

KEY ENERGY SERVICES INC  
Form 10-K  
February 29, 2008

Use these links to rapidly review the document

[KEY ENERGY SERVICES, INC. ANNUAL REPORT ON FORM 10-K For the Year Ended December 31, 2007](#)  
[ITEM 8. Consolidated Financial Statements and Supplementary Data](#)

---

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

---

**FORM 10-K**

(Mark One)

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

For the fiscal year ended December 31, 2007

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

Commission file number 1-8038

**KEY ENERGY SERVICES, INC.**

(Exact name of registrant as specified in its charter)

**Maryland**

(State or other jurisdiction of  
incorporation or organization)

**04-2648081**

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

**1301 McKinney Street  
Suite 1800**

**Houston, Texas 77010**

(Address of principal executive offices, including ZIP Code)

**(713) 651-4300**

(Registrant's telephone number, including area code)

**Securities registered pursuant to Section 12(b) of the Act:**

**Title of Each Class**

**Name of Exchange on Which Registered**

---

Common Stock, \$0.10 par value

New York Stock Exchange

**Securities registered pursuant to Section 12(g) of the Act:**

**Title of Each Class**

---

Edgar Filing: KEY ENERGY SERVICES INC - Form 10-K

None

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

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

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

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

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

As of June 30, 2007, the aggregate market value of the common stock of the Registrant held by non-affiliates of the Registrant, based on the \$18.53 per share price for the Registrant's common stock as quoted by the National Quotation Bureau's Pink Sheets on June 29, 2007 was \$2,145,411,905 (for purposes of calculating these amounts, only directors, officers and beneficial owners of 10% or more of the outstanding capital stock of the Registrant have been deemed affiliates).

As of February 20, 2008, the number of outstanding shares of common stock of the Registrant was 128,149,793.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant's definitive proxy statement to be filed pursuant to Regulation 14A under the Securities Exchange Act of 1934 with respect to the 2008 Annual Meeting of Shareholders are incorporated by reference into Part III of this Form 10-K.

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

**KEY ENERGY SERVICES, INC.**  
**ANNUAL REPORT ON FORM 10-K**  
**For the Year Ended December 31, 2007**

**INDEX**

	<u>Page Number</u>
<u>PART I</u>	4
<u>ITEM 1.</u> Business	4
<u>ITEM 1A.</u> Risk Factors	16
<u>ITEM 1B.</u> Unresolved Staff Comments	22
<u>ITEM 2.</u> Properties	22
<u>ITEM 3.</u> Legal Proceedings	23
<u>ITEM 4.</u> Submission of Matters to a Vote of Security Holders	25
 <u>PART II</u>	 26
<u>ITEM 5.</u> Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	26
<u>ITEM 6.</u> Selected Financial Data	28
<u>ITEM 7.</u> Management's Discussion and Analysis of Financial Condition and Results of Operations	30
<u>ITEM 7A.</u> Quantitative and Qualitative Disclosures About Market Risk	59
<u>ITEM 8.</u> Consolidated Financial Statements and Supplementary Data	61
<u>ITEM 9.</u> Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	132
<u>ITEM 9A.</u> Controls and Procedures	132
<u>ITEM 9B.</u> Other Information	136
 <u>PART III</u>	 136
<u>ITEM 10.</u> Directors, Executive Officers and Corporate Governance	136
<u>ITEM 11.</u> Executive Compensation	136
<u>ITEM 12.</u> Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	136
<u>ITEM 13.</u> Certain Relationships and Related Transactions, and Director Independence	136
<u>ITEM 14.</u> Principal Accountant Fees and Services	136
 <u>PART IV</u>	 136
<u>ITEM 15.</u> Exhibits and Financial Statement Schedules	136

**CAUTIONARY NOTE REGARDING FORWARD LOOKING STATEMENTS**

In addition to statements of historical fact, this report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Statements that are not historical in nature or that relate to future events and conditions are, or may be deemed to be, forward-looking statements. These "forward-looking statements" are based on our current expectations, estimates and projections about the Company, our industry and management's beliefs and assumptions concerning future events and financial trends affecting our financial condition and results of operations. In some cases, you can identify these statements by terminology such as "may," "will," "predicts," "projects," "potential" or "continue" or the negative of such terms and other comparable terminology. These statements are only predictions and are subject to substantial risks and uncertainties. In evaluating those statements, you should carefully consider the information above as well as the risks outlined in Item 1A. "Risk Factors." Actual performance or results may differ materially and adversely.

We undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date of this report except as required by law. All of our written and oral forward-looking statements are expressly qualified by these cautionary statements and any other cautionary statements that may accompany such forward-looking statements.

**PART I**

**ITEM 1. Business**

**THE COMPANY**

Key Energy Services, Inc. is a Maryland corporation. References to "Key," the "Company," "we," "us" or "our" are intended to refer to Key Energy Services, Inc. and its subsidiaries.

We provide a broad array of services including: well servicing, oilfield transportation services, cased-hole electric wireline services, contract drilling services, pressure pumping and well stimulation services and fishing and rental services. Over the years, our business has grown primarily through acquisitions. From 1994 through 2002, we grew rapidly through a series of over 100 acquisitions. From 2003 through 2006, we grew primarily through organic growth as we were engaged in a financial reporting process that involved a restatement of financial statements for 2003 and prior periods and delays in filing periodic reports with the Securities and Exchange Commission (the "SEC"). During this period, we also focused on improving the quality and reliability of our equipment. We completed this process and became current in our financial reporting in September 2007. With the completion of our financial reporting process in 2007, we commenced a program of geographic-focused acquisitions.

