company established a plan to sell certain assets that were considered non-core to Transocean's business with the disposition of these assets expected to be complete by December 31, 2002. At December 31, 2002, the Company had either disposed of these non-core assets, including certain drilling rigs, surplus equipment and an office building, or reclassified them to property and equipment in accordance with SFAS 144. There were no assets classified as held for sale at December 31, 2003.

Goodwill Prior to the adoption of SFAS 142, *Goodwill and Other Intangible Assets* effective January 1, 2002, the excess of the purchase price over the estimated fair value of net assets acquired was accounted for as

TODCO AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

goodwill and was amortized on a straight-line basis over a 40-year life. The amortization period was based on the nature of the offshore drilling industry and the Company's long-lived drilling equipment.

During the first quarter of 2002, the Company implemented SFAS 142 and performed the initial test of impairment of goodwill. The test was applied utilizing the estimated fair value of the Company as of January 1, 2002 and was determined based on a combination of the Company's discounted cash flows and publicly traded company multiples and acquisition multiples of comparable businesses. Because of deterioration in the Gulf of Mexico shallow and inland water market sector since the completion of the Transocean Merger, a \$1,363.7 million impairment of goodwill was recognized as a cumulative effect of a change in accounting principle in the first quarter of 2002. Additionally, due to a general decline in market conditions and other factors, the Company recognized a \$3,153.3 million impairment of goodwill related to discontinued operations, which was recognized as a cumulative effect of a change in accounting principle in the first quarter of 2002.

During the fourth quarter of 2002, the Company performed its annual test of goodwill impairment. Due to a general decline in market conditions, the Company recognized a non-cash impairment charge of \$381.9 million. After giving effect to the goodwill write-downs, the Company had no goodwill balance as of December 31, 2002 or December 31, 2003.

Net loss for the year ended December 31, 2002, the eleven months ended December 31, 2001 and the one month ended January 31, 2001, adjusted for goodwill amortization, was as follows (in millions):

	Post-Transocean Merger		Pre-Transocean Merger
	Year Ended December 31, 2002	Eleven Months Ended December 31, 2001	One Month Ended January 31, 2001
Reported net loss before cumulative effect of a change in accounting principle	\$ (1,041.2)	\$ (154.1)	\$ (89.3)
Add back: goodwill amortization		42.9	0.2
Adjusted reported net loss before cumulative effect of a change in accounting principle	(1,041.2)	(111.2)	(89.1)
Cumulative effect of a change in accounting principle	(4,517.0)		
Adjusted net loss	\$ (5,558.2)	\$ (111.2)	\$ (89.1)
Basic and diluted loss per share			
Reported net loss applicable to common shareholders before cumulative effect of a change in accounting principle	\$ (85.73)	\$ (12.69)	\$ (0.42)
Add back: goodwill amortization		3.53	
Adjusted reported net loss before cumulative effect of a change in accounting principle	(85.73)	(9.16)	(0.42)
Cumulative effect of a change in accounting principle	(371.92)		
Adjusted net loss per share basic and diluted	\$ (457.65)	\$ (9.16)	\$ (0.42)

TODCO AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Impairment of Long-Lived Assets The carrying value of long-lived assets, principally goodwill and property and equipment, is reviewed for potential impairment when events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. For property and equipment held for use, the determination of recoverability is made based upon the estimated undiscounted future net cash flows of the related asset or group of assets being evaluated. Property and equipment held for sale are recorded at the lower of net book value or net realizable value. See Note 10. Prior to January 1, 2002, recoverability of goodwill was determined based upon a comparison of the Company's net book value to the undiscounted cash flows associated with the related assets. See Goodwill.

Operating Revenues and Expenses Operating revenues are recognized as earned, based on contractual daily rates or on a fixed price basis. Although the Company ceased providing turnkey drilling services in 2001, turnkey profits were recognized on completion of the well and acceptance by the customer. Events occurring after the date of the financial statements and before the financial statements are issued that are within the normal exposure and risk aspects of the turnkey contracts are considered refinements of the estimation process of the prior year and are recorded as adjustments at the date of the financial statements. Provisions for losses are made on contracts in progress when losses are anticipated. In connection with drilling contracts, the Company may receive revenues for preparation and mobilization of equipment and personnel or for capital improvements to rigs. In connection with new drilling contracts, revenues earned and incremental costs incurred directly related to the preparation and mobilization of the rig are deferred and recognized over the primary contract term of the drilling project for contracts that have a primary contract term of two months or longer and where such amounts are material. Costs of relocating drilling units without contracts to more promising market areas are expensed as incurred. Upon completion of drilling contracts, any demobilization fees received are reported in income, as are any related expenses. Capital upgrade revenues received are deferred and recognized over the primary contract term of the drilling project. The actual cost incurred for the capital upgrade is depreciated over the estimated remaining useful life of the asset.

At December 31, 2003, \$21.2 million in deferred preparation and mobilization costs were included in other assets in the Company's consolidated balance sheet. There were no similar deferred costs at December 31, 2002. During 2003, the Company amortized \$1.2 million of these costs, which is included in operating and maintenance expense in the Company's consolidated statement of operations.

Foreign Currency Translation The Company accounts for translation of foreign currency in accordance with SFAS 52, *Foreign Currency Translation*. The majority of the Company's revenues and expenditures are denominated in U.S. dollars to limit the Company's exposure to foreign currency fluctuations, resulting in the use of the U.S. dollar as the functional currency for all of the Company's operations. Foreign currency translations and exchange gains and losses are included in other income (expense), net as incurred. Net foreign currency exchange gains (losses) were \$(2.7) million, \$0.4 million, \$(0.3) million and \$0.3 million for the years ended December 31, 2003 and 2002, the eleven months ended December 31, 2001 and the one month ended January 31, 2001, respectively.

Income Taxes 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 at year end. 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 asset will not be realized. See Note 12.

Stock-Based Compensation In accordance with the provisions of SFAS 123, *Accounting for Stock-based Compensation*, the Company has elected to follow the Accounting Principles Board Opinion (APB) 25, *Accounting for Stock Issued to Employees*, and related interpretations in accounting for its employee stock-based compensation plans through December 31, 2002. Under the intrinsic value method of APB 25, if the exercise price of employee stock options equals or exceeds the fair value of the underlying stock

TODCO AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

on the date of grant, no compensation expense is recognized. If an employee stock option is modified subsequent to the original grant date, and the exercise price is less than the fair value of the underlying stock on the date of the modification, compensation expense equal to the excess of the fair value over the exercise price is recognized over the remaining vesting period. Compensation expenses for grants of restricted shares to employees is calculated based on the fair value of the shares on the date of grant and is recognized over the vesting period. Stock appreciation rights are considered variable grants and are recorded at fair value, with the change in the recorded fair value recognized as compensation expense.

Effective January 1, 2003, the Company adopted the fair value recognition provisions of SFAS 123 using the prospective method. Under the prospective method and in accordance with the provisions of SFAS 148, *Accounting for Stock-Based Compensation Transition and Disclosure*, the recognition provisions are applied to all employee awards granted, modified or settled after January 1, 2003. See Notes 15 and 24.

The compensation expense related to stock-based employee compensation included in the determination of net income for the years ended December 31, 2003 and 2002 and the eleven months ended December 31, 2001 is less than that which would have been recognized if the fair value method had been applied to all awards granted after the original effective date of SFAS 123. If the Company had elected to adopt the fair value recognition provisions of SFAS 123 as of its original effective date pro forma net income and diluted net income per share would have been as follows (in millions, except per share amounts):

	Post-Transocean Merger		
	Year Ended December 31, 2003	Year Ended December 31, 2002	Eleven Months Ended December 31, 2001
Net loss applicable to common stockholders as reported	\$(286.2)	\$(5,558.2)	\$(154.1)
Add: stock-based employee compensation included in reported net income, net of related tax effects			
Deduct: total stock-based employee compensation expense under fair value based method for all awards, net of tax	0.5	1.8	0.6
Pro forma net loss applicable to common stockholders	\$(286.7)	\$(5,560.0)	\$(154.7)
Basic and diluted loss per share			
As reported	\$(23.56)	\$ (457.65)	\$(12.69)
Pro forma	\$(23.61)	\$ (457.80)	\$(12.74)

The pro forma effect on net loss for the one month ended January 31, 2001 was not significant. The pro forma net loss effects of applying SFAS 123 recognition of compensation expense for the periods shown above may not be representative of the effects on reported net income for future years.

There were no options granted to the Company's employees under the Transocean Incentive Plan for the year ended December 31, 2003. The fair value of each option grant under the Transocean Incentive Plans for

TODCO AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

the years ended December 31, 2003 and 2002 and the eleven months ended December 31, 2001 was estimated using the Black-Scholes options pricing model with the following weighted-average assumptions:

	Post-Transocean Merger	
	Year Ended December 31, 2002	Eleven Months Ended December 31, 2001
Dividend yield	0.00%	0.30%
Expected price volatility	50.7%	50.2%
Risk-free interest rate	3.49%	4.25%
Expected life of options (in years)	3.9	4.1
Weighted-average fair value of options granted	\$ 12.24	\$ 16.45

There were no outstanding awards under the Company's long-term incentive plan at December 31, 2003. See Note 24.

New Accounting Pronouncements In April 2002, the FASB issued SFAS 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections*. This statement eliminates the requirement under SFAS 4 to aggregate and classify all gains and losses from extinguishment of debt as an extraordinary item, net of related income tax effect. This statement also amends SFAS 13 to require certain lease modifications with economic effects similar to sale-leaseback transactions be accounted for in the same manner as sale-leaseback transactions. In addition, SFAS 145 requires reclassification of gains and losses in all prior periods presented in comparative financial statements related to debt extinguishment that do not meet the criteria for extraordinary item in APB 30. The statement is effective for fiscal years beginning after May 15, 2002 with early adoption encouraged. The Company adopted SFAS 145 effective January 1, 2002. The adoption of this statement had no effect on the Company's consolidated financial position or results of operations.

In December 2002, the FASB issued SFAS 148, *Accounting for Stock-Based Compensation - Transition and Disclosure*, which is effective for fiscal years ending after December 15, 2002. SFAS 148 amends SFAS 123, *Accounting for Stock-Based Compensation*, to permit two additional transition methods for a voluntary change to the fair value based method of accounting for stock-based employee compensation from the intrinsic method under APB 25. The prospective method of transition under SFAS 123 is an option for entities adopting the recognition provisions of SFAS 123 in a fiscal year beginning before December 15, 2003. In addition, SFAS 148 amends the disclosure requirements of SFAS 123 to require prominent disclosures in both annual and interim financial statements concerning the method of accounting used for stock-based employee compensation and the effects of that method on reported results of operations. Under SFAS 148, pro forma disclosures are required in a specific tabular format in the Summary of Significant Accounting Policies. The Company has adopted the disclosure requirements of this statement effective December 31, 2002. The adoption had no effect on the Company's consolidated financial position or results of operations. The Company adopted the fair value method of accounting for stock-based compensation using the prospective method of transition under SFAS 123 effective January 1, 2003. As a result of the completion of the Company's initial public offering in February 2004 (see Notes 1 and 24), management expects compensation expense will increase approximately \$11 million in 2004 as a result of the adoption. See Stock-Based Compensation.

In January 2003, the FASB issued Interpretation No. 46, *Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51 (FIN 46)*. FIN 46 requires that an enterprise consolidate a variable interest entity (VIE) if the enterprise has a variable interest that will absorb a majority of the entity's expected losses and/or receives a majority of the entity's expected residual returns as a

TODCO AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

result of ownership, contractual or other financial interests in the entity, if such loss or residual return occurs. If one enterprise absorbs a majority of a VIE's expected losses and another enterprise receives a majority of that entity's expected residual returns, the enterprise absorbing a majority of the losses is required to consolidate the VIE and will be deemed the primary beneficiary. FIN 46 is effective immediately for those VIEs created after January 31, 2003. The provisions, as amended, are effective for the first interim or annual period ending after December 15, 2003 for those VIEs held prior to February 1, 2003 that are considered to be special purpose entities. The provisions, as amended, are to be applied no later than the end of the first reporting period that ends after March 14, 2004 for all other VIEs held prior to February 1, 2003. Early adoption is allowed. The Company adopted and applied the provisions of FIN 46 effective December 31, 2003. See Note 17.

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

In connection with the IPO, certain components of costs previously classified in operating and maintenance expense were reviewed and reclassified to general and administrative expense to be consistent with the ongoing classification of the Company's corporate support costs. The aggregate costs reclassified totaled \$17.1 million for the year ended December 31, 2002 and \$12.7 million for the eleven months ended December 31, 2001. This reclassification had no effect on the Company's previously reported operating income or net income.

Note 3 Other Comprehensive Income (Loss)

The components of accumulated other comprehensive income (loss) are as follows (in millions):

	Unrealized Gains on Available-for-Sale Securities	Other Comprehensive Loss Related to Unconsolidated Joint Venture	Total Other Comprehensive Income (Loss)
Pre-Transocean Merger			
Balance at December 31, 2000	\$ 0.3	\$	\$ 0.3
Other comprehensive loss	(0.1)		(0.1)
Balance at January 31, 2001	0.2		0.2
Post-Transocean Merger			
Other comprehensive loss	(0.2)	(2.3)	(2.5)
Balance at December 31, 2001		(2.3)	(2.3)
Other comprehensive income		0.3	0.3
Balance at December 31, 2002		(2.0)	(2.0)
Other comprehensive income		2.0	2.0
Balance at December 31, 2003	\$	\$	\$

Note 4 Transocean Merger

On August 19, 2000, the Company entered into an Agreement and Plan of Merger with Transocean, whereby each share of the Company's common stock would convert into 0.5 ordinary shares of Transocean. The Company's common shareholders approved the Transocean Merger at a special meeting on December 12, 2000. On January 31, 2001, the Transocean Merger was completed and the Company became an indirect

TODCO AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

wholly owned subsidiary of Transocean and a new board of directors was elected. In connection with the merger, Transocean assumed warrants and options exercisable for the Company's common stock prior to the Transocean Merger. At the merger date such warrants and options were exercisable for approximately 13 million Transocean ordinary shares.

