

KEY ENERGY SERVICES INC
Form 11-K
June 30, 2003

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 10549

FORM 11-K

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
[NO FEE REQUIRED]**

For the fiscal year end **December 31, 2002**

**TRANSITION REPORT PURSUANT TO SECTION 15(d) OF THE SECURITIES EXCHANGE ACT OF
1934 [NO FEE REQUIRED]**

For the transition period from _____ to _____

Commission file number **1-8038**

**KEY ENERGY SERVICES, INC. 401(k) SAVINGS AND
RETIREMENT PLAN**

(Full title of the plan and the address of the plan,
if different from that of the issuer named below)

**KEY ENERGY SERVICES, INC.
6 Desta Drive, Suite 4400
Midland, TX 79705**

(Name of Issuer of the securities held pursuant to the plan
and the address of its principal executive office)

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Exhibit 23.1

Consent of Independent Auditors

Exhibit 99.1

Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Key Energy Services, Inc.
401(k) Savings and Retirement Plan
Financial Statements
and Supplementary Schedule

For the Years Ended:
December 31, 2002, 2001 and 2000

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I. Schedule of Assets Held for Investment Purposes as of December 31, 2002

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Independent Auditors Report

To the Trustees

Key Energy Services, Inc. 401(k) Savings and Retirement Plan

Midland, Texas

We have audited the accompanying statements of net assets available for benefits of Key Energy Services, Inc. 401(k) Savings and Retirement Plan (the Plan) as of December 31, 2002 and 2001, and the related statements of changes in net assets available for benefits for the years ended December 31, 2002, 2001, and 2000. These financial statements are the responsibility of the Plan s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 the 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 net assets available for benefits of the Plan as of December 31, 2002 and 2001, and the changes in net assets available for benefits for the years ended December 31, 2002, 2001, and 2000 in conformity with accounting principles generally accepted in the United States of America.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental Schedule of Assets Held for Investment Purposes as of December 31, 2002 is presented for the purpose of additional analysis and is not a required part of the basic financial statements but are supplementary information required by the United States Department of Labor s Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. The supplemental schedule is the responsibility of the plan s management. The supplemental schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

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/s/ Robinson Burdette Martin Seright & Burrows, L.L.P.

Lubbock, Texas
May 13, 2003

Key Energy Services, Inc.
401(k) Savings and Retirement Plan

Statements of Net Assets Available for Benefits

December 31, 2002 and 2001

| | 2002 | 2001 |
|--|----------------------|----------------------|
| Sponsor contributions | \$ 84,628 | \$ 93,082 |
| Participant contributions | 207,072 | 250,595 |
| Receivables | 291,700 | 343,677 |
| Participant directed: | | |
| Guaranteed investment contract | 19,032,880 | 15,580,961 |
| Pooled separate accounts | 21,048,083 | 19,983,335 |
| Nonparticipant directed: | | |
| Key Energy Employer Stock Fund | 5,555,225 | 3,682,038 |
| Investments, at fair value | 45,636,188 | 39,246,334 |
| Participant loans | 3,307,373 | 2,449,246 |
| Assets | 49,235,261 | 42,039,257 |
| Liabilities | 226,834 | |
| Net Assets Available for Benefits | \$ 49,008,427 | \$ 42,039,257 |

The accompanying *Notes to Financial Statements* are an integral part of these statements

Key Energy Services, Inc.**401(k) Savings and Retirement Plan**

Statements of Changes in Net Assets Available for Benefits

For the Years Ended December 31, 2002, 2001 and 2000

| | Participant Directed | 2002 Nonparticipant Directed | Total |
|---|---------------------------------|---|----------------|
| Net appreciation (depreciation) in fair value of investments | \$ (3,900,246) | \$ (135,245) | \$ (4,035,491) |
| Interest | 889,299 | 7,068 | 896,367 |
| Investment gain (loss), net | (3,010,947) | (128,177) | (3,139,124) |
| Sponsor | 11,789 | 2,292,465 | 2,304,254 |
| Participants | 7,058,529 | 450,159 | 7,508,688 |
| Contributions | 7,070,318 | 2,742,624 | 9,812,942 |
| Investments transferred from merged plans | 5,398,929 | | 5,398,929 |
| Loans transferred from merged plans | 443,650 | | 443,650 |
| Other transfers, net | 184,533 | (184,533) | |
| Transferred assets | 6,027,112 | (184,533) | 5,842,579 |
| Additions to Net Assets | 10,086,483 | 2,429,914 | 12,516,397 |
| Benefits paid to participants | 4,914,008 | 538,495 | 5,452,503 |
| Third-party administrator charges | 68,038 | 26,686 | 94,724 |
| Deductions from Net Assets | 4,982,046 | 565,181 | 5,547,227 |
| Net Increase (Decrease) in Net Assets Available for Benefits | 5,104,437 | 1,864,733 | 6,969,170 |
| Net Assets Available for Benefits: | | | |
| Beginning of year | 38,264,136 | 3,775,121 | 42,039,257 |
| End of year | \$ 43,368,573 | \$ 5,639,854 | \$ 49,008,427 |