We believe that we are the leading onshore, rig-based well servicing contractor in the United States. We operate in all major energy-providing regions of the United States. We also have limited operations offshore. We operate internationally in Argentina and Mexico, and we have a technology development group based in Calgary, Canada.

Key's principal executive office is located at 1301 McKinney Street, Suite 1800, Houston, Texas 77010. Our phone number is (713) 651-4300 and website address is [www.keyenergy.com](http://www.keyenergy.com). We make available free of charge through our website our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with the SEC. Information on our website is not a part of this report.

**DESCRIPTION OF BUSINESS SEGMENTS**

Our business is comprised of three primary business segments: well servicing, pressure pumping services and fishing and rental services. Key operates in various regions in the continental United States and internationally in Argentina and Mexico. The following is a description of these three business segments. For financial information regarding these business segments, see Item 8. "Consolidated Financial Statements and Supplementary Data," Note 18 "Segment Information."

**Well Servicing Segment**

Through our well servicing segment (approximately 76% of our revenues for the year ended December 31, 2007), we provide a broad range of well services, including rig-based services, oilfield transportation services, cased-hole electric wireline services, contract drilling services and other ancillary oilfield services. These services collectively are necessary to complete, stimulate, maintain and workover oil and natural gas producing wells. During 2007, Key conducted well servicing operations onshore: in the continental United States in the following regions Gulf Coast (including South Texas, Central Gulf Coast of Texas and South Louisiana), Permian Basin of West Texas and Eastern New Mexico, Mid-Continent (including the Anadarko, Hugoton and Arkoma Basins and the Ark-La-Tex and North Texas regions), Four Corners (including the San Juan, Piceance, Uinta and Paradox Basins), the Appalachian Basin, Rocky Mountains (including the Denver Julesberg, Powder River, Wind River, Green River and Williston Basins), and California (the San Joaquin Basin), and internationally in Argentina and Mexico.

*Rig-based Services*

Rig-based services include the maintenance of existing wells, workover of existing wells, completion of newly drilled wells, recompletion of existing wells (re-entering a well to complete the well in a new geologic zone or formation) and plugging and abandonment of wells at the end of their useful lives. Our rig fleet is diverse and allows us to work on all types of wells, ranging from very shallow wells to wells as deep as 20,000 feet. Over 200 of our well service rigs are outfitted with our proprietary KeyView® technology, which captures and reports well site operating data. This technology allows our customers and our crews to actively monitor well site operations, to improve efficiency and safety, and to add value to the services we offer. Included in our domestic well service fleet are eight inland barge rigs. Inland barge rigs are mobile, self-contained, drilling and/or workover vessels that are used in the search for oil and gas in shallow marshes, inland lakes, rivers and swamps along the Gulf Coast of the United States. When moved from one location to another, the barge floats; when stationed on the drill or workover site, the barge is submerged to rest on the bottom. Typically, inland barge rigs are used to drill or workover wells in marshes, shallow inland bays and offshore where the water covering the drill site is not too deep. Our barge rigs can operate at depths between three and 17 feet.

*Maintenance Services.* We provide the well service rigs, equipment and crews for maintenance services, which are performed on both oil and natural gas wells, but more frequently on oil wells. While some oil wells in the United States flow oil to the surface without mechanical assistance, most require pumping or some other method of artificial lift. Oil wells that require pumping characteristically require more maintenance than flowing wells due to the operation of the mechanical pumping equipment. Because few natural gas wells have mechanical pumping systems in the wellbore, maintenance work on natural gas wells is less frequent.

Maintenance services are required throughout the life of most producing wells to ensure efficient and continuous operation. These services consist of routine mechanical repairs necessary to maintain production from the well, such as repairing inoperable pumping equipment in an oil well or replacing defective tubing in an oil or natural gas well, and removing debris such as sand and paraffin from the well. Other services include pulling the rods, tubing, pumps and other downhole equipment out of the wellbore to identify and repair a production problem.

Maintenance services are often performed on a series of wells in close proximity to each other and typically require less than 48 hours per well to complete. The general demand for maintenance services is closely related to the total number of producing oil and natural gas wells in a geographic market, and maintenance services are generally the most stable type of well service activity.

*Workover Services.* In addition to periodic maintenance, producing oil and natural gas wells occasionally require major repairs or modifications, called "workovers." Workover services are performed to enhance the production of existing wells. Such services include extensions of existing wells to drain new formations either by deepening wellbores to new zones or by drilling horizontal or lateral wellbores to improve reservoir drainage. In less extensive workovers, our rigs are used to seal off depleted zones in existing wellbores and access previously bypassed productive zones. Our workover rigs are also used to convert former producing wells to injection wells through which water or carbon dioxide is pumped into the formation for enhanced recovery operations. Other workover services include: conducting major subsurface repairs such as casing repair or replacement, recovering tubing and removing foreign objects in the wellbore, repairing downhole equipment failures, plugging back a section of a well to reduce the amount of water being produced with the oil and natural gas, cleaning out and recompleting a well if production has declined, and repairing leaks in the tubing and casing. These extensive workover operations are normally performed by a well service rig with a workover package, which may include rotary drilling equipment, mud pumps, mud tanks and blowout preventers, depending upon the particular type of workover operation. Most of our well service rigs are designed to perform complex workover operations.

## Edgar Filing: KEY ENERGY SERVICES INC - Form 10-K

Workover services are more complex and time consuming than routine maintenance operations and consequently may last from a few days to several weeks. These services are almost exclusively performed by well service rigs. Demand for workover services is closely related to capital spending by oil and natural gas producers, which is generally a function of oil and natural gas prices. As commodity prices increase, oil and natural gas producers tend to increase capital spending for workover services in order to increase oil and natural gas production.