The purchase price of \$6.7 billion was comprised of \$6.1 billion market value of Transocean's ordinary shares issued in the merger and the estimated fair value of Transocean's stock options and warrants that replaced the Company's stock options and warrants at the time of the merger of \$0.6 billion. The market capitalization of Transocean's ordinary shares was calculated using the average closing price of Transocean's ordinary shares for a period immediately before and after August 21, 2000, the date the merger was announced.

In January 2001, in connection with the Transocean Merger, the Company recorded a pre-tax expense of approximately \$58 million including: (1) a \$19.6 million investment advisory fee, (2) \$25.1 million of termination benefits to seven employees in accordance with employment contracts, and (3) a \$9.5 million charge due to the acceleration of vesting of certain stock options and restricted stock grants previously awarded to certain employees. In addition, in connection with the Transocean Merger, the Company was required to dispose of its marine support vessel business, consisting primarily of shallow water tugs, crewboats and utility barges. As a result, the Company contributed its marine support vessel business to a joint venture, Delta Towing Holdings, LLC (Delta Towing), in return for secured contingent notes with a face value of \$144.0 million and a 25 percent ownership interest in Delta Towing. The Company recorded a pre-tax charge of \$64.0 million in January 2001, which is included in impairment loss on long-lived assets to reflect the fair value of the consideration received in the exchange. See Note 18.

In conjunction with the Transocean Merger, the Company established a liability of \$16.5 million for the estimated severance-related costs associated with the involuntary termination of 569 of the Company's employees pursuant to management's plan to consolidate operations and administrative functions and to dispose of the Venezuela operations post-merger. Included in the 569 planned involuntary terminations were 387 employees engaged in the Company's land drilling business in Venezuela. The Company has suspended active marketing efforts to divest this business and, as a result, reduced the estimated liability by \$4.3 million in the third quarter of 2001 with an offset to goodwill. As of December 31, 2002, all required severance-related costs were paid to 182 employees whose positions were eliminated as a result of this plan.

Note 5 Venezuelan Financial Assets

Due to continuing political instability in Venezuela and the continuation of recent foreign exchange controls, the Company established a currency valuation allowance of \$2.4 million pertaining to cash and receivables in Venezuela in the second quarter of 2003 to adjust the Company's Venezuelan financial assets to net realizable value as of June 30, 2003. As of December 31, 2003, the Company had financial assets denominated in local currency with a net carrying value of \$3.7 million. The foreign exchange controls limit the Company's ability to convert local currency into U.S. dollars and transfer excess funds out of Venezuela. In August 2003, the Company negotiated an agreement with its principal customer in Venezuela to pay the majority of the contracted U.S. dollar denominated dayrate in U.S. dollars to one of our banks in the United States.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 6 Debt and Capital Lease Obligations

Third Party Obligations

Third party debt and capital lease obligations, which excludes debt to Transocean and its affiliates, net of unamortized discounts, premiums and fair value adjustments, is comprised of the following (in millions):

	Post- Transocean Merger December 31,	
	2003	2002
6.5% Senior Notes, due April 2003	\$	\$ 5.0
9.125% Senior Notes, due December 2003		10.5
6.75% Senior Notes, due April 2005	7.8	7.8
6.95% Senior Notes, due April 2008	2.2	2.2
9.5% Senior Notes, due December 2008	11.4	11.7
7.375% Senior Notes, due April 2018	3.5	3.5
Capital Lease Obligations	1.9	
	—	—
Total	26.8	40.7
Less debt due within one year	1.2	15.5
	—	—
Total long-term debt	\$25.6	\$25.2

The expected maturity of the face value of the Company's third party debt, excluding capital lease obligations, is as follows (in millions):

	Years Ended December 31,
2004	\$
2005	7.7
2006	
2007	
2008	12.4
Thereafter	3.5
	—
Total	\$23.6

Third Party Debt - Revolving Credit Facility. In December 2003, the Company entered into a two-year \$75 million floating-rate secured revolving credit facility that will decline to \$60 million in December 2004.

The facility is secured by most of the Company's drilling rigs, receivables, 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

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funds rate plus 0.5%, plus a margin in either case of 2.50% or (2) the Eurodollar rate plus a margin of 3.50%. Commitment fees on the unused portion of the facility are 1.5% 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% 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% of the orderly liquidated value of the

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TODCO AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

drilling rigs securing the facility plus 80% 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 the following:

a ratio of (1) current assets plus unused availability under the facility to (2) current liabilities (excluding specified subordinated liabilities owed to Transocean) of at least 1.2 to 1,

a ratio of total debt to total capitalization of not more than 20% (excluding specified subordinated liabilities owed to Transocean from debt but including those liabilities in total capitalization),

tangible net worth plus specified subordinated liabilities owed to Transocean of not less than the sum of (1) \$425 million plus (2) to the extent positive, 50% of net income after December 31, 2003,

a ratio of (1) the orderly liquidation value of the drilling rigs securing the facility to (2) the amount of borrowings and letters of credit outstanding under the facility of not less than 3 to 1, and

in the event liquidity (defined as working capital (excluding specified subordinated liabilities owed to Transocean) plus availability under the facility) is less than \$25 million, a ratio of (1) EBITDA minus capital expenditures during the preceding 12 fiscal months to (2) interest expense (excluding interest on specified subordinated debt owed to Transocean) during such period of not less than 2 to 1.

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.

As of December 31, 2003, the Company had no borrowings outstanding under the facility.

Third Party Debt 6.5%, 6.75%, 6.95%, 7.375%, 9.125% and 9.5% Senior Notes and Exchange Offer In April 1998, the Company issued 6.5% Senior Notes, 6.75% Senior Notes, 6.95% Senior Notes and 7.375% Senior Notes with an aggregate principal amount of \$1.1 billion. In December 1998, the Company issued 9.125% Senior Notes and 9.5% Senior Notes with an aggregate principal amount of \$400.0 million. Each of these notes was recorded at fair value on January 31, 2001 in conjunction with the Transocean Merger.

In March 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, approximately \$234.5 million, \$342.3 million, \$247.8 million, \$246.5 million, \$76.9 million and \$289.8 million principal amount of the Company's outstanding 6.5%, 6.75%, 6.95%, 7.375%, 9.125% and 9.5% notes, respectively, were exchanged by Transocean for newly issued 6.5%, 6.75%, 6.95%, 7.375%, 9.125% and 9.5% Transocean notes having the same principal amount, interest rate, redemption terms and payment and maturity dates (and accruing interest from the last date for which interest had been paid on the Company's notes). Because the holders of a majority in principal amount of each of these series of notes consented to the proposed amendments to the applicable indenture pursuant to which the notes were issued, some covenants, restrictions and events of default were eliminated from the indentures with respect to these series of notes. Both the exchanged notes and the notes not exchanged remained the obligation of the Company. In connection with the Exchange Offer, an aggregate of \$8.3 million in consent payments was made by the Company to holders of the Company's notes whose notes were exchanged. The consent payments are being amortized as an increase to interest expense over the remaining term of the respective notes and such amortization was \$0.5 million and \$1.3 million for the years ended December 31, 2003 and 2002, respectively. As of December 31, 2003, Transocean was the holder of the notes that were exchanged for Transocean notes

TODCO AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

in the Exchange Offer. Correspondingly, the Company had debt obligations to Transocean for those exchanged notes. See **Related Party Debt** below for amounts due to Transocean.

In December 2003, the Company repaid all of the \$10.2 million outstanding principal amount of the 9.125% Senior Notes, plus accrued and unpaid interest, in accordance with their scheduled maturities. In April 2003, the Company repaid the entire \$5.0 million principal amount outstanding of the 6.5% Senior Notes, plus accrued and unpaid interest, in accordance with their scheduled maturities.

At December 31, 2003, approximately \$7.7 million, \$2.2 million, \$3.5 million, and \$10.2 million principal amount of the 6.75%, 6.95%, 7.375%, and 9.5% Senior Notes, respectively, due to third parties were outstanding. The fair value of these notes at December 31, 2003 was approximately \$8.1 million, \$2.4 million, \$4.0 million, and \$12.5 million, respectively, based on the estimated yield to maturity as of that date.

Third Party Debt Redeemed and Repurchased Debt In November and December of 2001, the Company repurchased and retired approximately \$11.3 million principal amount of the 9.125% Senior Notes due 2003 and \$10.5 million principal amount of the 6.5% Senior Notes due 2003. The Company funded the repurchases from cash on hand. The Company recognized a net after-tax loss on retirement of debt of approximately \$0.6 million in the fourth quarter of 2001 relating to the early retirement of this debt.

On April 10, 2001, the Company acquired, pursuant to a tender offer, all of the approximately \$400.0 million principal amount outstanding 11.375% Senior Secured Notes due 2009 of its affiliate, RBF Finance Co., at 122.51 percent of principal amount, or \$1,225.10 per \$1,000 principal amount, plus accrued and unpaid interest. On April 6, 2001, RBF Finance Co. also redeemed all of the approximately \$400.0 million principal amount outstanding 11% Senior Secured Notes due 2006 at 125.282 percent, or \$1,252.82 per \$1,000 principal amount, plus accrued and unpaid interest. In the second quarter of 2001, the Company recognized a net after-tax loss on retirement of debt of \$14.4 million on the early retirement of this debt.

On April 6, 2001, the Company redeemed all of the approximately \$200.0 million principal amount outstanding 12.25% Senior Notes due 2006 at 130.675 percent or \$1,306.75 per \$1,000 principal amount, plus accrued and unpaid interest. In the second quarter of 2001, the Company recognized a net after-tax loss on retirement of debt of \$4.5 million on the early retirement of this debt.

On March 30, 2001, pursuant to an offer made in connection with the Transocean Merger, Cliffs Drilling Company (**Cliffs Drilling**), a wholly owned subsidiary of the Company, acquired approximately \$0.1 million of the 10.25% Senior Notes due 2003 at an amount equal to 101 percent of the principal amount. On May 18, 2001, Cliffs Drilling redeemed all of the approximately \$200.0 million principal amount outstanding 10.25% Senior Notes due 2003, at 102.5 percent, or \$1,025.00 per \$1,000 principal amount, plus interest accrued to the redemption date. The Company recognized a net after-tax gain on retirement of debt of \$1.6 million in the second quarter of 2001 relating to the early retirement of this debt.

The Company obtained sufficient funds to pay for the March and April 2001 offers and redemptions from borrowings under a revolving credit agreement with Transocean. See **Related Party Debt** below.

Capital Lease Obligations The Company leases certain drilling equipment under two-year capital lease agreements. During 2003, the Company entered into two capital lease agreements in the amounts of \$1.0 million and \$1.1 million with final maturity dates of September 2005 and October 2005, respectively. Both lease agreements bear interest at a rate of 10 percent per annum. Assets recorded under capital leases are included in property and equipment in the consolidated balance sheets and amounted to \$2.1 million at December 31, 2003. Accumulated depreciation of these assets was not significant for 2003 and is included in accumulated depreciation combined with the Company's owned assets. Depreciation expense on these assets was not significant during the year ended December 31, 2003 and is included in depreciation expense.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Future minimum lease payments under scheduled capital leases that have initial or remaining noncancellable terms in excess of one year are as follows (in millions):

	Years Ending December 31,
	<u> </u>
2004	\$ 1.3
2005	0.7
	<u> </u>
Total minimum lease payments	2.0
Amount representing interest	0.1
	<u> </u>
Capital lease obligations	1.9
Less amounts due within one year	1.2
	<u> </u>
Long-term capital lease obligations	\$0.7
	<u> </u>

Related Party Debt

Related party debt, net of unamortized discounts, premiums, and fair value adjustments, is comprised of the following (in millions):

	Post-Transocean Merger	
	<u> </u>	
	December 31,	
	<u>2003</u>	<u>2002</u>
	<u> </u>	<u> </u>
Revolving Credit Agreement, maturing April 2003	\$	\$ 100.0
6.75% Senior Notes, due April 2005	153.2	153.9
6.95% Senior Notes, due April 2008		249.7
9.5% Senior Notes, due December 2008	322.9	329.5
7.375% Senior Notes, due April 2018	45.9	247.0
Other Debt	3.0	
	<u> </u>	<u> </u>
Total	525.0	1,080.1
Less debt due within one year	3.0	100.0
	<u> </u>	<u> </u>
Total long-term debt	\$522.0	\$ 980.1
	<u> </u>	<u> </u>

The expected maturity of the face value of the Company's related party debt is as follows (in millions):

**Years Ended
December 31,**

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2004	\$ 3.0
2005	152.5
2006	
2007	
2008	289.8
Thereafter	45.8
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Total	\$491.1
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TODCO AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Revolving Credit Agreement The Company was party to a \$1.8 billion two-year revolving credit agreement (the Two-Year Revolver) with Transocean, dated April 6, 2001. Amounts outstanding under the Two-Year Revolver bore interest quarterly at a rate of the London Interbank Offered Rate (LIBOR) plus 0.575 percent to 1.3 percent depending on Transocean's non-credit enhanced senior unsecured public debt rating. On April 6, 2003 the approximately \$81.2 million then outstanding under the Two-Year Revolver was converted into a 2.76% fixed rate promissory note issued by the Company to Transocean which was scheduled to mature on April 6, 2005. This note was cancelled in full in connection with the sales of the Company's interest in a wholly-owned subsidiary and interests in two joint ventures. See 6.5%, 6.75%, 6.95%, 7.375%, 9.125% and 9.5% Senior Notes and Note 13.

During the years ended December 31, 2003 and 2002 and the eleven months ended December 31, 2001, the Company recognized interest expense of \$0.8 million, \$1.8 million and \$25.4 million, respectively, related to the Two-Year Revolver.

6.5%, 6.75%, 6.95%, 7.375%, 9.125% and 9.5% Senior Notes In March 2002 and in conjunction with the Exchange Offer (see Third Party Debt 6.5%, 6.75%, 6.95%, 7.375%, 9.125% and 9.5% Senior Notes and Exchange Offer above), Transocean became the holder of \$1,437.8 million aggregate principal amount of 6.5%, 6.75%, 6.95%, 7.375%, 9.125% and 9.5% Senior Notes that had previously been publicly held. In December 2002, the Company repurchased from Transocean and retired approximately \$234.5 million and \$76.9 million principal amount outstanding of the 6.5% and 9.125% Senior Notes, respectively, and approximately \$189.8 million principal amount outstanding of the 6.75% Senior Notes, plus accrued and unpaid interest. The market values attributed to the repurchased notes were provided by an independent third party. The repurchased 6.5%, 9.125% and 6.75% Senior Notes were acquired at market values equal to 101.15 percent, 105.83 percent and 107.91 percent of the principal amount, respectively, resulting in the recognition of an aggregate loss on retirement of debt, net of tax, of \$12.2 million in the fourth quarter of 2002. The repayment was funded from cash received from Transocean's repayment to the Company of approximately \$518.0 million aggregate principal amount outstanding notes receivable plus accrued and unpaid interest.