The accompanying *Notes to Financial Statements* are an integral part of these statements

Key Energy Services, Inc.
401(k) Savings and Retirement Plan

Statements of Changes in Net Assets Available for Benefits

For the Years Ended December 31, 2002, 2001 and 2000

| | Participant Directed | 2001 Nonparticipant Directed | Total | Participant Directed | 2000 Nonparticipant Directed | Total |
|---|-------------------------|------------------------------------|----------------|-------------------------|------------------------------------|----------------|
| Net appreciation (depreciation) in fair value of investments | \$ (2,693,775) | \$ (396,409) | \$ (3,090,184) | \$ (1,867,359) | \$ 197,630 | \$ (1,669,729) |
| Interest | 951,298 | 4,792 | 956,090 | 908,135 | 3,905 | 912,040 |
| Investment gain (loss), net | (1,742,477) | (391,617) | (2,134,094) | (959,224) | 201,535 | (757,689) |
| Sponsor | (1,510) | 2,207,079 | 2,205,569 | 740 | 987,912 | 988,652 |
| Participants | 6,785,301 | 275,434 | 7,060,735 | 5,552,848 | 103,007 | 5,655,855 |
| Contributions | 6,783,791 | 2,482,513 | 9,266,304 | 5,553,588 | 1,090,919 | 6,644,507 |
| Investments transferred from merged plans | | | | 24,877 | | 24,877 |
| Loans transferred from merged plans | | | | | | |
| Other transfers, net | (103,292) | 103,292 | | (506,033) | 506,033 | |
| Transferred assets | (103,292) | 103,292 | | (481,156) | 506,033 | 24,877 |
| Additions to Net Assets | 4,938,022 | 2,194,188 | 7,132,210 | 4,113,208 | 1,798,487 | 5,911,695 |
| Benefits paid to participants | 3,791,980 | 153,272 | 3,945,252 | 5,570,197 | 30,860 | 5,601,057 |
| Third-party administrator charges | 103,748 | 22,113 | 125,861 | 164,947 | 11,309 | 176,256 |
| Deductions from Net Assets | 3,895,728 | 175,385 | 4,071,113 | 5,735,144 | 42,169 | 5,777,313 |
| Net Increase (Decrease) in Net Assets Available for Benefits | 1,042,294 | 2,018,803 | 3,061,097 | (1,621,936) | 1,756,318 | 134,382 |
| Net Assets Available for Benefits: | | | | | | |
| Beginning of year | 37,221,842 | 1,756,318 | 38,978,160 | 38,843,778 | | 38,843,778 |
| End of year | \$ 38,264,136 | \$ 3,775,121 | \$ 42,039,257 | \$ 37,221,842 | \$ 1,756,318 | \$ 38,978,160 |

The accompanying *Notes to Financial Statements* are an integral part of these statements

Key Energy Services, Inc.
401(k) Savings and Retirement Plan

Notes to Financial Statements

For the Years Ended December 31, 2002, 2001 and 2000

Note 1: Plan Description

This description of Key Energy Services, Inc. 401(k) Savings and Retirement Plan (the Plan) provides only general information. Participants should refer to the plan document for a complete description of the provisions of the Plan.

General. The Plan is a contributory, defined contribution plan covering substantially all employees of Key Energy Services, Inc. (the Sponsor). It is subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA), as amended.

Contributions. As amended in January 2002, participants may contribute up to 100% of their Eligible Considered Compensation annually. Eligible Considered Compensation, as defined in the Plan, is the participant's pretax compensation, less any contributions to any cafeteria plan or other deferred compensation plans, garnishments, and withholdings for applicable payroll taxes. Participants may also contribute amounts representing distributions from other qualified plans. Participants direct the investment of their contributions into various investment options offered by the Plan. The Plan currently offers 23 investment options, including the Key Energy Employer Stock Fund which invests in Sponsor common stock. The Sponsor contributes 100% of the first 3% of base compensation that a participant contributes to the Plan up to \$1,000 in 2002 and 2001, and \$750 in 2000. The Sponsor's matching contribution is invested in the Key Energy Employer Stock Fund. Additional profit sharing amounts may be contributed at the option of the Sponsor's board of directors and are invested in a portfolio of investments as directed by the Participant. Contributions are subject to certain limitations.

