



## OMNI ENERGY SERVICES CORP. (OMNI: NASDAQ)

**Rating:** Downgrade to Speculative Buy

Symbol	OMNI
Current Price (11/19/04)	\$2.81
High/Low 52 weeks	\$9.0/2.8\$
Average volume (3m)	130,590
Market Capitalization	\$31.36 Mn
Shares outstanding	11.16Mn

Source: Yahoo Finance, SEC Filings, analyst estimates

### Analyst Rating Downgrade Rationale

*We downgrade our rating for OMNI Energy Services Corp. ("OMNI") to Speculative Buy after the earnings release for Q3FY04 (ending 30 September'04). We consider that OMNI registered outcomes under our expectations even though some objective factors such as harsher than anticipated bad weather conditions intervened. Among the other impetus that triggered our downgrade are: i) poor profit margins; ii) net losses exceeding \$4 million; iii) the restructuring process of aviation business unit that generated additional expenses. Simultaneously there are some drivers that inject confidence that the company will return back to profitability according to its strategic business model targeting further expansion and growth. Among them are: i) a 41% yoy revenue growth resulted primary from the completed acquisition of Trussco in June'04; ii) a strong growth experienced by the oil industry; and iii) a \$100 million Senior Credit Facility that should allow the management be more flexible in implementing its business plans. Also it is worth mentioning that the current \$ 2.81 per share is the lowest recorded over the last 52 weeks. Moreover, the acquisitions and ongoing expansion of service apparatus has engendered charges in the Q3FY04 results that we believe will not be a sustainable cost drag in the business.*

### Investment Highlights

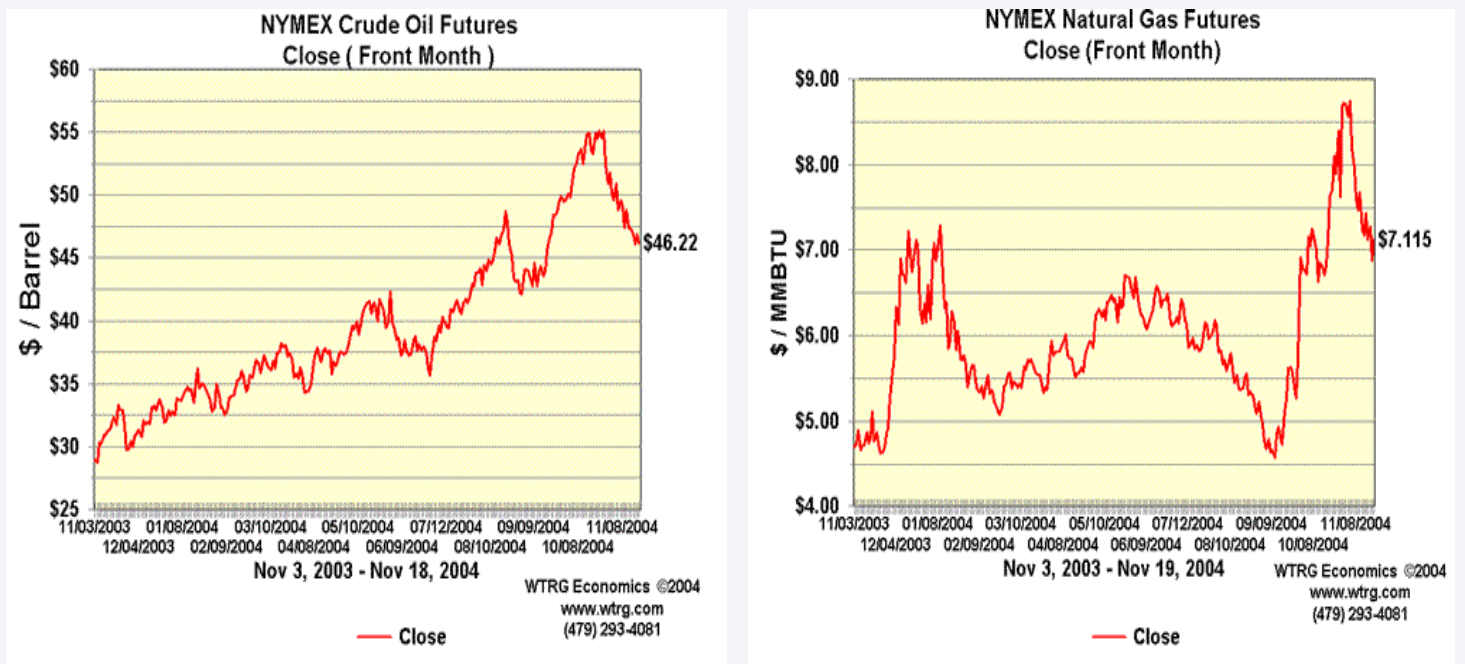
- **OMNI has taken a series of restructuring measures within the aviation operations during the Q3FY04.** The purpose of these actions is to consolidate the aviation business. Hence, a number of duplicative managerial positions have been removed. A number of aviation facilities have been closed. The helicopters acquired during 2003 from the American Helicopters, Inc. were re-certified as well.
- **Shawn L. Rice has been appointed as OMNI's Vice President responsible for Quality, Health, Safety and Environment areas.** The management expects that Mr. Rice will help OMNI in developing the Environment business segment. He has gained more than twenty years of international and domestic management experience within WesternGeco, a subsidiary of Schlumberger serving in various positions. Before joining OMNI, Mr. Rice worked as a Vice President responsible for Quality, Health, Safety and Environment for WesternGeco's worldwide operations.
- **OMNI anticipates completing during the Q4FY04 of a \$100 million Senior Credit Facility from Ableco Finance LLC, an affiliate of Cerberus Capital Management L.P.** The proceeds will be