*Completion Services.* Our completion services prepare a newly drilled oil or natural gas well for production. The completion process may involve selectively perforating the well casing to access producing zones, stimulating and testing these zones and installing downhole equipment. We typically provide a well service rig and may also provide other equipment such as a workover package to assist in the completion process. However, during periods of weak drilling rig demand, some drilling contractors may compete with service rigs for completion work. Also, for some completion work on natural gas wells, coiled tubing units can be used in place of a well service rig.

The completion process typically requires a few days to several weeks, depending on the nature and type of the completion, and generally requires additional auxiliary equipment that we provide for an additional fee. The demand for well completion services is directly related to drilling activity levels, which are highly sensitive to expectations relating to, and changes in, oil and natural gas prices. As the number of newly drilled wells decreases, the number of completion jobs correspondingly decreases.

*Plugging and Abandonment Services.* Well service rigs and workover equipment are also used in the process of permanently shutting-in oil and natural gas wells at the end of their productive lives. Plugging and abandonment work can be performed with a well service rig along with electric wireline and cementing equipment. Plugging and abandonment services require compliance with state regulatory requirements. The demand for oil and natural gas does not significantly affect the demand for plugging and abandonment services because well operators are required by state regulations to plug wells that are no longer productive. The need for these services is also driven by lease or operator policy requirements.

### *Oilfield Transportation Services*

We provide oilfield transportation services, which primarily include vacuum truck services, fluid transportation services and disposal services for operators whose oil or natural gas wells produce salt water and other fluids. In addition, we are a supplier of frac tanks which are used for temporary storage of fluids in conjunction with the fluid hauling operations.

Fluid hauling trucks are utilized in connection with drilling and workover projects, which tend to use large amounts of various oilfield fluids. We transport fresh water to the well site and provide temporary storage and disposal of produced salt water and drilling or workover fluids. These fluids are removed from the well site and transported for disposal in a salt water disposal well. Key owned or leased 47 active salt water disposal wells at December 31, 2007. In addition, we provide equipment trucks that are used to move large pieces of equipment from one well site to the next, and we operate a fleet of hot oilers which are capable of pumping heated fluids that are used to clear soluble restrictions in a wellbore. Demand and pricing for these services generally correspond to demand for our well service rigs. Fluid hauling and equipment hauling services are typically priced on a per barrel or per hour basis while frac tank rentals are typically billed on a per day basis.

### *Cased-Hole Electric Wireline Services*

Key provides cased-hole electric wireline services in the Appalachian Basin, Texas and Louisiana. This service is performed at various times throughout the life of the well and includes perforating, completion logging, production logging and casing integrity services. After the wellbore is cased and cemented, we can provide a number of services. Perforating creates the flow path between the reservoir

and the wellbore. Production logging can be performed throughout the life of the well to measure temperature, fluid type, flow rate, pressure and other reservoir characteristics. This service helps the operator analyze and monitor well performance and determine when a well may need a workover or further stimulation.

In addition, cased-hole services may involve wellbore remediation, which could include the positioning and installation of various plugs and packers to maintain production or repair well problems, and casing inspection for internal or external abnormalities in the casing string. Wireline services are provided from surface logging units, which lower tools and sensors into the wellbore. We operated 22 units as of December 31, 2007, and we have seven units ordered that are expected to be delivered in 2008. Cased-hole electric wireline services are conducted during the completion of an oil or natural gas well and often times throughout the life of a producing well. Services include: production logging, perforating, pipe recovery, pressure control and setting services. We use advanced wireline instruments to evaluate well integrity and perform cement evaluations and production logging. Demand for our cased-hole electric wireline services is correlated to current and anticipated oil and natural gas prices and the resulting effect on the willingness of our customers to make operating and capital expenditures.

#### ***Contract Drilling Services***

We provide limited drilling services to oil and natural gas producers. In Argentina, we operate seven drilling rigs and in the continental United States we operate several heavy-duty well service rigs that are capable of providing drilling services. Our drilling services are primarily provided under standard day rate, and, to a lesser extent, footage contracts. Our drilling rigs vary in size and capability. The rigs located in Argentina are equipped with mechanical power systems and have depth ratings of approximately 10,000 feet, although one rig can drill up to approximately 15,000 feet. Like workover services, the demand for contract drilling is directly related to expectations about, and changes in, oil and natural gas prices which, in turn, are driven by the supply of and demand for these commodities.

#### ***Ancillary Oilfield Services***

We provide ancillary oilfield services, which include, among others: well site construction (preparation of a well site for drilling activities); roustabout services (provision of manpower to assist with activities on a well site); and air drilling services (drilling technique using compressed air). Demand and pricing for these services are generally related to demand for our well service operations.

#### **Pressure Pumping Services Segment**

Through our pressure pumping services segment (approximately 18% of our revenues for the year ended December 31, 2007), we provide well stimulation and cementing services to oil and natural gas producers. Well stimulation services include fracturing, nitrogen services, and acidizing. These services (which may be completion or workover services) are provided to oil and natural gas producers and are used to enhance the production of oil and natural gas wells from formations which exhibit restricted flow of oil and natural gas. In the fracturing process, we typically pump fluid and sized sand, or proppants, into a well at high pressure in order to fracture the formation and thereby increase the flow of oil and natural gas. With our cementing services, we pump cement into a well between the casing and the wellbore. Our pressure pumping services in 2007 were provided in the Permian Basin, the San Juan Basin, the Barnett Shale region of North Texas and the Mid-Continent region. We also provide cementing services in conjunction with our plugging and abandonment operations in California. Demand for our pressure pumping services is primarily influenced by current and anticipated oil and natural gas prices and the resulting effect on the willingness of our customers to make operating and capital expenditures.