Participant Accounts. Each participant's account is credited with the participant's contributions and allocations of the Sponsor's contributions and earnings on the participant's account investments. Sponsor contribution allocations are based on pro rata participant compensation.

Vesting. Participants are always vested in their contributions and earnings thereon. Participants vest in the Sponsor's contribution portion of their accounts (including earnings thereon) based on years of continuous service within a 4-year graded vesting schedule.

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Participant Loans. Participants may borrow a minimum of \$1,000, up to a maximum equal to the lesser of \$50,000 or 50% of their vested account balance, whichever is less. The loans are secured by the balance in the participant's account and bear interest at rates that range from 4% to 11%, which are commensurate with local prevailing rates as determined quarterly by the Plan administrator. Principal and interest are paid ratably through payroll deductions.

Payment of Benefits. On termination of service due to death, disability or retirement, a participant will receive a lump-sum amount equal to the value of the participant's vested interest in his or her account. A participant may receive the value of the vested interest in his or her account as a lump-sum distribution upon termination for other reasons.

Forfeited Accounts. At December 31, 2002, 2001 and 2000, forfeited nonvested accounts totaled \$32,932, \$43,911 and \$111,103, respectively. Forfeitures are available to reduce administrative expenses and future employer contributions and were used as follows:

| | 2002 | 2001 | 2000 |
|-------------------------|-----------|-----------|------------|
| Administrative expenses | \$ 18,141 | \$ 57,429 | \$ 116,448 |
| Employer contributions | 2,374 | 2,522 | 9,919 |

Amendment. The Plan was amended and restated during 2002 to modify the compensation deferral guidelines. Additionally, the amended and restated Plan contained numerous technical changes to ensure that the terms and provisions of the Plan continue to meet the requirements for qualification and exemption under applicable provisions of certain regulatory codes and acts.

Tax Status. The Internal Revenue Service (IRS) had determined and informed the Sponsor by a letter dated September 7, 2001, that the Plan and related Trust were designed in accordance with applicable sections of the Internal Revenue Code (IRC). Although the Plan has been amended since receiving the determination letter, the Plan administrator and the Plan's tax counsel believe that the Plan continues to be designed and operated in compliance with the applicable IRC requirements.

Termination. Although it has no intent to do so, the Sponsor has the right under the Plan to discontinue its contributions at any time and to terminate the Plan subject to the provisions set forth in ERISA. In the event of Plan termination, participants would automatically become 100% vested in their Sponsor contributions.

Note 2: Summary of Significant Accounting Policies

The Plan's financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP), including specialized industry practices as specified in the American Institute of Certified Public Accountants audit and accounting guide titled *Audits of Employee Benefit Plans*.

Use of Estimates. Financial statements prepared in conformity with GAAP require management to make estimates and assumptions that affect the reported amounts of assets, liabilities and changes therein, and disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

Investments. The Plan's investments are held by CIGNA Bank & Trust Company, FSB as trustee for the Plan. The Plan's investment options currently include Sponsor common stock and insurance contracts with Connecticut General Life Insurance Company (CIGNA). Participants may direct all or a portion of their account to be invested in Sponsor common stock, but part of the investments in Sponsor common stock are not participant directed and it is not administratively feasible to separate these investments; therefore, investments in Sponsor common stock are all reported as non-participant directed investments. Investments in Sponsor common stock are stated at fair value, as determined by quoted market prices, in the accompanying financial statements.

Participants may direct investment of their account to a variety of investment contracts. Assets invested in the CIGNA Guaranteed Income Account are maintained in CIGNA's general account. CIGNA credits the account with earnings on the underlying investments and charges the

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account for participant withdrawals and administrative expenses. The contract is included in the accompanying financial statements at fair value as reported to the plan by CIGNA. Fair value is deemed to approximate contract value which represents contributions made under the contract, plus earnings, less participant withdrawals and administrative expenses. Participants may ordinarily direct withdrawal or transfer all or a portion of their investment at contract value, however, CIGNA has the right to defer such withdrawals or transfers. There are no reserves against contract value for credit risk of the contract issuer or otherwise. The average yield and interest rates were approximately 5.33%, 5.12% and 5.12% for 2002, 2001 and 2000, respectively. The crediting interest rate is based on a formula agreed upon with the issuer and is adjusted on a semi-annual basis to reflect market conditions.