In March 2003, the Company sold to Transocean its approximate 75 percent ownership interest in Arcade Drilling AS. In consideration for the sale of this stock, Transocean cancelled \$233.3 million principal amount outstanding of the 6.95% Senior Notes held by Transocean. Interest accrued on these notes was settled in cash. The market value attributed to the cancelled notes, 113.21 percent of the principal amount, was based on an independent third party appraisal. The Company recognized a net pre-tax loss on retirement of debt of \$30.0 million in the first quarter of 2003 relating to the early retirement of this debt.

In May 2003, the Company acquired, and then retired, \$13.9 million principal amount of the 6.95% senior notes in exchange for the sale of *Cliffs Platform Rig 1* to Transocean. The Company recorded a pre-tax loss on retirement of debt of \$1.5 million.

In June 2003, the Company sold to Transocean its membership interests in its wholly owned subsidiary, R&B Falcon Drilling (International & Deepwater) Inc. LLC. As consideration for the interests sold, Transocean cancelled \$238.8 million principal amount of the Company's outstanding debt held by Transocean (\$37.5 million of the 2.76% fixed note (see Revolving Credit Agreement), \$0.6 million of 6.95% Senior Notes and \$200.7 million of 7.375% Notes). The Company recorded a pre-tax loss on the retirement of debt of \$48.0 million in connection with this transaction. See Note 23.

During the years ended December 31, 2003 and 2002, the Company recognized \$42.7 million and \$77.9 million, respectively, in interest expense related party related to these notes held by Transocean.

At December 31, 2003, approximately \$152.5 million, \$45.8 million and \$289.8 million principal amount of 6.75%, 7.375%, and 9.5% Senior Notes, respectively, due to Transocean were outstanding. The fair value of

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

these Senior Notes due to Transocean at December 31, 2003 was approximately \$161.3 million, \$52.2 million, and \$355.4 million, respectively, based on the estimated yield to maturity as of that date. See Note 24.

Other Debt In connection with the acquisition of the marine business, Delta Towing entered into a \$3.0 million note agreement with Beta Marine Services, L.L.C. (Beta Marine) dated January 30, 2001. The note bears interest at 8%, payable quarterly. In January 2004, Delta Towing failed to make its scheduled principal payment to Beta Marine. The \$3.0 million note has been classified as a current obligation in the Company's consolidated balance sheet.

Note 7 Financial Instruments and Risk Concentration

Foreign Exchange Risk The Company's international operations expose the Company to foreign exchange risk. This risk is primarily associated with employee compensation costs denominated in currencies other than the U.S. dollar and with purchases from foreign suppliers. The Company uses a variety of techniques to minimize exposure to foreign exchange risk, including customer contract payment terms and foreign exchange derivative instruments.

The Company's primary foreign exchange risk management strategy involves structuring customer contracts to provide for payment in both U.S. dollars and local currency. The payment portion denominated in local currency is based on anticipated local currency requirements over the contract term. Foreign exchange derivative instruments, specifically foreign exchange forward contracts, may be used to minimize foreign exchange risk in instances where the primary strategy is not attainable. A foreign exchange forward contract obligates the Company to exchange predetermined amounts of specified foreign currencies at specified exchange rates on specified dates or to make an equivalent U.S. dollar payment equal to the value of such exchange.

Gains and losses on foreign exchange derivative instruments that qualify as accounting hedges are deferred as other comprehensive income and recognized when the underlying foreign exchange exposure is realized. Gains and losses on foreign exchange derivative instruments that do not qualify as hedges for accounting purposes are recognized currently based on the change in market value of the derivative instruments. At December 31, 2003 and 2002, the Company did not have any foreign exchange derivative instruments not qualifying as accounting hedges.

Interest Rate Risk The Company's use of debt directly exposes the Company to interest rate risk. Fixed rate debt, in which the rate of interest is fixed over the life of the instrument and the instrument's maturity is greater than one year, exposes the Company to changes in market rates of interest should the Company refinance maturing debt with new debt.

In addition, the Company is exposed to interest rate risk in its cash investments, as the interest rates on these investments change with market interest rates.

The Company, from time to time, may use interest rate swap agreements to manage the effect of interest rate changes on future income. These derivatives would be used as hedges and would not be used for speculative or trading purposes.

The major risks in using interest rate derivatives include changes in interest rates affecting the value of such instruments, potential increases in the interest expense of the Company due to market increases in floating interest rates, in the case of derivatives that exchange fixed interest rates for floating interest rates, and the creditworthiness of the counterparties in such transactions.

At December 31, 2003 and 2002, the Company did not have any interest rate swap agreements outstanding.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Credit Risk Financial instruments that potentially subject the Company to concentrations of credit risk are primarily cash and cash equivalents and trade receivables and, prior to December 31, 2003, notes receivable from Delta Towing (see Note 18). It is the Company's practice to place its cash and cash equivalents in time deposits at commercial banks with high credit ratings or mutual funds that invest exclusively in high quality money market instruments. In foreign locations, local financial institutions are generally utilized for local currency needs. The Company limits the amount of exposure to any one institution and does not believe it is exposed to any significant credit risk.

The Company derives the majority of its revenue from services to independent oil and natural gas companies, major international oil companies and government-owned and government-controlled oil companies. Receivables are concentrated in various countries (see Note 19). The Company maintains an allowance for doubtful accounts receivable based upon expected collectibility. The Company is not aware of any significant credit risks relating to its customer base and does not generally require collateral or other security to support customer receivables.

Note 8 Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash and cash equivalents The carrying amount of cash and cash equivalents approximates fair value because of the short maturity of those instruments.

Notes receivable from related parties The fair value of notes receivable from related parties and advances to joint ventures with a carrying amount of \$78.7 million at December 31, 2002 could not be determined because there is no available market price for such notes. Due to the adoption of FIN 46 (see Notes 2 and 18) the notes receivable have been eliminated in consolidation at December 31, 2003.

Debt The fair value of the Company's debt, including capital lease obligations, is estimated based on the current rates offered to the Company for debt of the same remaining maturities.

	Post-Transocean Merger			
	December 31, 2003		December 31, 2002	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(In millions)			
Cash and cash equivalents	\$ 20.0	\$ 20.0	\$	\$
Debt - third party	(26.8)	(28.9)	(40.7)	(43.3)
Debt - related party	(525.0)	(571.9)	(1,080.1)	(1,175.9)

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 9 Other Current Liabilities

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

	Post- Transocean Merger	
	December 31,	
	2003	2002
Accrued workers insurance	\$28.0	\$33.5
Accrued payroll and employee benefits	5.7	14.2
Accrued interest	0.2	0.4
Accrued taxes, other than income	1.6	1.1
Deferred income	7.3	
Other	0.6	0.6
	<u> </u>	<u> </u>
Total other current liabilities	\$43.4	\$49.8
	<u> </u>	<u> </u>

Note 10 Impairment of Long-Lived Assets

In the second quarter of 2003, the Company decided to remove five jackup rigs from drilling service and market the rigs for alternative uses. The Company does not anticipate returning the five rigs to drilling service as it would be cost prohibitive. As a result of this decision and in accordance with SFAS 144, the Company tested the carrying value of the rigs for impairment during the second quarter of 2003 and recorded a pre-tax \$10.6 million non-cash impairment charge as a result of the impairment test.

As a result of the lack of success of the original business strategy of Energy Virtual Partners, Inc. and Energy Virtual Partners, LP, the Company determined that the assets of those entities did not support the Company's \$1.0 million recorded investment and recorded a pre-tax \$1.0 million non-cash impairment charge in the second quarter of 2003. As of December 31, 2003, these entities were in the process of being liquidated, and, in December 2003, the Company received \$0.3 million in proceeds from the sale of certain assets of the joint venture. These proceeds were recorded as a reduction of the impairment charge previously recorded.

In 2002, the Company recorded non-cash impairment charges of \$16.4 million relating to the reclassification of assets held for sale to assets held and used. The impairment of these assets resulted from management's assessment that they no longer met the held for sale criteria under SFAS 144. In accordance with SFAS 144, the carrying values of these assets were adjusted to the lower of fair market value or carrying value adjusted for depreciation from the date the assets were classified as held for sale. The fair market value of these assets was based on third party valuations.

In 2002, the Company recorded a non-cash impairment charge of \$1.1 million relating to an asset held for sale. The impairment resulted from deterioration in market conditions. The impairment was determined and measured based on an offer from a potential buyer.

The Company performed its annual test of goodwill as of October 1, 2002. As a result of that test and a general decline in market conditions, the Company recorded a non-cash impairment of \$381.9 million in the fourth quarter of 2002. See Note 2.

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During the fourth quarter of 2001, the Company recorded a non-cash impairment charge of \$1.1 million. The impairment related to certain non-core assets to be held and used as a result of deterioration in market conditions.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The impairment losses noted above have been included in the Company's reportable segments results based on the segment of each of the assets impaired. See Note 19.

Note 11 Supplementary Cash Flow Information

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

	Post-Transocean Merger			Pre-Transocean Merger
	Year Ended December 31, 2003	Year Ended December 31, 2002	Eleven Months Ended December 31, 2001	One Month Ended January 31, 2001
Interest paid, net of capitalized interest	\$ 8.7	\$ 55.3	\$ 191.0	\$ 1.5
Interest paid to related party	50.7	73.6	23.6	
Income taxes paid, net	11.1	23.2	15.3	1.1
Noncash investing activities				
Sales of assets to related party in exchange for debt ^{(a)(b)}		(87.6)	(1,676.2)	
Net reclassification of property and equipment from (to) assets held for sale ^(c)		29.5	(171.9)	
Noncash financing activities				
Fair value adjustments related to the Transocean Merger				5,354.0
Net distribution of assets to parent ^{(d)(e)}	(224.7)	(371.8)		
Debt exchanged in Exchange Offer ^(f)		(1,437.8)		
Equity contribution from parent ^(g)	(84.7)			

- (a) In August 2001, the Company sold certain drilling units to a related party (see Note 18). This was reflected in the consolidated balance sheet as a decrease in non-current assets related to discontinued operations of \$1,676.2 million, a decrease in long-term advances from related party of \$1,190.0 million and an increase in note receivable from related party of \$425.0 million. The sale of these drilling units resulted in a net loss from discontinued operations of \$61.2 million.
- (b) In April 2002, the Company sold two rigs to a related party (see Note 23). The excess of the sales price over the net book value of the units was treated as a capital contribution to the Company. This was reflected in the consolidated balance sheet as a decrease to non-current assets related to discontinued operations of \$87.6 million, an increase in note receivable from related party of \$93.0 million and an increase in additional paid-in capital of \$5.4 million.
- (c) Concurrent with and subsequent to the Transocean Merger (see Note 4), the Company removed certain non-strategic assets from the active fleet and categorized them as assets held for sale. This was reflected as a decrease in property and equipment with a corresponding increase in other assets. In the third quarter of 2002, the Company reclassified certain assets from assets held for sale to property and equipment based on management's assessment that these assets no longer met the held for sale criteria under SFAS 144 (see Note 10). This was reflected as an increase in property and equipment with a corresponding decrease in other assets.
- (d) In the third and fourth quarters of 2002, nine rigs, 15 subsidiaries and certain other assets were sold or distributed to affiliated companies (see Note 23). The \$10.4 million net reduction in cash held by subsidiaries at the time of the sales or distributions was

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

reflected in financing activities in the consolidated statement of cash flows. The non-cash effect on the consolidated balance sheet was reflected as a decrease in accounts receivable-trade and other of \$59.4 million, an increase in accounts receivable-related party of \$30.2 million, a decrease in materials and supplies of \$7.2 million, a decrease in non-current assets related to discontinued operations of \$383.4 million, a decrease in accounts payable-trade of \$5.6 million, a decrease in accounts payable-related party of \$56.6 million, a decrease in accrued income taxes of \$2.4 million, a decrease in other current liabilities of \$5.6 million, an increase in deferred income taxes of \$45.2 million, a decrease in non-current liabilities related to discontinued operations of \$23.0 million and a decrease in additional paid-in capital of \$371.8 million.

- (e) In the first half of 2003, four subsidiaries, ownership interests in two majority-owned subsidiaries, a platform rig and certain other assets were sold or distributed to affiliated companies (see Note 23). The \$103.9 million in cash held by subsidiaries at the time of the sales or distributions was reflected in financing activities in the consolidated statement of cash flows. The non-cash effect on the consolidated balance sheet was reflected as a decrease in accounts receivable-trade and other receivables of \$21.4 million, a decrease in accounts receivable-related party of \$298.8 million, an \$8.3 million decrease in other current assets, a \$752.2 million decrease in non-current assets related to discontinued operations, a \$39.0 million decrease in other assets, a decrease in accounts payable trade and other current liabilities of \$31.9 million, a decrease in accounts payable-related party of \$108.4 million, a \$15.5 million decrease in deferred taxes, a decrease in other long-term liabilities of \$28.3 million, a decrease in notes payable of \$88.0 million, a \$524.7 million decrease in long-term debt-related party, a \$98.2 million decrease in minority interest and a decrease in additional paid-in capital of \$224.7 million.
- (f) In March 2002 and in conjunction with the Exchange Offer, Transocean became the holder of \$1,437.8 aggregate principal amount senior notes (see Note 6). The effect on the consolidated balance sheet was a decrease in long-term debt and an increase to long-term debt related party.
- (g) In December 2003, Transocean contributed to the Company \$84.7 million in net accounts payable-related party owed to Transocean.