**Fishing and Rental Services Segment**

Through our fishing and rental services segment (approximately 6% of revenues for the year ended December 31, 2007), we provided fishing and rental services to major and independent oil and natural gas production companies in the Gulf Coast, Mid-Continent and Permian Basin regions, as well as in California. We also provided limited services offshore in the Gulf of Mexico. Fishing services involve recovering lost or stuck equipment in the wellbore utilizing a "fishing tool." We offer a full line of services and rental equipment designed for use both onshore and offshore for drilling and workover services. Our rental tool inventory consists of tubulars, handling tools, pressure-controlled equipment, power swivels, and foam air units. Demand for our fishing and rental services is also closely related to capital spending by oil and natural gas producers, which is generally a function of oil and natural gas prices.

**Equipment Overview**

*Well Service Rigs*

Our rigs typically are billed to customers on a per hour basis but in certain cases may be billed on a day rate. We categorize our rigs as active, stacked or inactive. We consider an active rig or piece of equipment to be a unit that is working, on standby, or down for repairs but with work orders assigned to it or that is available for work, which means that the equipment has a crew and is ready to work. A stacked rig or piece of equipment is defined as a unit that is in the remanufacturing process or a unit that does not have a crew assigned to it and could not be put to work without significant investment in repairs and additional equipment. A rig or piece of equipment is considered inactive if we intend to salvage the unit for parts, sell the unit or scrap the unit. The definitions of active, stacked and inactive are used for the majority of our equipment.

As of December 31, 2007, our active fleet of well service rigs totaled 975 rigs. These rigs are located throughout the United States and internationally in Argentina and Mexico. Our geographic diversification provides us with a balanced mix of oil versus natural gas exposure. We estimate that approximately 60% of our rigs are located in predominantly oil regions while 40% of our rigs are located in predominantly natural gas regions.

Our fleet is diverse and allows us to work on all types of wells, ranging from very shallow wells to wells as deep as 20,000 feet. The following table classifies our rigs based on size and location. Typically, heavy duty rigs will be utilized on deep wells while light duty rigs will be used on shallow wells. In most cases, these rigs can be reassigned to other regions should market conditions warrant the transfer of equipment.

Edgar Filing: KEY ENERGY SERVICES INC - Form 10-K

Well Service Rig Fleet as of December 31, 2007

Region	Swab(1)	Light Duty(2)	Medium Duty(3)	Heavy Duty(4)	Total
Appalachia	2	15	8	1	26
Argentina	1	3	31	7	42
Ark-La-Tex	7	0	51	4	62
California	0	86	57	9	152
Gulf Coast	2	1	41	11	55
Mexico	0	0	2	1	3
Mid-Continent	12	13	97	4	126
Permian Basin	13	36	232	66	347
Rocky Mountains	3	2	47	37	89
Southeastern(5)	6	5	46	16	73
<b>Total</b>	<b>46</b>	<b>161</b>	<b>612</b>	<b>156</b>	<b>975</b>

- (1) Swab rigs include rigs used in shallow-depth wells.
- (2) Light Duty rigs include rigs with rated capacity of less than 90 tons.
- (3) Medium Duty rigs include rigs with rated capacity of 90 tons to 125 tons.
- (4) Heavy Duty rigs include rigs with rated capacity of greater than 125 tons.
- (5) Includes eight inland barge rigs acquired in the acquisition of Moncla Well Service, Inc. and related entities. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations Acquisitions."

**Oilfield Transportation Equipment**

We have a broad and diverse fleet of oilfield transportation service vehicles. We broadly define an oilfield transportation service vehicle as any heavy-duty, revenue-generating vehicle weighing over one ton. Our transportation fleet includes vacuum trucks, winch trucks, hot oilers and other vehicles, including kill trucks and various hauling and transport trucks.

Transportation Fleet as of December 31, 2007

Region	Vacuum Truck	Winch Truck	Hot Oil Truck	Other	Total
Appalachia	16	20	0	9	45
Argentina	1	15	2	29	47
Ark-La-Tex	175	26	0	27	228
California	24	1	0	44	69
Gulf Coast	151	37	0	10	198
Mid-Continent	30	16	7	18	71
Permian Basin	183	25	63	110	381
Rocky Mountains	12	2	0	4	18
Southeastern	0	34	2	2	38
<b>Total</b>	<b>592</b>	<b>176</b>	<b>74</b>	<b>253</b>	<b>1,095</b>

**Pressure Pumping Equipment**

Edgar Filing: KEY ENERGY SERVICES INC - Form 10-K

Our pressure pumping segment operates a diverse fleet of equipment, including: frac pumps, cementing units, acidizing units and nitrogen units.

## Pressure Pumping Fleet as of December 31, 2007

Region	Frac Pumps	Cement Units	Acidizing Units	Nitrogen Units	Total
California	0	8	0	0	8
Barnett Shale	41	4	3	0	48
Four Corners	7	3	4	5	19
Mid-Continent	18	4	1	0	23
Permian Basin	20	5	3	2	30
Total	86	24	11	7	128

## SEASONALITY

Our operations are impacted by seasonal factors. Historically, our business has been negatively impacted during the winter months due to inclement weather, fewer daylight hours and holidays. Our well service rigs are mobile, and we operate a significant number of oilfield transportation service vehicles. During periods of heavy snow, ice or rain, we may not be able to move our equipment between locations, thereby reducing our ability to generate rig or truck hours. In addition, the majority of our well service rigs work only during daylight hours. In the winter months when days become shorter, this reduces the amount of time that the rigs can work and therefore has a negative impact on total hours worked. Lastly, during the fourth quarter, we historically have experienced significant slowdown during the Thanksgiving and Christmas holiday seasons.