Other insurance contract investment options include various CIGNA pooled separate accounts (PSA s). The only amounts that CIGNA allows to be allocated to these PSA s are amounts contributed in accordance with the terms of pension or profit sharing plans qualified under section 401 of the IRC, as amended, governmental plans as defined in section 414(d) of the IRC, as amended, or eligible deferred compensation plans as defined in section 457 of the IRC, as amended. Assets allocated to the PSA s are segregated from CIGNA s other assets and are subject only to the claims of contracts participating in each PSA. Any transfer, distribution or disbursement from these PSA s may be delayed for a period of up to thirty days if there is a negative cash flow into the PSA considering all contracts with funds in the PSA on that valuation date.

Certain of these PSA s invest primarily either in publicly issued bonds or common stocks of domestic or non-United States companies, other types of equity securities or in debt-types of securities. Such assets may, however, be invested in any investment which CIGNA deems to be permissible, in its sole discretion, under applicable law. Any income, gains or losses, realized or unrealized, from the assets in these PSA s is credited to or charged against said PSA without regard to the other income, gains or losses of CIGNA. These PSA s are divided into units of participation. The value of a unit of participation is determined by CIGNA daily and is equal to the market value of the account, determined by CIGNA based on its established procedures for valuing assets, divided by the total number of units of participation.

Other PSA s invest in shares of underlying mutual funds sponsored and advised by investment companies not related to CIGNA. In addition, from time to time, the Insurance Company may invest such assets in short-term money market instruments, cash or cash equivalents. Any income, gains or losses, realized or unrealized, from the assets in these PSA s are credited to or charged against that PSA without regard to the other income, gains or losses of CIGNA. These PSA s are divided into units of participation. The value of a unit of participation is determined by CIGNA daily and is based on the market value of the assets in the PSA at the close of CIGNA s business on that day, as determined by CIGNA in accordance with generally recognized accounting procedures, divided by the total number of units of participation. The market value of the investments in these PSA s are determined by the net asset value (NAV) of the shares plus the value of any dividends and capital gain distributions.

Payment of Benefits. Benefits are paid when due and recorded when paid.

Administrative Costs. Certain administrative services and the use of office fixtures and equipment are provided to the Plan by the Sponsor and no provision for these costs are included in the accompanying financial statements. All other administrative expenses are recognized when incurred.

Prohibited Transactions. A party-in-interest is a fiduciary or employee of the Plan, any person who provides services to the Plan, the Sponsor or an employee association whose members are covered by the Plan, a person who owns 50 percent or more of the Sponsor or such employee association or relatives of such person just listed. Under ERISA, a Plan fiduciary is prohibited from causing the Plan to engage in the following transactions with a party-in-interest, with certain conditional exemptions provided by ERISA:

A sale, exchange or lease of property;

A loan or other extension of credit;

The furnishing of goods, services or facilities;

A transfer of plan assets to a party-in-interest for the use or benefit of a party-in-interest; or

An acquisition of employer securities or real property.

A fiduciary is also generally prohibited from using the Plan's assets for his or her own interest or account, acting in any Plan transactions on behalf of a party whose interests are adverse to those of the Plan or its participants and receiving consideration for his or her own account from a party dealing with the Plan in connection with a transaction involving the Plan's assets.

The Trustees of the Plan do not believe the Plan engaged in any prohibited transactions in 2002, 2001 or 2000.

Note 3: Investments

Components of the Plan's investments are presented below. Individual investments that represent 5 percent or more of the Plan's net assets are separately identified with an asterisk (*). Investments at fair value as determined by quoted market price are identified with QMP. Investments at fair value as determined by CIGNA in accordance with contract terms (see Note 2 investment discussion) are identified with Con. Key Energy common stock is non-participant directed (see Note 2 investment discussion), all other investments (investments in insurance contracts) are participant directed.