Note 12 Income Taxes

Income tax expense (benefit) from continuing operations before minority interest and cumulative effect of a change in accounting principle consisted of the following (in millions):

	Post-Transocean Merger			Pre-Transocean Merger
	Year Ended December 31, 2003	Year Ended December 31, 2002	Eleven Months Ended December 31, 2001	One Month Ended January 31, 2001
Current:				
Foreign	\$ 0.9	\$ 0.6	\$ 3.7	\$
State			0.8	
Total current	0.9	0.6	4.5	
Deferred federal	(51.0)	(75.2)	(26.1)	(33.4)
Income tax benefit before minority interest and cumulative effect of a change in accounting principle	\$(50.1)	\$(74.6)	\$(21.6)	\$(33.4)

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The domestic and foreign components of income (loss) from continuing operations before income taxes, minority interest and cumulative effect of a change in accounting principle were as follows (in millions):

	Post-Transocean Merger			Pre-Transocean Merger
	Year Ended December 31, 2003	Year Ended December 31, 2002	Eleven Months Ended December 31, 2001	One Month Ended January 31, 2001
Domestic	\$ (264.3)	\$ (580.4)	\$ (118.6)	\$ (124.3)
Foreign	(7.2)	(23.4)	0.3	0.8
	<u>\$ (271.5)</u>	<u>\$ (603.8)</u>	<u>\$ (118.3)</u>	<u>\$ (123.5)</u>

The effective tax rate, as computed on income (loss) from continuing operations before income taxes, minority interest and cumulative effect of a change in accounting principle differs from the statutory U.S. income tax rate due to the following:

	Post-Transocean Merger			Pre-Transocean Merger
	Year Ended December 31, 2003	Year Ended December 31, 2002	Eleven Months Ended December 31, 2001	One Month Ended January 31, 2001
Statutory tax rate	35.0%	35.0%	35.0%	35.0%
Use of previously reserved tax benefits				
Foreign tax expense (net of federal benefit)	(0.3)		(1.9)	
State tax expense (net of federal benefit)			(0.3)	
Non-deductible merger expenses				(7.4)
Non-deductible expenses goodwill amortization and other			(12.8)	(0.2)
Non-deductible expenses goodwill impairment losses		(22.1)		
Increase in valuation allowance	(14.6)			
Expiration of net tax operating loss carryforwards	(2.1)	(0.4)	(1.5)	(0.2)
Other	0.5	(0.1)	(0.2)	(0.2)
	<u>18.5%</u>	<u>12.4%</u>	<u>18.3%</u>	<u>27.0%</u>

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Deferred income taxes result from those transactions that affect financial and taxable income in different years. The nature of these transactions and the income tax effect of each were as follows (in millions):

	Post-Transocean Merger	
	December 31,	
	2003	2002
Deferred Tax Assets		
Net tax operating and other loss carryforwards ^(a)	\$ 310.1	\$ 190.3
Foreign tax credit carryforwards	157.0	157.0
Accrued expenses	16.7	15.8
Debt issue costs	0.4	26.3
Other	8.4	6.3
Valuation allowance	(148.6)	(109.0)
	<u>344.0</u>	<u>286.7</u>
Deferred Tax Liabilities		
Depreciation	(190.7)	(218.9)
Deferred gains	(151.9)	(117.7)
Other	(1.4)	—
	<u>(344.0)</u>	<u>(336.6)</u>
Net deferred tax liabilities ^(a)	\$ —	\$ (49.9)

(a) The December 31, 2002 net operating loss carryforwards balances have been increased by \$9.3 million, for the deferred tax benefits from stock option exercises with corresponding increases in additional paid-in capital. Such adjustments had no effect on the historical statements of operations or cash flows for all periods presented.

At December 31, 2002, \$17.2 million of current deferred tax assets were included in other current assets in the accompanying consolidated balance sheet.

The valuation allowance reflects the possible expiration of tax benefits (primarily foreign tax credit carryforwards) prior to their utilization because, in the opinion of management, it is more likely than not that some or all of the benefits will not be realized. The change in the valuation allowance was \$39.6 million, \$13.1 million, \$15.2 million, and \$0.5 million for the years ended December 31, 2003 and 2002, the eleven months ended December 31, 2001, and the one month ended January 31, 2001, respectively.

The Company is a member of an affiliated group that includes its parent company, Transocean Holdings Inc. (THH), which files a consolidated United States tax return. The Company's tax provision, including the deferred taxes reflected above, is computed as if it were a stand alone entity.

Recapitalizations of Reading & Bates Corporation (R&B) in 1989 and 1991, the merger of R&B and Falcon Drilling Company, Inc. in 1997 and the Transocean Merger in 2001 resulted in ownership changes for federal income tax purposes. As a result of these ownership changes, the amount of tax benefit carryforwards generated prior to the ownership changes, which may be utilized to offset federal taxable income, is limited

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by the Internal Revenue Code. The amount of consolidated United States net tax operating loss carryforwards (NOLs) allocated to the Company and available after consideration of the ownership change limitation was approximately \$1.2 billion as of December 31, 2003, before adjustments to these NOLs for the impact of discontinued operations. These NOLs expire in years 2004 through 2023.

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There were no NOLs utilized for the years ended December 31, 2003 and 2002, the eleven months ended December 31, 2001 and the one month ended January 31, 2001.

There was no income tax effect on the cumulative effect of a change in accounting principle relating to the adoption of FIN 46 in 2003 or the adoption of SFAS 142 in 2002. See Note 2.

In conjunction with the closing of the Company's initial public offering, the Company entered into a tax sharing agreement with Transocean that has a significant effect on the Company's ability to utilize the majority of its tax benefits included in the Company's consolidated financial statements at December 31, 2003. See Note 24.

Note 13 Commitments and Contingencies

Operating Leases The Company has operating leases covering premises and equipment. Certain operating leases contain renewal options. Lease expense was \$13.8 million, \$15.3 million, \$17.1 million, and \$1.7 million for the years ended December 31, 2003 and 2002, the eleven months ended December 31, 2001 and the one month ended January 31, 2001, respectively. As of December 31, 2003, future minimum lease payments relating to operating leases were as follows (in millions):

	<u>Years Ended December 31,</u>
2004	\$ 1.9
2005	1.0
2006	0.9
2007	0.6
2008	0.6
Thereafter	0.6
	—
Total	<u>\$ 5.6</u>

Litigation In March 1997, an action was filed by Mobil Exploration and Producing U.S. Inc. and affiliates, St. Mary Land & Exploration Company and affiliates and Samuel Geary and Associates, Inc. against a subsidiary of the Company, Cliffs Drilling, its underwriters at Lloyd's (the Underwriters) and an insurance broker in the 16th Judicial District Court of St. Mary Parish, Louisiana. The plaintiffs alleged damages amounting to in excess of \$50 million in connection with the drilling of a turnkey well in 1995 and 1996. The case was tried before a jury in January and February 2000, and the jury returned a verdict of approximately \$30 million in favor of the plaintiffs for excess drilling costs, loss of insurance proceeds, loss of hydrocarbons, expenses and interest. The Company and the Underwriters appealed such judgment, and the Louisiana Court of Appeals has reduced the amount for which the Company may be responsible to less than \$10 million. The plaintiffs requested that the Supreme Court of Louisiana consider the matter and reinstate the original verdict. The Company and the Underwriters also appealed to the Supreme Court of Louisiana requesting that the Court reduce the verdict or, in the case of the Underwriters, eliminate any liability for the verdict. Prior to the Supreme Court of Louisiana ruling on these petitions, the Company settled with the St. Mary group of plaintiffs and the State of Louisiana. Subsequently, the Supreme Court of Louisiana denied the applications of all remaining parties. The Company has settled with all remaining plaintiffs. The Company believes that any amounts, apart from a small deductible, paid in settlement are covered by relevant primary and excess liability insurance policies. However, the insurers and Underwriters have denied all coverage. The Company has instituted litigation against those insurers and Underwriters to enforce its rights under the relevant policies. One group of insurers has asserted a counterclaim against the Company claiming that they issued the policy as a result of a misrepresentation. The settlements did not have a material adverse effect on the Company's business or consolidated financial position, and the Company does not expect the ultimate

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

outcome of the case involving the insurers and Underwriters will have a material adverse effect on its business or consolidated financial position. In connection with the Company's separation from Transocean, Transocean has agreed to indemnify the Company of any losses it incurs as a result of this legal proceeding. See Note 24.

In October 2001, the Company was notified by the U.S. Environmental Protection Agency (EPA) that the EPA had identified a subsidiary of the Company as a potentially responsible party in connection with the Palmer Barge Line superfund site located in Port Arthur, Jefferson County, Texas. Based upon the information provided by the EPA and the Company's review of its internal records to date, the Company disputes its designation as a potentially responsible party and does not expect that the ultimate outcome of this case will have a material adverse effect on its business or consolidated financial position. The Company continues to investigate the matter.

In December 2002, the Company received an assessment for corporate income taxes in Venezuela of approximately \$16.0 million (based on current exchange rates) relating to calendar years 1998 through 2000. In March 2003 the Company paid approximately \$2.6 million of the assessment, and the Company is contesting the remainder of the assessment. The resolution of this assessment is not expected to impact the Company as Transocean has agreed to indemnify the Company against any payments as long as it cooperates and provides assistance to Transocean in resolution of the assessment.

In 1984, in connection with the financing of the corporate headquarters, at that time, for R&B, a predecessor to one of our subsidiaries, in Tulsa, Oklahoma, the Greater Southwestern Funding Corporation (Southwestern) issued and sold, among other instruments, Zero Coupon Series B Bonds due 1999 through 2009 with an aggregate \$189 million value at maturity. Paine Webber Incorporated purchased all of the Series B Bonds for resale and in 1985 acted as underwriter in the public offering of most of these bonds. The proceeds from the sale of the bonds were used to finance the acquisition and construction of the headquarters. R&B's rental obligation was the primary source for repayment of the bonds. In connection with the offering, R&B entered into an indemnification agreement to indemnify Southwestern and Paine Webber from loss caused by any untrue statement or alleged untrue statement of a material fact or the omission or alleged omission of a material fact contained or required to be contained in the prospectus or registration statement relating to that offering. Several years after the offering, R&B defaulted on its lease obligations, which led to a default by Southwestern. Several holders of Series B bonds filed an action in Tulsa, Oklahoma in 1997 against several parties, including Paine Webber, alleging fraud and misrepresentation in connection with the sale of the bonds. In response to a demand from Paine Webber in connection with that lawsuit and a related lawsuit, R&B agreed in 1997 to retain counsel for Paine Webber with respect to only that part of the referenced cases relating to any alleged material misstatement or omission relating to R&B made in certain sections of the prospectus or registration statement. The agreement to retain counsel did not amend any rights and obligations under the indemnification agreement. There has been only limited progress on the substantive allegations in the case. The trial court has denied class certification, and the plaintiffs have appealed this denial to a higher court. The Company disputes that there are any matters requiring the Company to indemnify Paine Webber. In any event, the Company does not expect that the ultimate outcome of this matter will have a material adverse effect on its business or consolidated financial position. In addition, Transocean has agreed to indemnify the Company for any losses that may be incurred as a result of this litigation. See Note 24.

In April 2003, Gryphon Exploration Company (Gryphon) filed suit against some of the Company's subsidiaries, Transocean and other third parties in the United States District Court in Galveston, Texas claiming damages in excess of \$6 million. In its complaint, Gryphon alleges the defendants were responsible for well problems experienced by Gryphon with respect to a well in the Gulf of Mexico drilled by the Company's subsidiaries in 2001. The Company disputes the allegations of Gryphon and intends to vigorously defend this claim. While the Company continues to investigate this matter, the Company does not currently expect the ultimate outcome of this matter to have a material adverse effect on its business or consolidated

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financial position. In addition, Transocean has agreed to indemnify the Company for any losses that may be incurred as a result of this litigation. See Note 24.

The Company and its subsidiaries are involved in a number of other lawsuits, all of which have arisen in the ordinary course of the Company's business. The Company does not believe that ultimate liability, if any, resulting from any such other pending litigation will have a material adverse effect on its business or consolidated financial position.

The Company cannot predict with certainty the outcome or effect of any of the litigation matters specifically described above or of any such other pending litigation. There can be no assurance that the Company's belief or expectations as to the outcome or effect of any lawsuit or other litigation matter will prove correct and the eventual outcome of these matters could materially differ from management's current estimates.

Letters of Credit and Surety Bonds The Company had letters of credit outstanding at December 31, 2003 totaling \$0.7 million. These outstanding letters of credit guarantee performance against certain claims not related to the Company's Shallow Water business. Transocean has agreed to indemnify us against any liabilities unrelated to the Shallow Water business. See Note 24.

As is customary in the contract drilling business, the Company also has various surety bonds totaling \$13.4 million in place as of December 31, 2003 that secure customs obligations and certain performance and other obligations.

Self-Insurance The Company is self-insured for the deductible portion of its insurance coverage. In the opinion of management, adequate accruals have been made based on known and estimated exposures up to the deductible portion of the Company's insurance coverages.

Employment Agreements In July 2002, the Company entered into employment agreements with two employees to serve as the Company's President and Chief Executive Officer (CEO) and Senior Vice President and Chief Financial Officer at the closing of the initial public offering. The agreements, which were amended in December 2003, provide for specified compensation and benefits including stock option awards, and in the case of the CEO, a restricted stock award upon closing of the initial public offering and other incentives that may be included in the Company's incentive plans to be adopted by the Company's board of directors prior to the closing of the initial public offering.

Note 14 Capital Stock

During the one month ended January 31, 2001 the Company issued 28,126 shares of common stock for its matching contribution to the employee savings plans.

In February 2004, the Company amended its articles 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. The Class B common stock is convertible at any time into shares of Class A common stock on a share per share basis at the sole option of Transocean.

In February 2004, prior to the Company's IPO, the Company completed debt-for-equity exchanges for approximately \$488.1 million principal amount of its senior notes payable to Transocean (see Note 24).

Immediately following the debt-for-equity exchanges, the Company declared a dividend of 11.145 shares of its Class B common stock with respect to each share of its Class B common stock outstanding immediately following the debt-for-equity exchanges. The stock dividend of 11.145 shares of Class B common stock for

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

each outstanding share of Class B common stock has been retroactively applied to the 1,000,000 shares of common stock held by Transocean prior to the debt-for-equity exchanges and has been reflected in the Company's historical consolidated financial statements since January 31, 2001, the date of the Transocean Merger. The effect of this retroactive application was to increase the authorized common shares of the Company's Class B common stock to 260,000,000 shares and issued and outstanding to 12,144,751 shares for all periods presented with a corresponding decrease to additional paid-in capital. The effect of the debt-for-equity exchanges and the stock dividend on such newly issued shares of common stock will be reflected in the first quarter of 2004.