## PATENTS, TRADE SECRETS, TRADEMARKS AND COPYRIGHTS

We are the owner of numerous patents, trademarks and proprietary technology that we believe provide us with a competitive advantage in the various markets in which we operate or intend to operate. We have devoted significant resources to developing technological improvements in our well service business and have sought patent protection both inside and outside the United States for products and methods that appear to have commercial significance. In the United States, as of December 31, 2007, we had 30 patents issued and 16 patents pending. As of December 31, 2007, we had 11 patents issued and 121 patents pending in foreign countries. All the issued patents have varying remaining durations and begin expiring between 2013 and 2025. The most notable of our technologies include numerous patents surrounding the KeyView® system, a field data acquisition system that captures vital well site operating data from service equipment. We believe this information helps us and our customers improve safety, reduce costs and increase productivity.

We own several trademarks that are important to our business both in the United States and in foreign countries. In general, depending upon the jurisdiction, trademarks are valid as long as they are in use or their registrations are properly maintained and they have not been found to become generic. Registrations of trademarks can generally be renewed indefinitely as long as the trademarks are in use. While our patents and trademarks, in the aggregate, are of considerable importance to maintaining our competitive position, no single patent or trademark is considered to be of a critical or essential nature to our business.

We also rely on a combination of trade secret laws, copyright and contractual provisions to establish and protect proprietary rights in our products and services. We typically enter into confidentiality agreements with our employees, strategic partners and suppliers and limit access to the distribution of our proprietary information.

## FOREIGN OPERATIONS

During 2007, we operated internationally in Argentina and Mexico. In Argentina, we operated 37 well service rigs and seven drilling rigs and oilfield transportation vehicles, all of which we include in our well servicing segment. We commenced operations in Mexico during the second quarter of 2007. In February 2007, Petróleos Mexicanos, the Mexican national oil company ("PEMEX"), awarded our Mexican subsidiary, Key Energy Services de México S. de R.L. de C.V., a 22-month contract valued at \$45.8 million (USD) to provide field production solutions and well workover services. Under the terms of the contract, we initially provided three well service rigs outfitted with our proprietary KeyView® system, and we installed two KeyView® systems on PEMEX-owned well service rigs. The contract grants PEMEX the option to call for additional rigs and KeyView® systems in the future, although these incremental services are not included in the contract. The current project covers PEMEX's North Region assets and initially focuses on oil wells in Burgos, Poza Rica-Altamira and Cerro Azul. We anticipate that we will expand our presence in Mexico during 2008. Recently, PEMEX has requested that we send additional equipment and KeyView® systems to Mexico. We anticipate that we will deploy up to an additional eight well service rigs with our proprietary KeyView® technology and will install three KeyView® units on PEMEX-owned rigs during 2008. Concurrent with the deployment of additional equipment, we intend to seek an extension of our contract with PEMEX.

Revenue from our international operations during 2007 totaled \$105.8 million, or 6.4% of total revenue. Revenue from international operations for 2006 and 2005 totaled \$78.3 million and \$68.2 million, respectively.

On September 5, 2007, we acquired Advanced Measurements, Inc., a privately-held Canadian technology company focused on oilfield service equipment controls, data acquisition and digital information work flow. In addition, in connection with the acquisition, we acquired a 51% ownership interest in Advanced Flow Technologies, Inc., a privately-held Canadian technology company focused on low cost wireless gas well production monitoring. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations Acquisitions."

## CUSTOMERS

Our customers include major oil companies, independent oil and natural gas production companies, and foreign national oil and natural gas production companies. During the years ended December 31, 2007, 2006 and 2005, no single customer accounted for 10% or more of our consolidated revenues.

## COMPETITION AND OTHER EXTERNAL FACTORS

In the well servicing markets, we believe that, based on available industry data, we are the largest provider of well service rigs in the United States. At December 31, 2007, we had 975 active rigs. Based on the Weatherford-AESC ("AESC") well service rig count, which is available on Weatherford International's internet website, there were approximately 2,839 well service rigs in the United States at December 31, 2007. A recent well service industry survey published by a U.S. investment bank suggests that there are more well service rigs in the United States than are reported by the AESC count. We agree that there are likely more rigs than reported by the AESC and we believe the active rig count could be as high as 3,600 well service rigs. The difference between the AESC data and the investment bank survey is likely attributable to (i) not all U.S. well service providers being members of the AESC, (ii) some U.S. oil and natural gas producers owning well service rigs and not reporting to the AESC, and (iii) poor reporting of equipment by certain members of the AESC.

The markets in which we operate are highly competitive. Competition is influenced by such factors as price, capacity, availability of work crews, and reputation and experience of the service provider. We believe that an important competitive factor in establishing and maintaining long-term customer

relationships is having an experienced, skilled and well-trained work force. In recent years, many of our larger customers have placed increased emphasis on the safety performance and quality of the crews, equipment and services provided by their contractors. We have devoted, and will continue to devote, substantial resources toward employee safety and training programs. In addition, we believe that the KeyView® system has provided and will continue to provide important safety enhancements. Although we believe customers consider all of these factors, price is generally the primary factor in determining which service provider is awarded the work. However, we believe that most customers are willing to pay a slight premium for the quality and efficient service we provide.