| | Fair Value Determined By | 2002 | 2001 |
|---|-----------------------------|---------------|---------------|
| * Stock Index Fund | Con | \$ 2,112,402 | \$ 2,222,464 |
| * Janus Worldwide Account | Con | 1,358,567 | 1,804,311 |
| * State Street Global Advisors | | | |
| Intermediate Bond Account | Con | 3,026,358 | 2,010,293 |
| * Fidelity Advisor Growth Opportunities | Con | 2,956,773 | 3,857,711 |
| * Balanced-Wellington Management | Con | | 2,969,407 |
| * INVESCO Dynamics | Con | 1,553,260 | 2,204,302 |
| * Balanced I-Wellington Management | Con | 2,569,216 | |
| Other pooled separate accounts | Con | 7,471,507 | 4,914,847 |
| Pooled separate accounts(1) | | 21,048,083 | 19,983,335 |
| * CIGNA Guaranteed Income Account | Con | 19,032,880 | 15,580,961 |
| Insurance Contracts | | 40,080,963 | 35,564,296 |
| * Key Energy Employer Stock Fund | QMP | 5,555,225 | 3,682,038 |
| | | \$ 45,636,188 | \$ 39,246,334 |

(1) Pooled separate accounts invested exclusively in shares of underlying mutual funds sponsored and advised by investment companies not related to CIGNA are described by the name of that mutual fund in the table above.

During the years ended December 31, 2002, 2001, and 2000, participant directed investments (including gains and losses realized and unrealized) depreciated in value by \$3,900,246, \$2,693,775, and \$1,867,359, respectively.

During the years ended December 31, 2002, 2001, and 2000, non-participant directed investments, the Key Energy Employer Stock fund, appreciated (depreciated) in value (including gains and losses realized and unrealized) by (\$135,245), (\$396,409), and \$197,630, respectively.

Note 4: Plan Mergers

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During 2002 and 2000, certain employee benefit plans sponsored by companies acquired by the Sponsor were merged into the Plan. In connection with these mergers, investments of \$5,398,929 and \$24,877, respectively, were transferred into the Plan. In addition, participant loans of \$443,650 were transferred into the plan in 2002.

Note 5: Related Party Transactions

The Employer pays certain administrative expenses of the Plan. In addition, the Employer provides certain administrative services to the Plan at no cost. These costs were not significant.

Key Energy Services, Inc.

401(k) Savings and Retirement Plan

Supplemental Schedule

For the Year Ended:

December 31, 2002

Key Energy Services, Inc.
401(k) Savings and Retirement Plan

Schedule of Assets Held for Investment Purposes
as of December 31, 2002

| (a) | (b) Identity of issue, borrower, lessor or similar party (1) | (c) Description of investment including maturity date, rate of interest, collateral, par or maturity value | (d) Cost | (e) Current Value |
|-----|---|--|-------------|-------------------------|
| * | Connecticut General Life Insurance Company | Guaranteed Income Fund | \$ | \$ 19,032,880 |
| * | Connecticut General Life Insurance Company | <i>Pooled Separate Accounts with CIGNA:</i> | | |
| | | Stock Index Fund | | 2,112,402 |
| | | Fidelity Advisor Value Strategies A | | 897,329 |
| | | Janus Worldwide Account | | 1,358,567 |
| | | State Street Global Advisors Intermediate Bond Account | | 3,026,358 |
| | | Templeton Foreign Account | | 408,948 |
| | | Fidelity Advisor Growth Opportunities | | 2,956,773 |
| | | Wellington Management Balanced | | |
| | | John A. Levin Large Cap Value | | 2,371,133 |
| | | Goldman Sachs Large Cap Growth | | 256,749 |
| | | Morgan Stanley Large Cap Growth | | 484,707 |
| | | Janus Advisor Growth Account | | 550,575 |
| | | INVESCO Dynamics | | 1,553,260 |
| | | BERGER Small Cap Value | | 915,873 |
| | | Timesquare Small Cap Growth | | 270,726 |
| | | INVESCO Small Company Growth Account | | 597,457 |
| | | CIGNA Lifetime20 | | 106,738 |
| | | CIGNA Lifetime30 | | 200,987 |
| | | CIGNA Lifetime40 | | 169,519 |
| | | CIGNA Lifetime50 | | 130,435 |
| | | CIGNA Lifetime60 | | 110,331 |
| | | Wellington Management Balanced I | | 2,569,216 |
| * | CIGNA Financial Services, Inc. | Key Energy Employer Stock Fund | | 5,555,225 |
| | | Loans to Participants (1) | | 3,307,373 |
| | | | (2) \$ | 48,943,561 |

* An asterisk (*) in column "a" indicates a party-in-interest to the Plan.

- (1) Participant loans are aggregated and presented with a general description of terms and interest rates.
- (2) Cost information is omitted with respect to participant and/or beneficiary-directed transactions.

See accompanying *Independent Auditors Report*.