In February 2004, the Company completed the IPO of its Class A common shares at \$12.00 per share. See Note 24.

Note 15 Stock-Based Compensation Plans

Stock Plans Prior to the Transocean Merger, the Company had 17 stock plans (the Incentive Plans) intended to provide an incentive that would allow the Company to retain persons of the training, experience and ability necessary for the development and financial success of the Company. Such plans provided for grants of stock options, stock appreciation rights, stock awards and cash awards, which could be granted singly, in combination or in tandem. All stock options awarded under these plans expire 10 years from the date of their grant and were granted at the market price on the date of grant unless otherwise noted. As a result of the Transocean Merger, Transocean assumed all outstanding R&B Falcon stock options, which were converted into options to purchase Transocean ordinary shares. All options and restricted stock granted prior to announcement of the Transocean Merger were early vested in January 2001. See Note 4.

The Company's 1998 Employee Long-Term Incentive Plan authorized 3.2 million shares of common stock to be available for awards. In 1998, restricted stock awards with respect to 941,500 shares were granted to certain employees of the Company. The transfer of these awarded shares was restricted until fully vested three years from the date of grant. The market value at the date of grant of the restricted common stock was recorded as unearned compensation and was amortized to expense based on a three-year vesting period.

The Company's 1999 Employee Long-Term Incentive Plan authorized 6.5 million shares of common stock to be available for awards. In 2000, restricted stock awards with respect to 137,350 shares were granted to certain employees of the Company. The transfer of these awarded shares was restricted until fully vested four years from the date of grant. The market value at the date of grant of the restricted common stock was recorded as unearned compensation and was amortized to expense based on a four-year vesting period.

Unearned compensation relating to the Company's restricted stock awards was shown as a reduction of stockholders' equity. All unvested restricted stock was vested in January 2001 as a result of the Transocean Merger. Compensation expense recognized for the one month ended January 31, 2001 related to stock awards totaled approximately \$4.1 million.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Stock option transactions under the plans were as follows:

	Number of Shares Under Option	Weighted-Average Exercise Price
Pre-Transocean Merger R&B Falcon Corporation Options		
Options outstanding at December 31, 2000	16,154,272	\$ 11.15
Granted	88,440	23.44
Exercised	(48,612)	21.92
Forfeited	(6,080)	15.27
	<hr/>	
Options outstanding at January 31, 2001	16,188,020	11.13
	<hr/>	
Post-Transocean Merger Transocean Options		
Conversion to Transocean options	(8,094,010)	11.13
Granted	392,800	38.07
Exercised	(1,005,035)	20.07
Forfeited	(30,289)	51.92
	<hr/>	
Transocean options outstanding at December 31, 2001	7,451,486	23.46
Granted	354,050	28.80
Exercised	(92,450)	34.26
Forfeited	(49,900)	46.30
	<hr/>	
Transocean options outstanding at December 31, 2002	7,663,186	23.62
Assumed by Transocean	(6,781,561)	22.69
Transferred to TODCO	55,987	32.39
Forfeited	(60,914)	37.33
	<hr/>	
Transocean options outstanding at December 31, 2003	876,698	\$ 30.40
	<hr/>	
Post-Transocean Merger Transocean Options		
Exercisable at December 31, 2001	6,955,284	\$ 22.19
Exercisable at December 31, 2002	7,027,665	\$ 22.68
Exercisable at December 31, 2003	761,299	\$ 30.11

During 2003, in connection with the transfer of the Transocean Assets to Transocean, certain of the Company's employees not associated with the Company's Shallow Water business became employees of Transocean, and Transocean assumed any future expense relating to the vesting of the options held by these employees. Additionally, certain former Transocean employees became employees of the Company. The Company assumed any future expense relating to the vesting of options held by these former Transocean employees.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes information about Transocean stock options held by employees of the Company at December 31, 2003:

Range of Exercise Prices	Weighted-Average Remaining Contractual Life	Options Outstanding		Options Exercisable	
		Number Outstanding	Weighted-Average Exercise Price	Number Outstanding	Weighted-Average Exercise Price
\$10.00-\$19.50	5.97 years	278,051	\$ 18.46	278,051	\$ 18.46
\$21.06-\$28.80	7.91 years	265,364	\$ 27.19	192,864	\$ 26.59
\$37.00-\$81.78	7.79 years	333,283	\$ 42.91	290,384	\$ 43.59

The Company accounted for these plans under APB 25 under which no compensation expense was recognized for options granted with an exercise price at or above the market price of the Company's common stock. See Note 2.

In connection with the Company's initial public offering in February 2004 all outstanding Transocean options became fully-vested. See Note 24.

Note 16 Retirement Plans and Other Post Employment Benefits

Pension and Postretirement Benefits The Company had three noncontributory pension plans prior to the Transocean Merger. One or more of these plans covered substantially all of the R&B Falcon employees paid from a U.S. payroll. Plan benefits were primarily based on years of service and average high 60-month compensation.

The R&B Falcon U.S. Pension Plan (the U.S. Pension Plan) is qualified under the Employee Retirement Income Security Act (ERISA). The R&B Falcon Non-U.S. Pension Plan (the Non-U.S. Pension Plan) is a nonqualified plan and is not subject to ERISA funding requirements. The R&B Falcon Retirement Benefit Replacement Plan (the Replacement Plan) is a self-administered unfunded excess benefit plan. All members of the U.S. Pension Plan are potential participants in the Replacement Plan.

In addition to providing pension benefits, the Company provided certain life and health care insurance benefits for its retired employees. Effective January 1, 1999, the Company no longer provides a retiree life insurance plan to its current employees. Only those former employees who retired prior to May 1, 1986 were eligible to retain their retiree life insurance. Retiree life insurance benefits are provided through an insurance company whose premiums are based on benefits paid during the year. Retiree health coverage was also significantly restricted effective January 1, 1999. Effective August 1, 2002, all retiree medical coverage and retiree life insurance for former R&B Falcon employees were transferred to plans maintained by THI, the Company's parent.

Effective August 1, 2002, THI became the plan sponsor for the U.S. Pension Plan, the Non-U.S. Pension Plan and the Replacement Plan and assumed all liabilities related to these plans. The Company recorded a net distribution to THI of the prepaid (accrued) cost relating to these plans and the postretirement benefit plans. In conjunction with the change in the plan sponsor, the plans were renamed the Transocean Holdings U.S. Pension Plan (formerly R&B Falcon U.S. Pension Plan), the Transocean Holdings Non-U.S. Pension Plan (formerly R&B Falcon Non-U.S. Pension) and the Transocean Holdings Replacement Plan (formerly R&B Falcon Replacement Plan).

Savings Plans The Company had two savings plans that allowed employees to contribute up to 15 percent of their base salary (subject to certain limitations). Under these plans, the Company made matching contributions to equal 100 percent of employee contributions on the first 6 percent of their base salary. From July 1, 1999 through the date of the Transocean Merger, the Company made its matching

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

contributions in the form of issuing shares of R&B Falcon common stock. Certain of the Company's employees were allowed to begin participation in the Transocean U.S. Savings Plan (formerly, Transocean Sedco Forex Savings Plan) on June 1, 2001, July 1, 2001 or August 1, 2001 based on their assignment and geographic location. Effective August 1, 2001 and in conjunction with eligible employee participation in the Transocean U.S. Savings Plan, the R&B Falcon U.S. Savings Plan and the R&B Falcon Non-U.S. Savings Plan were closed to all new participants and contributions into the plans ceased. Participants continued to direct the investment of their accumulated contributions into various plan investment options. Effective August 1, 2002, THI became the plan sponsor for the R&B Falcon Non-U.S. Savings Plan, which was renamed the Transocean Holdings Non-U.S. Savings Plan.

Effective November 1, 2002, the Transocean U.S. Savings Plan was amended and the Company's Shallow Water employees were restricted from participation in this Plan. Effective December 1, 2002, all savings plan assets of the employees were liquidated and transferred from the Transocean U.S. Savings Plan into the R&B Falcon U.S. Savings Plan. Additionally, all savings plan assets in the R&B Falcon U.S. Savings Plan of active former R&B Falcon employees who were not assigned to the Shallow Water operations were liquidated and transferred into the Transocean U.S. Savings Plan. The R&B Falcon U.S. Savings Plan has also been amended and restated effective January 1, 2003.

Compensation costs under the plans amounted to \$2.6 million, \$1.6 million, \$0.1 million and \$0.1 million for the years ended December 31, 2003 and 2002, the eleven months ended December 31, 2001, and the one month ended January 31, 2001, respectively.

Note 17 Investments in and Advances to Joint Ventures

Investments in and advances to unconsolidated joint ventures were as follows (in millions):

	Post-Transocean Merger	
	December 31,	
	2003	2002
Delta Towing	\$	\$78.7
Other	0.1	1.0
	\$0.1	\$79.7

Equity in earnings (losses) of joint ventures consisted of the following (in millions):

	Post-Transocean Merger			Pre-Transocean Merger
	Year Ended December 31, 2003	Year Ended December 31, 2002	Eleven Months Ended December 31, 2001	One Month Ended January 31, 2001
Delta Towing	\$(6.6)	\$(3.2)	\$(0.9)	\$
Other	—	0.5	—	—
	\$(6.6)	\$(2.7)	\$(0.9)	\$



Delta Towing The Company owns a 25 percent equity interest in 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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

with a face value of \$144.0 million. The Company valued these notes at \$80.0 million immediately prior to the closing of the merger transaction with Transocean. No value was assigned to the ownership interest in Delta Towing. The note agreement was subsequently amended to provide for a \$4.0 million, three-year revolving credit facility. Delta Towing's property and equipment, with a net book value of \$50.6 million at December 31, 2003, are collateral for the Company's notes receivable. The carrying value of the notes receivable, net of allowance for credit losses and equity losses in Delta Towing was \$49.0 million at December 31, 2003 and has been eliminated in consolidation. The remaining 75 percent ownership interest is held by Beta Marine, which also loaned Delta Towing \$3.0 million.

In the first quarter of 2003, the Company recorded its share of a \$2.5 million non-cash impairment charge on the carrying value of idle equipment recorded by Delta Towing. In December 2003, the Company recorded a non-cash impairment charge of \$1.9 million as a result of Delta Towing's annual test of impairment of long-lived assets, which is included in equity in loss of joint ventures in our consolidated statement of operations.

Under FIN 46, Delta Towing is considered a VIE because its equity is not sufficient to absorb the joint venture's expected future losses. The Company is 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 consolidated Delta Towing in its December 31, 2003 consolidated financial statements. The consolidation of Delta Towing resulted in an increase in net assets and a corresponding gain of \$0.8 million which has been presented as a cumulative effect of a change in accounting principle in the consolidated statement of operations. Prior to December 31, 2003, the Company accounted for its investment in Delta Towing under the equity method.

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

Note 18 Related Party Transactions

Delta Towing The secured notes issued in connection with the formation of the joint venture consisted of (i) an \$80 million principal amount note bearing interest at eight percent per annum due January 30, 2024 (the Tier 1 Note), (ii) a contingent \$20 million principal amount note bearing interest at eight percent per annum with an expiration date of January 30, 2011 (the Tier 2 Note) and (iii) a contingent \$44 million principal amount note bearing interest at eight percent per annum with an expiration date of January 30, 2011 (the Tier 3 Note). The 75 percent equity interest holder in the joint venture also loaned Delta Towing \$3 million in the form of a Tier 1 Note. Until January 2011, Delta Towing must use 100 percent of its excess cash flow towards the payment of principal and interest on the Tier 1 Notes. After January 2011, 50 percent of its excess cash flows are to be applied towards the payment of principal and unpaid interest on the Tier 1 Notes. Interest is due and payable quarterly without regard to excess cash flow.

Delta Towing must repay at least (i) \$8.3 million of the aggregate principal amount of the Tier 1 Note no later than January 2004, (ii) \$24.9 million of the aggregate principal amount no later than January 2006, and (iii) \$62.3 million of the aggregate principal amount no later than January 2008. After the Tier 1 Note has been repaid, Delta Towing must apply 75 percent of its excess cash flow towards payment of the Tier 2 Note. Upon the repayment of the Tier 2 Note, Delta Towing must apply 50 percent of its excess cash to repay principal and interest on the Tier 3 Note. Any amounts not yet due under the Tier 2 and Tier 3 Notes at the time of their expiration will be waived. The Tier 1, 2 and 3 Notes are secured by mortgages and liens on the vessels and other assets of Delta Towing. See Note 24.

The Company valued its Tier 1, 2 and 3 Notes at \$80 million immediately prior to the closing of the Transocean Merger, the effect of which was to fully reserve the Tier 2 and 3 Notes. At December 31, 2002, \$78.7 million principal amount was outstanding under the Company's Tier 1 Note. In December 2001, the note agreement was amended to provide for a \$4 million, three-year revolving credit facility (the Delta

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Towing Revolver) from the Company. Amounts drawn under the Delta Towing Revolver accrue interest at eight percent per annum, with interest payable quarterly. At December 31, 2002, \$3.9 million was outstanding under the Delta Towing Revolver. During the years ended December 31, 2003 and 2002 and the eleven months ended December 31, 2001, the Company earned \$3.3 million, \$6.6 million and \$5.8 million of interest income on the Delta Towing Tier 1 Note and Revolver, respectively. At December 31, 2002, the Company had interest receivable from Delta Towing of \$1.7 million.

As a result of its issuance of notes to the Company, Delta Towing is highly leveraged. In January 2003, Delta Towing defaulted on the notes by failing to make its scheduled quarterly interest payments and remains in default as a result of its continued failure to make its quarterly interest payments. As a result of the Company's continued evaluation of the collectibility of the notes, the Company recorded a \$21.3 million impairment of the notes in June 2003 based on Delta Towing's discounted cash flows over the terms of the notes, which deteriorated in the second quarter of 2003 as a result of the continued decline in Delta Towing's business outlook. As permitted in the notes in the event of default, the Company began offsetting a portion of the amount owed by the Company to Delta Towing against the interest due under the notes. Additionally, in 2003, the Company established a \$1.6 million reserve for interest income earned during the year on the notes receivable.

As a result of the Company's adoption of FIN 46, the Company consolidated Delta Towing effective December 31, 2003 and intercompany accounts have been eliminated. See Note 17.