used to redeem the OMNI's outstanding 6.5% Subordinated Convertible Debentures, re-finance certain long-term debt and provide working capital. The credit facility will allow the management to follow its strategic business model aiming at further expanding and growing of the business.

- **On October 12, 2004 OMNI entered into an Amendment and Conditional Waiver Agreement.** The agreement concluded on October 8, 2004 with Manchester Securities Corporation, Provident Premier Master Fund, Ltd., Gemini Master Fund, Ltd. and Portside Growth and Opportunity Fund, the holders of the OMNI's 6.5% Subordinated Convertible Debentures was amended. On October 25, OMNI has exercised its option to use cash to redeem approximately \$1.3 million of its 6.5% Subordinated Convertible Debentures.

## Industry Highlights

- **The record price of oil and natural gas should be an important impetus for increasing the demand for the services rendered by OMNI.** During the last months oil prices have reached the highest prices ever on this commodity, over \$55 per barrel. Also, the price of natural gas surged to more than \$8.5 per MMBTU<sup>1</sup>.



- **There is an obvious growth in the number of rigs count driven by the record oil prices.** Both the rigs targeting oil and natural gas categories have experienced an increased level in the number of rotary rig count. There is a growth year-over-year oil exploration in the U.S. by 18.5% and gas exploration by 13.9%<sup>2</sup>.

### U.S. Rig Count

	11/19/04	11/21/03	YoY change	YoY % change
Total U.S.	1,268	1,107	161	14.5%

<sup>1</sup> Source: <http://www.wtrg.com>  
<sup>2</sup> Source: <http://www.wtrg.com>

<i>Offshore</i>	105	101	4	4.0%
<i>Land</i>	1,163	1,006	157	15.6%
<i>Inland Waters</i>	22	14	8	57.1%
Oil	186	157	29	18.5%
Gas	1,080	948	132	13.9%

Source: <http://www.wtrg.com>

The U.S. workover rig count was above the average upside worldwide trend reaching 1,329 and recording an increase of 197 rigs above last year's level of 1,132. The total number of rotary rigs world-wide was 2,454 up 7.3% compared to the same period of the year 2003.

### **International and Workover Rig Counts**

Percent Change	Oct-04	Sep-04	Oct-03	Change			
				Monthly	Annual	Monthly	Annual
International Rig Count*	842	866	790	-24	52	-2.80%	6.6%
World Rig Count	2,454	2,379	2,286	75	168	3.20%	7.3%
U.S. Workover Rig Count	1,329	1,293	1,132	36	197	2.80%	17.4%