Significant well service providers include Nabors Industries, Basic Energy Services and Complete Production Services. Other large competitors include Bronco Drilling and Forbes Energy Services. In addition, though there has been consolidation in the domestic well servicing industry, there are numerous small companies that compete in Key's well servicing markets. We do not believe that any other competitors have greater numbers of active well service rigs than Key. In Argentina, our largest competitors are Pride International, Nabors Industries, and Allis-Chalmers Energy. Schlumberger Ltd. and Nabors Industries are our largest competitors in Mexico.

The pressure pumping market is dominated by three major competitors: Schlumberger Ltd., Halliburton Company and BJ Services Company. These three companies have a substantially larger asset base than Key and are believed to operate in all major U.S. oil and natural gas producing basins. Other competitors include Weatherford International, Superior Well Service, Basic Energy Services, Complete Production Services, Frac-Tech and RPC. The pressure pumping industry is very competitive, and the three major competitors generally lead pricing in any particular region. Our pressure pumping services operate in niche markets and historically have competed effectively with these competitors based on performance and strong customer service. Where feasible, we cross market our pressure pumping services along with our well service rigs and fishing and rental services, thereby offering our customers the ability to minimize vendors, which, we believe, will improve efficiency. This cross marketing capability is unique to Key, because none of the three major pressure pumping contractors operate well service rigs in the United States.

The U.S. fishing and rental equipment market is fragmented compared to our other product lines. Companies which provide fishing services generally compete based on the reputation of their fishing tool operators and their relationships with customers. Competition for rental tools is sometimes based on price; however, in most cases, when a customer chooses a specific fishing tool operator for a particular job, then the necessary rental equipment will be part of that job as well. Our primary competitors include: Baker Oil Tools, Smith International, Weatherford International, Basic Energy Services, Superior Energy Services, Quail Tools (owned by Parker Drilling) and Knight Oil Tools.

The need for well servicing, pressure pumping services and fishing and rental services fluctuates, primarily, in relation to the price (or anticipated price) of oil and natural gas, which, in turn, is driven by the supply of and demand for oil and natural gas. Generally, as supply of those commodities decreases and demand increases, service and maintenance requirements increase as oil and natural gas producers attempt to maximize the productivity of their wells in a higher priced environment.

The level of our revenues, earnings and cash flows are substantially dependent upon, and affected by, the level of domestic and international oil and gas exploration and development activity, as well as the equipment capacity in any particular region. For a more detailed discussion, see Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations."

## EMPLOYEES

As of December 31, 2007, we employed approximately 8,380 persons in our domestic operations and approximately 1,440 additional persons in Argentina, Mexico and Canada. Our domestic employees are not represented by a labor union and are not covered by collective bargaining agreements. Many of

our field employees in Argentina are represented by formal unions. While Mexico has a strong petroleum workers union, we are currently only employing non-union workers in Mexico. We have not experienced any material work stoppages associated with labor disputes or grievances and consider our relations with our employees to be satisfactory. During 2007, we experienced an annual employee turnover rate of approximately 41%, compared to a turnover rate of approximately 45% in 2006. The high turnover rate is caused, in part, by the nature of the work, which is physically demanding and sometimes performed in harsh outdoor conditions. As a result, workers may choose to pursue employment in fields that offer a more desirable work environment at wage rates that are competitive with ours. Alternatively, some employees may leave Key if they can earn a higher wage with a competitor. A discussion of the risks associated with our high turnover is presented in Item 1A. "Risk Factors Business-Related Risk Factors."

## GOVERNMENTAL REGULATIONS

Our operations are subject to various federal, state, and local laws and regulations pertaining to health, safety and the environment. We cannot predict the level of enforcement of existing laws or regulations or how such laws and regulations may be interpreted by enforcement agencies or court rulings in the future. We also cannot predict whether additional laws and regulations affecting our business will be adopted, or the effect such changes might have on us, our financial condition or our business. The following is a summary of the more significant existing environmental, health and safety laws and regulations to which our operations are subject and for which compliance may have a material adverse impact on our results of operation or financial position.

### **Environmental Regulations**

Our operations routinely involve the storage, handling, transport and disposal of bulk waste materials, some of which contain oil, contaminants, and regulated substances. Various environmental laws and regulations require prevention, and where necessary, cleanup of spills and leaks of such materials, and some of our operations must obtain permits that limit the discharge of materials. Failure to comply with such environmental requirements or permits may result in fines and penalties, remediation orders and revocation of permits.

Laws and regulations protecting the environment have become more stringent over the years, and in certain circumstances may impose "strict liability," rendering us liable for environmental damage without regard to negligence or fault on our part. Moreover, cleanup costs, penalties, and other damages arising as a result of new or changes to existing environmental laws and regulations could be substantial and could have a material adverse effect on our financial condition, results of operations and cash flows. From time to time, claims have been made and litigation has been brought against us under such laws. However, the costs incurred in connection with such claims and other costs of environmental compliance have not had a material adverse effect on our past operations or financial statements. Management believes that Key conducts its operations in substantial compliance with current federal, state and local requirements related to health, safety and the environment.

### ***Hazardous Substances and Waste***

The Comprehensive Environmental Response, Compensation, and Liability Act, as amended, referred to as "CERCLA" or the "Superfund" law, and comparable state laws impose liability without regard to fault or the legality of the original conduct on certain defined persons, including current and prior owners or operators of a site where a release of hazardous substances occurred and entities that disposed or arranged for the disposal of the hazardous substances found at the site. Under CERCLA, these "responsible persons" may be liable for the costs of cleaning up the hazardous substances, for damages to natural resources, and for the costs of certain health studies. In the course of our operations, we generate materials that are regulated as hazardous substances and, as a result, may incur

CERCLA liability for cleanup costs. Also, claims may be filed for personal injury and property damage allegedly caused by the release of hazardous substances or other pollutants.