As part of the formation of the joint venture on January 31, 2001, the Company entered into an agreement with Delta Towing under which the Company committed to charter certain vessels for a period of one year ending January 31, 2002 and committed to charter for a period of 2.5 years from the date of delivery 10 crewboats then under construction, all of which had been placed into service as of December 31, 2002. During the years ended December 31, 2003 and 2002, the Company incurred charges totaling \$11.7 million, \$10.7 million from Delta Towing for services rendered, of which \$1.6 million was rebilled to the Company's customers and \$9.1 million was reflected in operating and maintenance-related party expense in 2002. During the eleven months ended December 31, 2001, the Company incurred charges totaling \$15.6 million from Delta Towing for services rendered, of which \$6.5 million was rebilled to the Company's customers and \$9.1 million was reflected in operating and maintenance-related party expense.

Allocation of Administrative Costs Subsidiaries of Transocean provide certain administrative support to the Company. Transocean charges the Company a proportional share of its administrative costs based on estimates of the percentage of work the individual Transocean departments perform for the Company. In the opinion of management, Transocean is charging the Company for all costs incurred on its behalf under a comprehensive and reasonable cost allocation method. The amount of expense allocated to the Company for the years ended December 31, 2003 and 2002 and the eleven months ended December 31, 2001 was \$1.4 million, \$9.7 million and \$2.0 million, respectively. These allocated expenses were classified as general and administrative-related party expense.

Note Receivable - Related Party As consideration for the sale of the *Harvey H. Ward* and the *Roger W. Mowell* to Transocean in April 2002 (Note 23), the Company received promissory notes due April 3, 2012 bearing interest at 5.5 percent per annum payable annually in the aggregate principal amount of \$93.0 million. The notes may be repaid at any time at Transocean's option, without penalty. For the year ended December 31, 2002, the Company accrued \$3.6 million in interest income relating to the notes. In December 2002, Transocean repaid to the Company the \$93.0 million aggregate principal amount of promissory notes plus accrued and unpaid interest.

In August 2001, as consideration for the sale of certain drilling rigs to Transocean, \$1,190.0 million of debt owed by the Company to Transocean was canceled. In addition, the Company received promissory notes due August 17, 2011 bearing interest at 5.72 percent per annum payable annually in the aggregate principal

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

amount of \$425.0 million. The notes may be repaid at any time at Transocean's option, without penalty. For the year ended December 31, 2002 and for the eleven months ended December 31, 2001, the Company had accrued \$23.4 million and \$9.1 million, respectively, in interest income relating to these promissory notes. In December 2002, Transocean repaid the \$425.0 million aggregate principal amount of promissory notes plus accrued and unpaid interest.

Transfer of Transocean Assets The Company sold and/or distributed the Transocean Assets to Transocean primarily as in-kind dividends and transfers in exchange for the cancellation of debt to Transocean, and in some instances, for cash. See Note 23.

Note 19 Segments, Geographical Analysis and Major Customers

The Company's operating assets consist of jackup and submersible drilling rigs and inland drilling barges and a platform rig located in the U.S. Gulf of Mexico and Trinidad, two jackup drilling rigs in Mexico, as well as land and lake barge drilling units located in Venezuela. We provide contract oil and gas drilling services and report the results of those operations in three business segments which correspond to our principal geographic regions in which we operate: U.S. Inland Barge Segment, U.S. Gulf of Mexico Segment and Other International Segment. The accounting policies of the reportable segments are the same as those described in Note 1.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Revenue, depreciation and amortization, impairment loss, operating income (loss) and identifiable assets by reportable business segment was as follows (in millions):

	U.S. Gulf of Mexico Segment	U.S. Inland Barge Segment	Other International Segment	Corporate & Other ^(a)	Total
Post-Transocean Merger					
2003					
Revenues	\$ 101.2	\$ 84.2	\$ 42.3	\$	\$ 227.7
Depreciation and amortization	55.3	23.3	13.6		92.2
Impairment loss on long-lived assets	10.6		0.7		11.3
Operating loss	(63.2)	(34.5)	(4.7)	(16.3)	(118.7)
Identifiable assets	334.6	170.4	171.3	101.9	778.2
2002					
Revenues	\$ 65.7	\$ 87.5	\$ 34.6	\$	\$ 187.8
Depreciation and amortization	58.1	23.3	10.5		91.9
Impairment loss on long-lived assets	1.1		16.4		17.5
Impairment loss on goodwill				381.9	381.9
Operating loss	(80.7)	(2.3)	(23.3)	(410.8)	(517.1)
Identifiable assets	447.8	210.6	103.3	1,465.5	2,227.2
Eleven-months ended December 31,					
2001					
Revenues	\$ 218.6	\$ 159.1	\$ 63.3	\$	\$ 441.0
Depreciation and amortization	63.3	220	11.2	42.9	139.4
Impairment loss on long-lived assets			1.1		1.1
Operating gain (loss)	26.9	52.2	(2.4)	(62.3)	14.4
Identifiable assets	508.1	240.4	155.1	7,935.2	8,838.8
Pre-Transocean Merger					
One-month ended January 31, 2001					
Revenues	\$ 26.0	\$ 13.8	\$ 8.7	\$	\$ 48.5
Depreciation and amortization	2.9	1.1	2.3	0.2	6.5
Impairment loss on long-lived assets				64.0	64.0
Operating income (loss)	15.4	4.5	(0.5)	(125.0)	(105.6)

- (a) Includes general and administrative expenses and impairment charges which were not allocated to a reportable segment. Identifiable assets include assets related to discontinued operations of \$0.1 million, \$995.5 million and \$5,446.9 million at December 31, 2003, 2002 and 2001, respectively, as well as assets related to the Delta Towing business of \$63.5 million at December 31, 2003. Goodwill in the amount of \$425.0 million at December 31, 2001 has not been allocated to the reportable segments. Such goodwill was fully impaired in 2002. See Note 2.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company provides contract oil and gas drilling services with different types of drilling equipment in several countries. Geographic information about the Company's operations was as follows (in millions):

	Post-Transocean Merger			Pre-Transocean Merger
	Year Ended December 31, 2003	Year Ended December 31, 2002	Eleven Months Ended December 31, 2001	One Month Ended January 31, 2001
Operating Revenues				
United States	\$ 185.4	\$ 153.9	\$ 383.2	\$ 42.9
Other countries	42.3	33.9	57.8	5.6
Total operating revenues	\$ 227.7	\$ 187.8	\$ 441.0	\$ 48.5
			Post-Transocean Merger	
			December 31,	
			2003	2002
Long-Lived Assets				
United States			\$ 542.5	\$ 727.5
Other countries			150.1	80.2

A substantial portion of the Company's assets are mobile. Asset locations at the end of the period are not necessarily indicative of the geographic distribution of the earnings generated by such assets during the periods.

The Company's international operations are subject to certain political and other uncertainties, including risks of war and civil disturbances (or other events that disrupt markets), expropriation of equipment, repatriation of income or capital, taxation policies, and the general hazards associated with certain areas in which operations are conducted.

The Company provides drilling rigs, related equipment and work crews primarily on a dayrate basis to customers who are drilling oil and gas wells. The Company provides these services mostly to independent oil and gas companies, but it also services major international and government-controlled oil and gas companies. In 2003, one customer, Applied Drilling Technologies, Inc., accounted for 11 percent of the Company's total operating revenue for the year. No other customer accounted for 10 percent or more of the Company's total operating revenues in 2003. For the years ended 2002 and 2001, no single customer accounted for 10 percent or more of the Company's total operating revenues in the respective periods. The loss of any significant customer could have a material adverse effect on the Company's results of operations.

Note 20 Restructuring Expense

In September 2002, the Company committed to a restructuring plan to consolidate certain functions and offices. The plan resulted in the closure of an office and warehouse in Louisiana and relocation of most of the operations and administrative functions previously conducted at that location. The Company established a liability of \$1.2 million for the estimated severance-related costs associated with the involuntary termination of 57 employees pursuant to this plan. The charge was reported as operating and maintenance expense in the Company's consolidated statements of operations. As of December 31, 2003 substantially all of the previously established liability was paid to the 50

employees whose employment was terminated as a result of this plan.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 21 Earnings Per Share

Incremental shares related to stock options, restricted stock grants and warrants are not included in the calculation of adjusted weighted-average shares and assumed conversions for diluted earnings per share because the effect of including those shares is anti-dilutive for the one month ended January 31, 2001.

Note 22 Quarterly Results (Unaudited)

Summarized quarterly financial data for the years ended December 31, 2003 and 2002 are as follows (in millions, except per share amounts):

	Post-Transocean Merger			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2003				
Operating revenues	\$ 53.3	\$ 55.5	\$ 58.5	\$ 60.4
Operating loss ^(a)	(29.4)	(50.0)	(24.8)	(14.5)
Loss from continuing operations	(57.0)	(101.7)	(35.0)	(28.3)
Loss from discontinued operations	(30.9)	(34.1)		
Cumulative effect of a change in accounting principle				0.8
Net loss ^(b)	(87.9)	(135.8)	(35.0)	(27.5)
Net loss per common share				
Basic and diluted				
Net loss from continuing operations	(4.70)	(8.37)	(2.88)	(2.33)
Net loss from discontinued operations	(2.54)	(2.81)		
Cumulative effect of a change in accounting principle				0.07
Net loss	\$(7.24)	\$(11.18)	\$(2.88)	\$(2.26)

	Post-Transocean Merger			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2002				
Operating revenues	\$ 44.7	\$ 37.1	\$ 54.0	\$ 52.0
Operating loss ^(c)	(37.6)	(33.9)	(39.0)	(406.6)
Loss from continuing operations	(37.1)	(32.2)	(36.5)	(423.3)
Income (loss) from discontinued operations	27.3	(0.5)	(570.1)	31.2
Cumulative effect of a change in accounting principle	(4,517.0)			
Net loss ^(d)	(4,526.8)	(32.7)	(606.6)	(392.1)
Net loss per common share				
Basic and diluted				
Net loss from continuing operations	(3.06)	(2.65)	(3.00)	(34.86)
Net income (loss) from discontinued operations	2.25	(0.04)	(46.94)	2.57
Cumulative effect of a change in accounting principle	(371.92)			
Net loss	\$(372.73)	\$(2.69)	\$(49.94)	\$(32.29)

(footnotes on following page)

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

- (a) First quarter of 2003 included a \$30.0 million loss on retirement of debt. Second quarter 2003 included an \$11.6 million impairment loss on long-lived assets, a \$21.3 million impairment loss on a note receivable from a then-unconsolidated joint venture and a \$49.5 (a) million loss on retirement of debt (see Notes 6 and 23).
- (b) Fourth quarter 2003 included a gain of \$0.8 million presented as a cumulative effect of a change in accounting principle as a result of the consolidation of Delta Towing (see Note 17).
- (c) First quarter 2002 included loss on impairments of \$1.1 million. Third quarter 2002 included loss on impairments of \$15.2 million. Fourth quarter 2002 included loss on impairments of (c) \$383.1 million. (See Note 10).
- (d) First quarter 2002 included a cumulative effect of a change in accounting principle of \$4,517.0 million (see Note 2) relating to the impairment of goodwill. Fourth quarter 2002 included loss on impairments of \$12.2 million relating to the early retirement of debt (see Note 6).

Note 23 Discontinued Operations

Operating revenues related to discontinued operations for the years ended December 31, 2003 and 2002, eleven months ended December 31, 2001, one month ended January 31, 2001 were \$53.4 million, \$658.3 million, \$758.8 million, and \$80.1 million, respectively.

A summary of assets and liabilities related to the discontinued operations as of December 31, 2003 and 2002 is as follows (in millions):

	December 31,	
	2003	2002
ASSETS		
Cash and cash equivalents	\$	\$ 103.6
Accounts receivable and other current assets	0.1	49.3
	—	—
Total current assets	0.1	152.9
	—	—
Property and equipment, net		775.5
Notes receivable		2.5
Investments in and advances to joint ventures		24.4
Other assets		40.2
	—	—
Total non-current assets		842.6
	—	—
Total assets	\$ 0.1	\$ 995.5
	—	—
LIABILITIES		
Accounts payable trade	\$ 0.2	\$ 18.2
Debt due within one year		41.5
Interest payable related party		5.7
Other current liabilities	0.3	37.2
	—	—
Total current liabilities	0.5	102.6
	—	—
Long-term liabilities		113.1
Minority interest		97.0

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Total non-current liabilities and other	—	210.1
Total liabilities	\$ 0.5	\$312.7
Net (liabilities) assets related to discontinued operations	\$(0.4)	\$682.8

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TODCO AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Transfer of Transocean Assets The Company transferred the Transocean Assets to Transocean in various transactions in various periods. The following is a summary of these transactions executed during 2003 and 2002:

In-Kind Distributions:

Twelve subsidiaries of the Company, Falcon Atlantic Ltd., R&B Falcon Drilling do Brasil, Ltda., R&B Falcon International Energy Services B.V., R&B Falcon B.V., R&B Falcon (M) Sdn. Bhd., RBF Rig Corporation LLC, Shore Services LLC, R&B Falcon Inc. LLC, R&B Falcon Canada Co., Transocean Offshore Drilling Services LLC, R&B Falcon (A) Pty. Ltd. and Cliffs Drilling do Brasil Servicos de Petroleo S/C Ltda, with an aggregate net book value of \$44.6 million and \$54.1 million, were distributed as in-kind dividends for no consideration to Transocean in 2003 and 2002, respectively. The transactions were recorded as decreases to additional paid-in capital. RBF Rig Corporation LLC owns the drilling rig *C. E. Thornton* and Transocean Offshore Drilling Services LLC owns the drilling rig *J. T. Angel*. R&B Falcon (A) Pty. Ltd. owns the drilling unit *Ron Tappmeyer*.

Nine drilling rigs, the *F. G. McClintock*, the *Peregrine III*, the *Charley Graves*, the *W. D. Kent*, *Land Rig 34*, the *J. W. McLean*, the *Randolph Yost*, the *D. R. Stewart* and the *George H. Galloway*, the operating lease for the *M. G. Hulme, Jr.* and certain other surplus assets with an aggregate net book value of \$278.8 million were distributed, in separate transactions, as in-kind dividends for no consideration to Transocean during 2002. The transactions were recorded as a decrease to additional paid-in capital.