\* Excludes the U.S. and Canada

Source: <http://www.wtrg.com>, Baker-Hughes

### **Financial Highlights**

- During the Q3FY04, OMNI witnessed an increase in the total revenue of 41% yoy compared to the last year comparable period. The revenue primary shifted up due the performance of the new environment service segment established in June 2004 after Trussco, Inc was acquired by the OMNI. Aviation business segment surged by 131% in the same period whereas the seismic drilling services with the highest contribution in the total revenue have slept down 21% yoy during the Q3FY04. The sales of this segment were impacted negatively by the lower permitting revenues in 2004 and project interruptions caused by third party permitting and weather delays during the current year.
- OMNI experienced a significant change in its sales mix which is likely to diversify the revenues and related risks. The decrease of revenues registered during the Q3FY04 in the seismic drilling services and establishment of a new business segment are the factors that affected the change in the revenue composition. The portion of the seismic drilling services in the aggregate OMNI' revenue moved down from 87% in Q3FY03 to 49% during the Q3FY04. The environmental services brought approximately 30% whereas the aviation services' contribution rose from 13% to 21% in Q4FY04.
- We have to point out that the profit margins posted a significant downside trend. Seismic drilling services and aviation service's Q3FY04 gross margin tumbled down to 12% of sales from 26% in the same period last year. Partially, the environmental services high margin offset the total gross margin, along with significantly greater levels of lower-margin, highland work (than was contracted in 2003). The aviation services margin was lower due to implementation of the consolidation plan requiring significant costs and investments to upgrade and re-certify certain units of the OMNI aviation fleet.

### **Revenue and margins**

US\$' million	Q3FY03	Q3FY04	YoY %
<b>SEISMIC DRILLING SERVICES</b>			
Revenues	9.0	7.1	-21%
Gross profit	2.4	0.8	-67%
Gross profit margin	26%	12%	

**AVIATION SERVICES**

Revenues	1.3	3	131%
Gross profit	0.4	0.3	-25%
Gross profit margin	28%	9%	

**ENVIRONMENTAL SERVICES**

Revenues	N/A	4.3	
Gross profit	N/A	1.6	
Gross profit margin	N/A	38%	

**REVENUE COMPOSITION**

Seismic drilling services	87%	49%
Aviation services	13%	21%
Environmental services	N/M	30%

Source: SEC Filing, Analyst Estimates

- OMNI incurred net losses totaling over \$4 million with an EPS of (\$0.36) in Q3FY04 versus \$0.11 posted in the similar period of 2003. The poorer gross margins and increased administrative costs/expenses led to the negative outcome. The costs incurred in connection with the acquisition of Trussco, Inc generated abnormal expenses amounting \$1.3 million. Also, the restructuring of the aviation segment also generated additional expenses and impacted the final result.

**Financial results**

US\$'000	year end Dec 31	Q3FY03	Q3FY04	YoY %	9moFY03	9moFY04	YoY %
<b>Operating revenue</b>		10,218	14,367	41%	26,834	37,863	41%
<b>Gross profit</b>		2,601	2,670	3%	6,522	7,783	19%
General and administrative expenses		1,090	3,416	213%	3,381	7,853	132%
<b>Operating income (loss)</b>		1,511	-746	N/M	3,141	-70	N/M
Net income (loss) from continuing operations		1,439	-2,551		2,866	-3,631	
<b>Net income (loss)</b>		1,439	-4,016		2,866	-5,169	
Net income (loss) applicable to common and common equivalent shares		1,197	-4,016		2,624	-5,659	
Gross profit margin		25%	19%		24%	21%	
Net profit margin		14%	-28%		11%	-14%	
General and administrative expenses, % of revenue		11%	24%		13%	21%	

Source: SEC Filing, Analyst Estimates

**Analyst:** Kipley J. Lytel, CFA, is a senior partner with money management firm Montecito Capital Management. For over three years, Mr. Lytel served as the lead securities analyst for M.L. Stern & Company. Previously, he performed portfolio management and analyst coverage during his employment with two hedge funds, Pacific Strategic Fund Group and DD Capital Management. His background has been marked by his experience as a Generalist, with analyst coverage spanning numerous industries, including: telecommunications & wireless, health care, retail, consumer products, technology, gaming and energy (E&P). Mr. Lytel has over fifteen years of investment finance experience, with expertise in equity valuation, credit analysis, private placements, and buy/sell recommendations. He received his Masters of Business Administration (MBA) with Honors from the Peter F. Drucker School of Management at Claremont Graduate University, where he also received his undergraduate Bachelors of Arts (BA) degree in Economics. Mr. Lytel is a Chartered Financial Analyst (CFA) and an active member of the Association of Investment Management and Research (AIMR). He serves as a Senior Grader for AIMR's CFA Examination and has been a Regional Expert for AIMR's advisory panel on investment management.

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