We also generate solid wastes that are subject to the requirements of the Resource Conservation and Recovery Act, as amended, or "RCRA," and comparable state statutes. Certain materials generated in the exploration, development, or production of crude oil and natural gas are excluded from RCRA's hazardous waste regulation, but these wastes, which include wastes currently generated during our operations, could be designated as "hazardous wastes" in the future and become subject to more rigorous and costly disposal requirements. Any such changes in these laws and regulations could have a material adverse effect on our operating expense.

Although we used operating and disposal practices that were standard in the industry at the time, hydrocarbons or other wastes may have been released at properties owned or leased by us now or in the past, or at other locations where these hydrocarbons and wastes were taken for treatment or disposal. Under CERCLA, RCRA and analogous state laws, we could be required to clean up contaminated property (including contaminated groundwater), or to perform remedial activities to prevent future contamination.

#### *Air Emissions*

The Clean Air Act, as amended, or "CAA," and state laws and regulations restrict the emission of air pollutants and also impose various monitoring and reporting requirements. These laws and regulations may require us to obtain approvals or permits for construction, modification or operation of certain projects or facilities and may require use of emission controls. Our failure to comply with CAA requirements and those of similar state laws and regulations could subject us to civil and criminal penalties, injunctions, and restrictions on operations.

#### *Global Warming and Climate Control*

Recent scientific studies suggest that emissions of greenhouse gases (including carbon dioxide and methane) may contribute to warming of the Earth's atmosphere. In response to such studies, the U.S. Congress is considering legislation to reduce greenhouse gas emissions. In addition, many states have already taken measures to address greenhouse gases through the development of greenhouse gas emission inventories, and/or regional greenhouse gas cap and trade programs. As a result of the U.S. Supreme Court's decision on April 2, 2007 in *Massachusetts et al. v. EPA*, the Environmental Protection Agency (the "EPA") may regulate greenhouse gas emissions from mobile sources (e.g. cars and trucks) even if Congress does not adopt new legislation. The Court's holding in *Massachusetts* that greenhouse gases are covered pollutants under the CAA may also result in future regulation of greenhouse gas emissions from stationary sources. Legislation or regulatory programs that restrict greenhouse gas emissions in areas where we conduct business could increase our costs in order to stay compliant with any new laws.

#### *Water Discharges*

We operate facilities that are subject to requirements of the Clean Water Act, or "CWA," and analogous state laws that impose restrictions and controls on the discharge of pollutants into navigable waters. Pursuant to these laws, permits must be obtained to discharge pollutants into state waters or waters of the United States, including to discharge storm water runoff from certain types of facilities. Spill prevention, control and countermeasure requirements under the CWA require implementation of measures to help prevent the contamination of navigable waters in the event of a hydrocarbon spill. Other requirements for the prevention of spills are established under the Oil Pollution Act of 1990, as amended, or "OPA", which amends the CWA and applies to owners and operators of vessels, including barges, offshore platforms, and certain onshore facilities. Under OPA, regulated parties are strictly

liable for oil spills and must establish and maintain evidence of financial responsibility sufficient to cover liabilities related to an oil spill for which such parties could be statutorily responsible. The CWA can impose substantial civil and criminal penalties for non-compliance.

## **Employees**

### ***Occupational Safety and Health Act***

We are subject to the requirements of the federal Occupational Safety and Health Act, as amended, or "OSHA", and comparable state laws that regulate the protection of employee health and safety. OSHA's hazard communication standard requires that information about hazardous materials used or produced in our operations be maintained and provided to employees, state and local government authorities and citizens. We believe that our operations are in substantial compliance with OSHA requirements.

### ***Marine Employees***

Certain of our employees who perform services on our barge rigs or work offshore are covered by the provisions of the Jones Act, the Death on the High Seas Act and general maritime law. These laws operate to make the liability limits established under state workers' compensation laws inapplicable to these employees. Instead, these employees or their representatives are permitted to pursue actions against us for damages resulting from job related injuries, with generally no limitations on our potential liability.

## **Other Laws and Regulations**

### ***Saltwater Disposal Wells***

We operate saltwater disposal wells that are subject to the CWA, Safe Drinking Water Act, and state and local laws and regulations, including those established by the EPA's Underground Injection Control Program which establishes the minimum program requirements. Most of our saltwater disposal wells are located in Texas and we also operate saltwater disposal wells in Arkansas, Louisiana and New Mexico. Regulations in these states require us to obtain a permit to operate each of our saltwater disposal wells. The applicable regulatory agency may suspend or modify one of our permits if our well operation is likely to result in pollution of freshwater, substantial violation of permit conditions or applicable rules, or leaks to the environment. We maintain insurance against some risks associated with our well service activities, but there can be no assurance that this insurance will continue to be commercially available or available at premium levels that justify its purchase by us. The occurrence of a significant event that is not fully insured or indemnified could have a material adverse effect on our financial condition and operations.

### ***Electric Wireline***

We conduct cased-hole electric wireline logging, which may entail the use of radioactive isotopes along with other nuclear, electrical, acoustic, and mechanical devices to evaluate downhole formation. Our activities involving the use of isotopes are regulated by the U.S. Nuclear Regulatory Commission and specified agencies of certain states. Additionally, we may use high explosive charges for perforating casing and formations, and various explosive cutters to assist in wellbore cleanout. Such operations are regulated by the U.S. Department of Justice, Bureau of Alcohol, Tobacco, Firearms, and Explosives and require us to obtain licenses or other approvals for the use of densitometers as well as explosive charges. We have obtained these licenses and approvals when necessary and believe that we are in substantial compliance with these federal requirements.