Certain accounts receivable balances from related parties in the amount of \$200.9 million were distributed to Transocean as an in-kind dividend for no consideration in 2003. The transaction was recorded as a decrease to additional paid-in capital.

Net deferred tax assets of \$45.2 million related to the distributions and sales of rigs, subsidiaries and certain assets were distributed as in-kind dividends for no consideration to Transocean in 2002. The transactions were recorded as a reduction to additional paid-in capital.

The prepaid (accrued) costs related to the Company's defined benefit pension plans and retiree life and medical insurance plans with a net book value of \$5.3 million were distributed as an in-kind dividend for no consideration to Transocean in 2002. The transaction was recorded as a decrease to additional paid-in capital. See Note 16.

A 12.5 percent undivided interest in an aircraft was assigned to Transocean for no consideration in 2003. The net book value of \$1.0 million was recorded as a decrease to additional paid-in capital.

Miscellaneous Transocean Assets with a value of \$1.4 million were distributed to Transocean in 2003. The transaction was recorded as a decrease to additional paid-in capital.

Sales:

The Company sold to Transocean the stock of Arcade Drilling AS, a subsidiary that owns and operates the *Paul B. Loyd, Jr.* and owns the *Henry Goodrich*, for net proceeds of \$264.1 million and recorded a net pre-tax loss of \$11.0 million. The sales transaction was at fair value determined based on an independent third party appraisal, which is included in the results of discontinued operations. In consideration for the sale of the subsidiary, Transocean cancelled \$233.3 million principal amount of the Company's 6.95% notes due April 2008. The market value attributable to the notes, 113.21 percent of the principal amount, was based on an independent third party appraisal. The Company

TODCO AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

recorded a net pre-tax loss of approximately \$30.0 million in 2003 related to the retirement of these notes. See Note 6.

The Company sold *Cliffs Platform Rig 1* to Transocean in consideration for the cancellation of \$13.9 million of the 6.95% Senior Notes held by Transocean. The Company recorded the excess of the sales price over the net book value of \$1.6 million as an increase to additional paid-in capital and a pre-tax loss on the retirement of debt of \$1.5 million in 2003. (See Note 6.)

In 2003, the Company sold to Transocean its 50 percent interest in Deepwater Drilling L.L.C. (DD LLC), which leases the drilling unit *Deepwater Pathfinder*, and its 60 percent interest in Deepwater Drilling II L.L.C. (DDII LLC), which leases the drilling unit *Deepwater Frontier*, in consideration for the cancellation of \$43.7 million principal amount of the Company's debt held by Transocean. The value of the Company's interests in DD LLC and DDII LLC was determined by Transocean based on a similar third party transaction. The Company recorded the excess of the sales price over the net book value of the membership interests of \$21.6 million as an increase to additional paid-in capital.

In 2003, the Company sold to Transocean its membership interests in its wholly-owned subsidiary, R&B Falcon Drilling (International & Deepwater) Inc. LLC, which owns: (1) the drilling unit *Jim Cunningham*; (2) all of the stock of R&B Falcon Deepwater (UK) Ltd., which has specified charter rights with respect to the drilling unit *Deepwater Nautilus*; (3) all of the stock of THE Exploration LLC, which is the issuer of the Class A1 Notes due May 2005 related to the drilling unit *Deepwater Nautilus*; (4) several dormant or near dormant subsidiaries; and (5) other miscellaneous assets. As consideration for the stock sold, Transocean cancelled \$238.8 million of the Company's outstanding debt held by Transocean. The sales transaction was based on a valuation by Transocean which takes into account valuations of the drilling units provided by R.S. Platou (U.S.A.) Inc. The Company recorded the excess of the net book value over the sales price of the membership interests of \$60.9 million as a loss on sale of assets, included in the results of discontinued operations and a pre-tax loss on the retirement of debt of \$48.0 million. See Note 6.

The Company sold, in separate transactions, the *Harvey H. Ward* and the *Roger W. Mowell* to Transocean for net proceeds of \$93.0 million during 2002. The sales transactions were at fair market value based on third party appraisals. In consideration for the sales of these drilling units, Transocean delivered promissory notes due April 3, 2012 bearing interest at 5.5 percent per annum payable annually in the aggregate principal amount of \$93.0 million. The excess of the sales price over the net book value of the rigs of \$5.4 million was recorded as additional paid-in capital. For the year ended December 31, 2002, the Company accrued \$3.6 million in interest income relating to the notes. In December 2002, Transocean repaid to the Company the \$93.0 million aggregate principal amount of the promissory notes plus accrued and unpaid interest.

Five subsidiaries of the Company, R&B Falcon (Ireland) Limited, RB Anton Limited, RB Astrid Limited, RB Mediterranean Limited and PT RBF Offshore Drilling, were sold in separate transactions during 2002, to Transocean for net proceeds of \$2.5 million. The sales prices of R&B Falcon (Ireland) Limited, RB Mediterranean Limited and PT RBF Offshore Drilling were determined by the Company based on internal valuations. The sales prices of RB Anton Limited and RB Astrid Limited were determined based on recommendations from a third party consulting firm that manages the assets held by these companies. The excess of the net proceeds over the net book value of the subsidiaries of \$1.2 million was recorded as additional paid-in capital.

TODCO AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Assignments:

The rights and obligations under a rig sharing agreement for the *Deepwater Millenium* and the drilling contracts for the *Deepwater Horizon* and the *Deepwater Discovery* were assigned for no consideration to Transocean in 2002.

The Company assigned to Transocean the drilling contracts for the drilling units *Deepwater Frontier* in 2003 and for the *Deepwater Navigator* and *Peregrine 1* in 2002 for no consideration.

Note 24 Subsequent Events (Unaudited)

Capital Stock Transactions and Retirement of Related Party Debt In February 2004, prior to the Company's IPO, the Company exchanged \$45,784,000 in principal amount of its outstanding 7.375% Senior Notes held by Transocean Holdings 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 the stock dividend discussed below). Immediately following this exchange the Company exchanged \$152,463,000 and \$289,793,000 principal amount of its outstanding 6.75% and 9.5% Senior Notes, respectively, held by Transocean 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 the 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. In connection with the exchange of related party debt for Class B common stock, the Company expensed \$1.9 million in deferred consent fees associated with these senior notes payable.

Immediately following the debt-for-equity exchanges, the Company declared a dividend of 11.145 shares of its Class B common stock with respect to each share of its Class B common stock outstanding immediately following the debt-for-equity exchanges.

The stock dividend of 11.145 shares of Class B common stock for each outstanding share of Class B common stock has been retroactively applied to the 1,000,000 shares of common stock held by Transocean prior to the debt-for-equity exchanges and has been reflected in the Company's historical consolidated financial statements since January 31, 2001, the date of the Transocean Merger. The effect of this retroactive application was to increase the authorized common shares of the Company's Class B common stock to 260,000,000 shares and issued and outstanding to 12,144,751 shares for all periods presented with a corresponding decrease to additional paid-in capital. The effect of the debt-for-equity exchanges and the stock dividend on such newly issued shares of common stock will be reflected in the first quarter of 2004.

As a result of the debt-for-equity exchanges and stock dividend, Transocean held an aggregate of 60,000,000 shares of Class B common stock prior to the closing of the IPO. A portion of these shares of Class B common stock was sold and converted into shares of Class A common stock in the IPO.

Initial Public Offering 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. Transocean currently owns 46,200,000 shares or 100 percent of the outstanding Class B common stock giving it 94 percent of the combined voting power of the Company's outstanding common stock due to the five votes per share of Class B common stock as compared to the one vote per share of Class A Common stock. Transocean does not own any of the Company's outstanding Class A common stock and has advised the Company that its current long-term intent is to dispose of the Company's Class B common stock owned by it.

Upon completion of the IPO, the Company entered into various agreements to complete the separation of the Shallow Water business 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

TODCO AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 13).

Under the tax sharing agreement, Transocean will indemnify the Company against substantially all pre-IPO income tax liabilities. However, the Company must pay Transocean for substantially all pre-closing income tax benefits utilized subsequent to the closing of the IPO. As of December 31, 2003, the Company had approximately \$450 million of pre-closing tax benefits subject to this obligation to reimburse Transocean. This amount includes approximately \$173 million of the tax benefits reflected in the Company's December 31, 2003 historical financial statements and additional tax benefits that we expect to result from the closing of the IPO, specified ownership changes, statutory allocations of tax benefits among Transocean Holdings' consolidated group members and other events. The tax sharing agreement also provides that if any person other than Transocean or its subsidiaries becomes the beneficial owner of greater than 50% of the total voting power of the Company's outstanding voting stock, it will be deemed to have utilized all of these pre-closing tax benefits, and the Company will be required to pay Transocean an amount for the deemed utilization of these tax benefits adjusted by a specified discount factor. If an acquisition of beneficial ownership had occurred on December 31, 2003, the estimated amount that the Company would have been required to pay to Transocean would have been approximately \$360 million.

Stock Based Compensation In February 2004, the Company adopted a long term incentive plan for certain employees and nonemployee directors of the Company in order to provide additional incentives through the grant of awards and to increase the personal stake of participants in the continued success of the Company (the Plan). The Plan provides for the grant of options to purchase shares of the Company's Class A common stock, restricted stock, deferred stock units, share appreciation rights, cash awards, supplemental payments to cover tax liabilities associated with the aforementioned types of awards, and performance awards. Most awards under the Plan vest over a three-year period. A maximum of 3,000,000 shares of the Company's Class A common stock has been reserved for issuance under the Plan.

In conjunction with the closing of the IPO, the Company granted shares of restricted stock and stock options to certain employees. Based upon the IPO price of \$12.00 per share, the value of these awards that the Company will recognize as compensation expense is approximately \$17.2 million, of which approximately \$6.5 million will be recognized in the first quarter of 2004. The remaining \$10.7 million of compensation expense will be recognized over the vesting period of the stock awards and options. The Company expects to recognize compensation expense related to these awards of \$4.2 million over the remainder of 2004, \$4.8 million in 2005 and \$1.7 million in 2006 and thereafter.

In addition, certain of the Company's employees hold options to acquire Transocean ordinary shares, which were granted prior to the IPO under the Transocean Incentive Plan (see Note 15). The employees holding these options were treated as terminated for the convenience of Transocean on the IPO date. As a result, these options became fully vested and will remain exercisable over the original contractual life. In connection with the modification of the options, the Company will recognize approximately \$1.5 million of additional compensation expense in the first quarter of 2004.

Delta Towing Tug Sale In March 2004, Delta Towing entered into an agreement to sell the *Goliath*, an offshore tug, for \$5.0 million, subject to satisfactory inspections and other customary closing conditions. The Company expects the sale to close in late March 2004 and result in a gain.

TODCO AND SUBSIDIARIES

SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS

	Balance at Beginning of Period	Additions		Deductions	Balance at End of Period
		Charged to Costs and Expenses	Charged to Other Accounts		
(In millions)					
Pre-Transocean Merger					
One Month Ended January 31, 2001					
Reserves and allowances deducted from asset accounts:					
Allowance for doubtful accounts receivable	\$6.5	\$0.1	\$	\$0.3(a)	\$6.3
Allowance for obsolete materials and supplies	0.7				0.7
Post-Transocean Merger					
Eleven Months Ended December 31, 2001					
Reserves and allowances deducted from asset accounts:					
Allowance for doubtful accounts receivable	6.3	4.2		1.7(a)	8.8
Allowance for obsolete materials and supplies	0.7			0.5(b)	0.2
Year Ended December 31, 2002					
Reserves and allowances deducted from asset accounts:					
Allowance for doubtful accounts receivable	8.8	4.1		6.2(a)	6.7
Allowance for obsolete materials and supplies	0.2			0.2(b)	
Year Ended December 31, 2003					
Reserves and allowances deducted from asset accounts:					
Allowance for doubtful accounts receivable	6.7	0.4	0.4(c)	2.5(a)	5.0
Allowance for obsolete materials and supplies	\$	\$0.3	\$	\$	\$0.3

(a) Uncollectible accounts receivable written off, net of recoveries.

(b) Amount is related to the sale of a rig and distribution of assets to a related party.

(c) Balance attributable to consolidation of Delta Towing at December 31, 2003.

Other schedules have been omitted either because they are not required or are not applicable, or because the required information is included in the consolidated financial statements or notes thereto.

TODCO AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2004	December 31, 2003
	(Unaudited)	
	(In millions, except share data)	
ASSETS		
Cash and cash equivalents	\$ 27.9	\$ 20.0
Accounts receivable, net		
Trade	55.4	52.3
Related party	11.0	0.9
Other	3.8	4.6
Materials and supplies, net	4.1	4.5
Deferred income taxes	14.6	
Other current assets	4.6	3.2
Current assets related to discontinued operations		0.1
	<u> </u>	<u> </u>
Total current assets	121.4	85.6
	<u> </u>	<u> </u>
Property and equipment	914.6	924.9
Less accumulated depreciation	303.3	264.0
	<u> </u>	<u> </u>
Property and equipment, net	611.3	660.9
	<u> </u>	<u> </u>
Other assets	24.0	31.7
	<u> </u>	<u> </u>
Total assets	\$ 756.7	\$ 778.2
	<u> </u>	<u> </u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Trade accounts payable	\$ 19.3	\$ 24.7
Accrued income taxes	10.7	11.1
Debt due within one year	7.8	1.2
Debt due within one year - related party	3.0	3.0
Interest payable - related party	0.2	4.3
Other current liabilities	35.4	43.4
Current liabilities related to discontinued operations	0.4	0.5
	<u> </u>	<u> </u>
Total current liabilities	76.8	88.2
	<u> </u>	<u> </u>
Long-term debt	17.0	25.6
Long-term debt - related party		522.0
Deferred income taxes	174.7	
Other long-term liabilities	3.6	4.7
	<u> </u>	<u> </u>
Total long-term liabilities	195.3	552.3
	<u> </u>	<u> </u>
Commitments and contingencies		
Preferred stock, \$0.01 par value, 50,000,000 shares authorized, none outstanding at June 30, 2004 and December 31, 2003		
	0.1	

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Common stock, Class A, \$0.01 par value, 500,000,000 shares authorized, 14,104,448 shares and 0 shares issued and outstanding at June 30, 2004 and December 31, 2003, respectively		
Common stock, Class B, \$0.01 par value, 260,000,000 shares authorized, 46,200,000 and 12,144,751 shares issued and outstanding at June 30, 2004 and December 31, 2003, respectively	0.5	0.1
Additional paid-in capital	6,516.0	6,136.3
Retained deficit	(6,028.4)	(5,998.7)
Unearned compensation	(3.6)	
	<u> </u>	<u> </u>
Total shareholders' equity	484.6	137.7
	<u> </u>	<u> </u>
Total liabilities and shareholders' equity	\$ 756.7	\$ 778.2
	<u> </u>	<u> </u>

See accompanying notes.