**ITEM 1A. Risk Factors**

In addition to the other information in this report, the following factors should be considered in evaluating us and our business.

**Business-Related Risk Factors**

*Our business is dependent on conditions in the oil and natural gas industry, especially oil and natural gas prices and capital expenditures by oil and natural gas companies.*

The demand for our services is primarily influenced by current and anticipated oil and natural gas prices. Prices for oil and natural gas historically have been extremely volatile and have reacted to changes in the supply of and demand for oil and natural gas. These include changes resulting from, among other things, the ability of the Organization of Petroleum Exporting Countries to establish and maintain production quotas to support oil prices, domestic and worldwide economic conditions and political instability in oil-producing countries. Weakness in oil and natural gas prices (or the perception by our customers that oil and natural gas prices will decrease) may cause lower utilization of available well service equipment and result in lower rates. In addition, when oil and natural gas prices are weak, or when our customers expect oil and natural gas prices to decrease, fewer wells are drilled, resulting in less completion and maintenance work for us. Additional factors that affect demand for our services include:

the level of development, exploration and production activity of, and corresponding capital spending by, oil and natural gas companies;

oil and natural gas production costs;

government regulation; and

conditions in the worldwide oil and natural gas industry.

Periods of diminished or weakened demand for our services have occurred in the past. Although we experienced a material decrease in the demand for our services beginning in August 2001 and continuing through September 2002, since September 2002 we have experienced continued strong demand for our services. We believe the previous decrease in demand was due to an overall weakening of demand for onshore well services, which was attributable to general uncertainty about future oil and natural gas prices and the U.S. economy, including the impact of the September 11, 2001 terrorist attacks. If any of these conditions return, demand for our services could again decrease, having a material adverse effect on our financial condition and results of operations. In light of these and other factors relating to the oil and natural gas industry, our historical operating results may not be indicative of future performance.

*We may be unable to maintain pricing on our core services.*

During the past three years, we have increased the prices on our services to offset rising costs and to generate higher returns for our shareholders. Recently, we have made some price concessions to our customers in order to maintain market share. We believe that market conditions should remain strong due to high commodity prices, and therefore anticipate that pricing for our services should be relatively stable during 2008; however, should market conditions deteriorate or additional new industry capacity increase, it may become more difficult for us to maintain prices.

The inability to maintain our pricing could:

limit our ability to offset rising costs; and

impact our ability to generate greater free cash flow which would be used to expand our business.

***Increases in industry capacity may adversely affect our business.***

Over the past three years, new capacity, including new well service rigs, new pressure pumping equipment and new fishing and rental equipment, has entered the market. In some cases, the new capacity is attributable to start-up oilfield service companies and in other cases, the new capacity has been employed by existing service providers to increase their service capacity. We have been adversely affected by the new capacity as our utilization for 2007 is down from prior years. Lower utilization of our fleet has led to reduced pricing for our services. Should oilfield service companies continue to add new capacity and demand for services not increase, we could experience continued pressure on the pricing of our services and experience lower utilization. This could have a material negative impact on our operating results.

***An economic downturn may adversely affect our business.***

There is a concern that the United States may enter into a recession in 2008, and if so, a downturn in the U.S. economy may cause reduced demand for petroleum-based products and natural gas. In addition, during a downturn many oil and natural gas production companies often reduce or delay expenditures to reduce costs, which in turn may cause a reduction in the demand for our services during these periods. If the economic environment should deteriorate, our business, financial condition and results of operations may be adversely impacted.

***Our business involves certain operating risks, which are primarily self-insured, and our insurance may not be adequate to cover all losses or liabilities we might incur in our operations.***

Our operations are subject to many hazards and risks, including the following:

blow-outs, the uncontrolled flow of natural gas, oil or other well fluids into the atmosphere or an underground formation;

reservoir damage;

fires and explosions;

accidents resulting in serious bodily injury and the loss of life or property;

pollution and other damage to the environment; and

liabilities from accidents or damage by our fleet of trucks, rigs and other equipment.

If these hazards occur, they could result in suspension of operations, damage to or destruction of our equipment and the property of others, or injury or death to our or a third party's personnel.

We self-insure a significant portion of these liabilities. For losses in excess of our self-insurance limits, we maintain insurance from unaffiliated commercial carriers. However, our insurance may not be adequate to cover all losses or liabilities that we might incur in our operations. Furthermore, our insurance may not adequately protect us against liability from all of the hazards of our business. We also are subject to the risk that we may not be able to maintain or obtain insurance of the type and amount we desire at a reasonable cost. If we were to incur a significant liability for which we were uninsured or for which we were not fully insured, it could have a material adverse effect on our financial position, results of operations and cash flows.

## Edgar Filing: KEY ENERGY SERVICES INC - Form 10-K

*We are subject to the economic, political and social instability risks of doing business in certain foreign countries.*

We currently have operations in Argentina and Mexico and may expand our operations into other foreign countries. We also have a technology development group in Canada. As a result, we are exposed to risks of international operations, including:

increased governmental ownership and regulation of the economy in the markets where we operate;

inflation and adverse economic conditions stemming from governmental attempts to reduce inflation, such as imposition of higher interest rates and wage and price controls;

increased trade barriers, such as higher tariffs and taxes on imports of commodity products;

exposure to foreign currency exchange rates;

exchange controls or other currency restrictions;