TODCO AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Six Months Ended June 30,	
	2004	2003
	(Unaudited) (In millions, except per share data)	
Operating Revenues	\$ 154.6	\$ 108.8
Costs and Expenses		
Operating and maintenance	128.0	116.2
Operating and maintenance related party		5.8
Depreciation	48.2	46.4
General and administrative	19.3	7.3
General and administrative related party	0.3	1.3
Impairment loss on long-lived assets		11.6
Gain on disposal of assets, net	(4.6)	(0.4)
	<u>191.2</u>	<u>188.2</u>
Operating Loss	(36.6)	(79.4)
Other Income (Expense), net		
Equity in loss of joint ventures		(2.6)
Interest income	0.1	0.4
Interest income related party		3.3
Interest expense	(2.0)	(1.6)
Interest expense related party	(3.2)	(26.6)
Loss on retirement of debt	(1.9)	(79.5)
Impairment of investment in and advance to joint venture		(21.3)
Other, net	0.6	(2.5)
	<u>(6.4)</u>	<u>(130.4)</u>
Loss from Continuing Operations Before Income Taxes	(43.0)	(209.8)
Income tax benefit	(13.3)	(51.0)
Minority interest		(0.1)
	<u>(29.7)</u>	<u>(158.7)</u>
Loss from Continuing Operations	(29.7)	(158.7)
Discontinued Operations:		
Income from operations of discontinued segment		(43.9)
Income tax expense		19.9
Minority interest		1.2
		<u>(22.8)</u>
Net loss from discontinued operations		(65.0)
Net Loss	<u>\$ (29.7)</u>	<u>\$ (223.7)</u>
Net Loss Per Common Share Basic and Diluted		
Continuing operations	\$ (0.58)	\$ (13.07)
Discontinued operations		(5.35)

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Net loss per common share basic and diluted	\$ (0.58)	\$(18.42)
Weighted Average Common Shares Outstanding:		
Basic and diluted	51.3	12.1

See accompanying notes.

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TODCO AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

	Six Months Ended June 30,	
	2004	2003
	(Unaudited) (In millions)	
Net loss	\$(29.7)	\$(223.7)
Other comprehensive income		
Change in share of unrealized income in unconsolidated joint venture s accumulated other comprehensive income, net of tax of \$0 and \$1.1, respectively		2.0
Other comprehensive income		2.0
Total comprehensive loss	\$(29.7)	\$(221.7)

See accompanying notes.

TODCO AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF EQUITY

	Common Stock				Additional Paid-in Capital	Retained Deficit	Unearned Compensation	Total Equity
	Class A		Class B					
	Shares	Amount	Shares	Amount				
					(Unaudited) (In millions)			
Balance at December 31, 2003		\$	12.1	\$ 0.1	\$6,136.3	\$ (5,998.7)	\$	\$ 137.7
Net loss						(29.7)		(29.7)
Debt for equity exchange			47.9	0.5	528.4			528.9
Conversion of common stock from Class B to Class A	13.8	0.1	(13.8)	(0.1)				
Distributions to parent					(173.7)			(173.7)
Equity contributions from parent					13.5			13.5
Issuance of restricted stock, net of forfeitures	0.3				4.4	(4.4)		
Stock options granted					7.1			7.1
Amortization of unearned compensation							0.8	0.8
Balance at June 30, 2004	14.1	\$0.1	46.2	\$ 0.5	\$6,516.0	\$ (6,028.4)	\$ (3.6)	\$ 484.6

See accompanying notes.

TODCO AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended June 30,	
	2004	2003
	(Unaudited) (In millions)	
Cash Flows from Operating Activities Continuing Operations and Discontinued Operations		
Net loss	\$(29.7)	\$(223.7)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation	48.2	56.7
Deferred income taxes	(13.6)	(34.9)
Stock-based compensation expense	9.4	
Equity in earnings of joint ventures		(2.9)
Net (gain) loss on disposal of assets	(4.6)	5.3
Impairment loss on long-lived assets		11.6
Amortization of debt issue costs	(0.2)	(3.1)
Deferred income, net	(6.7)	(13.9)
Deferred expenses, net	3.3	0.2
Loss on retirement of debt	1.9	79.5
Impairment of investment in and advance to joint venture		21.3
Changes in operating assets and liabilities, net of effect of distributions to related parties		
Accounts receivable, net	(2.1)	36.7
Accounts payable and other current liabilities	(6.2)	(24.8)
Accounts receivable/payable to related party, net	5.4	171.1
Income taxes receivable/payable, net	(0.4)	(3.7)
Other, net	0.2	1.6
Net cash provided by operating activities	4.9	77.0
Cash Flows from Investing Activities Continuing Operations and Discontinued Operations		
Capital expenditures	(4.8)	(5.1)
Proceeds from disposal of assets, net	9.7	74.4
Net cash provided by investing activities	4.9	69.3
Cash Flows from Financing Activities Continuing Operations and Discontinued Operations		
Net repayments of debt with related party		(54.0)
Repayments on other debt instruments		(78.8)
Cash of subsidiaries at distribution to affiliates		(103.9)
Other, net	(1.9)	1.1
Net cash used in financing activities	(1.9)	(235.6)
Net increase (decrease) in cash and cash equivalents	7.9	(89.3)
Cash and cash equivalents at beginning of period continuing operations and discontinued operations	20.0	102.9

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Cash and cash equivalents at end of period	_____	_____
continuing operations and discontinued operations	\$ 27.9	\$ 13.6
	_____	_____

See accompanying notes.

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TODCO AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1 Nature of Business and Principles of Consolidation

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. At June 30, 2004, the Company owned, had partial ownership interests in or operated 70 drilling rigs. As of this date, the Company s active fleet of drilling rigs consisted of 24 jackup rigs, 30 barge rigs, three submersible rigs and one platform rig, as well as nine land rigs and three lake barge rigs in Venezuela. The Company contracts its drilling rigs, related equipment and work crews primarily on a dayrate basis to drill oil and natural gas wells.

Effective January 31, 2001, a merger transaction between the Company and Transocean Inc. (Transocean) was completed (the Transocean Merger). A change of control occurred and the Company became an indirect wholly owned subsidiary of Transocean.

In July 2002, 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 Transocean Assets. Accordingly, the Transocean Assets and related operations have been reflected as discontinued operations in the Company s historical financial statements and notes thereto. The Company s historical financial statements and the notes thereto have been restated for the effect of discontinued operations for all periods presented, except for the statement of cash flows and related Note 9 for which restatement is not required. See Note 15.

In February 2004, the Company completed the initial public offering of 13,800,000 shares of its Class A common stock (the IPO). As of June 30, 2004, Transocean owns 46,200,000 shares or 100 percent of the outstanding Class B common stock of the Company, which represents 77 percent of the Company s outstanding common stock. Transocean has 94 percent of the combined voting power of the Company s outstanding common stock due to the five votes per share of Class B common stock, as compared to the one vote per share of Class A common stock. Transocean does not own any of the Company s outstanding Class A common stock. See Notes 3 and 17.

Note 2 Summary of Significant Accounting Policies

Basis of Consolidation The accompanying condensed consolidated financial statements of the Company have been prepared without audit in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information. Accordingly, pursuant to such rules and regulations, these financial statements do not include all disclosures required by GAAP for complete financial statements. Operating results for the six months ended June 30, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004 or for any future period. The accompanying condensed consolidated financial statements and notes thereto should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2003.

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 for investments in joint ventures where the Company s ownership is between 20 percent and 50 percent and for investments in joint ventures owned more than 50 percent where 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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 *Variable Interest Entities*).

Accounting Estimates The preparation of consolidated financial statements in conformity with GAAP 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, materials and 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.

Segments The Company's operations have been aggregated into four reportable business segments, which, for the Company's contract drilling services, correspond to the principal geographic regions in which the Company operates:

U.S. Inland Barge Segment The Company's barge rig fleet in this market segment consists of 12 conventional and 18 posted barge rigs. These units operate in marshes, rivers, lakes and shallow bay or coastal waterways that are known as the transition zone. This area along the U.S. Gulf Coast, where jackup rigs are unable to operate, is the world's largest market for this type of equipment.

U.S. Gulf of Mexico Segment The Company currently has 19 jackup and three submersible rigs in the U.S. Gulf of Mexico shallow water market segment which begins at the outer limit of the transition zone and extends to water depths of about 350 feet. The Company's jackup rigs in this market segment consist of independent leg cantilever type units, mat-supported cantilever type rigs and mat-supported slot type jackup rigs that can operate in water depths up to 250 feet.

Other International Segment The Company's other international operations are currently conducted in Mexico, Trinidad and Venezuela. In Mexico, the Company operates two jackup rigs and is preparing a platform rig to operate for PEMEX, the Mexican national oil company. Additionally, the Company has two jackup rigs in Trinidad and one in Venezuela, where the Company also has nine land rigs and three Lake Maracaibo barges. The Company may pursue selected opportunities in other regions from time to time.

Delta Towing Segment The Company has a partial interest in a joint venture that operates a fleet of U.S. marine support vessels consisting primarily of shallow water tugs, crewboats and utility barges (Delta Towing). See Note 4.

Impairment of Other Long-Lived Assets The carrying value of long-lived assets, principally property and equipment, is reviewed for potential impairment when events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable as prescribed by the Financial Accounting Standards Board's (FASB) Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for Impairment on Disposal of Long-Lived Assets* (SFAS 144). For property and equipment held for use, the determination of recoverability is made based upon the estimated undiscounted future net cash flows of the related asset or group of assets being evaluated. Property and equipment held for sale are recorded at the lower of net book value or net realizable value. See Note 5.

Operating Revenues and Expenses Operating revenues are recognized as earned, based on contractual daily rates. In connection with drilling contracts, the Company may receive revenues for preparation and mobilization of equipment and personnel or for capital improvements to rigs. In connection with new drilling contracts, revenues earned and incremental costs incurred directly related to the preparation and mobilization

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

of the rig are deferred and recognized over the primary contract term of the drilling project for contracts that have a primary contract term of two months or longer and where such amounts are material. Costs of relocating drilling units without contracts to more promising market areas are expensed as incurred. Revenues and expenses associated with the demobilization of drilling units are recognized upon completion of the related drilling contracts. Capital upgrade revenues received are deferred and recognized over the primary contract term of the drilling project. The actual cost incurred for the capital upgrade is depreciated over the estimated remaining useful life of the asset.

At June 30, 2004 and December 31, 2003, \$17.7 million and \$21.2 million, respectively, in deferred preparation and mobilization costs were included in other assets in the Company's condensed consolidated balance sheets. During the six months ended June 30, 2004, the Company amortized \$7.8 million of these costs to expense, which is included in operating and maintenance expense in the Company's condensed consolidated statements of operations. There were no similar costs amortized to expense during the six months ended June 30, 2003.

Interim Financial Information The condensed consolidated financial statements reflect all adjustments, which are, in the opinion of management, necessary for a fair statement of results of operations for the interim periods. Such adjustments are considered to be of a normal recurring nature unless otherwise identified.

Comprehensive Income (Loss) The Company reports comprehensive income in accordance with SFAS 130, *Reporting Comprehensive Income*. Comprehensive income consists of net income (loss) and other gains and losses affecting shareholders' equity that, under GAAP, are excluded from net income. From time to time, the Company may recognize components of other comprehensive income such as unrealized gains and losses on marketable equity investments and foreign currency translation gains and losses. The Company had no accumulated other comprehensive income as of June 30, 2004 and December 31, 2003.

Stock-Based Compensation Through December 31, 2002 and in accordance with the provisions of SFAS 123, *Accounting for Stock-based Compensation*, the Company elected to follow the Accounting Principles Board Opinion (APB) 25, *Accounting for Stock Issued to Employees*, and related interpretations in accounting for awards under its employee stock-based compensation plans using the intrinsic value method. Effective January 1, 2003, the Company adopted the fair value method of accounting for stock-based compensation using the prospective method of transition under SFAS 123. Under the prospective method and in accordance with the provisions of SFAS 148, *Accounting for Stock-Based Compensation Transition and Disclosure*, the recognition provisions are applied to all employee awards granted, modified or settled after January 1, 2003. See Note 14.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The compensation expense related to stock-based employee compensation included in the determination of net income for the six months ended June 30, 2004 is less than that which would have been recognized if the fair value method had been applied to all awards granted after the original effective date of SFAS 123. If the Company had elected to adopt the fair value recognition provisions of SFAS 123 as of its original effective date, pro forma net loss and diluted net loss per share would have been as follows (in millions, except per share amounts):

	Six Months Ended June 30,	
	2004	2003
Net loss, as reported	\$(29.7)	\$(223.7)
Add: stock-based employee compensation expense included in reported net income, net of related tax effects	6.1	0.1
Deduct: total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	6.2	0.1
Pro forma net loss	\$(29.8)	\$(223.7)
Loss per share:		
Basic and diluted-as reported	\$(0.58)	\$(18.42)
Basic and diluted-pro forma	\$(0.58)	\$(18.42)

Variable Interest Entities In January 2003, the FASB issued Interpretation No. 46, *Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51* (FIN 46). FIN 46 requires that an enterprise consolidate a variable interest entity (VIE) if the enterprise has a variable interest that will absorb a majority of the entity's expected losses and/or receives a majority of the entity's expected residual returns as a result of ownership, contractual or other financial interests in the entity, if such loss or residual return occurs. If one enterprise absorbs a majority of a VIE's expected losses and another enterprise receives a majority of that entity's expected residual returns, the enterprise absorbing a majority of the expected losses is required to consolidate the VIE and will be deemed the primary beneficiary for accounting purposes. The Company adopted and applied the provisions of FIN 46, as amended, effective December 31, 2003. See Note 4.

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

Note 3 Capital Stock and Related Transactions

Capital Structure In February 2004, the Company amended its articles of incorporation to, among other things, create two classes of common stock, Class A and Class B.