EnergyPoint Oilfield Note

QUARTERLY COMMENTARY

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EnergyPoint
RESEARCH

STEEL PARTNER'S DESIGNS FOR ROWAN'S LETOURNEAU [JAN 17, 2008]

Activist investor Steel Partners has announced its intention to nominate multiple candidates to the board of Rowan Companies (RDC), parent of Rowan Drilling and LeTourneau Technologies. Steel Partners contends that investors would be rewarded if Rowan were to spin off the manufacturing business from its contract drilling division, which generates the majority of the company's consolidated revenues and earnings. While history indicates that such "sum of the parts" calculus can benefit stakeholders in specific cases, certain factors suggest to us that separating Rowan Drilling from its manufacturing unit might in the long run do more harm than good.

The reason lies in the unique competitive position that Rowan Drilling has carved out for itself -- and carefully nurtured -- over the years. As much as any company we follow in the oilfield, Rowan focuses on performance and service at the customer level with steadfast single-mindedness. Seemingly everything it does is with the objective of ensuring that customers receive the kind of equipment, service and results they can't get elsewhere. The net result is that in EnergyPoint's most recent independent survey covering providers of drilling and wellsite services, Rowan Drilling rated No. 1 overall in terms of customer satisfaction. This is no small feat given that the rankings included both drilling contractors and service providers.

So what does this have to do with Steel Partners' apparent plans for Rowan? Rowan Drilling's strong reputation and extensive goodwill with customers –- and thus its potential to charge premiums compared to its peers over time -- is driven in part by the quality, reliability and availability of its equipment; and much of its equipment is designed, manufactured and maintained by the very unit Steel Partners appears to be proposing to jettison. While it is true that selling LeTourneau would not preclude Rowan Drilling from continuing to purchase LeTourneau's products, becoming "just another customer" of LeTourneau with no way of ensuring ongoing product quality or availability could in the end serve to erode the distinctive market position that Rowan Drilling has worked so hard to establish.

SCHLUMBERGER'S BALANCING ACT [JAN 20, 2008]

Given Schlumberger's generally lackluster performance in North America over the last couple of quarters, some might be inclined to ask whether its much publicized emphasis on national oil companies (NOCs) as the customers of the future has caused the company to lose at least some of its focus and edge in North America. Our data suggests Schlumberger's appeal with customers in the U.S. & Canada might be slipping, especially when it comes to pressure pumping and completions-related products and services. In EnergyPoint's latest independent surveys covering these areas, respondents' ratings of Schlumberger have lagged that of certain competitors.

To be sure, Schlumberger's products and services have always been perceived as pricey by many in the oilfield. But now, with moderating natural gas prices and incremental demand appearing to be met as much by LNG imports as by domestic drilling, we suspect some North American customers might be balking at some of Schlumberger's more expensive product and service offerings. It's ironic to think that $8.00/mmbtu gas and $90/bbl oil is not enough to allow customers to look past supplier pricing, but the fact is contractors have raised their prices so much during this cycle that some customers would rather switch suppliers or shelve projects altogether than pay historically high rates.

In addition, while hitching its wagon to NOCs is admittedly an attractive growth story for Schlumberger, it is not without risk. Providing NOCs with the same products and services it provides international oil companies (IOCs) like Exxon Mobil and Shell is certainly no sin; but it's difficult not to take notice of the fact that by doing so Schlumberger helps to undermine IOCs' traditional role with NOCs. In other words, Schlumberger is now arguably a quasi-competitor of IOCs. And since many IOCs are large customers of Schlumberger, we wonder if Schlumberger's results, along with its recent announcement to reduce headcount in North America, indicate that IOCs have begun to diversity their supplier relationships away from Schlumberger.

NOBLE'S CHANGE AT THE TOP [JAN 27, 2008]

Noble Corporation's (NE) fourth quarter 2007 earnings will likely be poked and prodded to a greater extent than usual over the next few days as Wall Street analysts and investors seek to gain a glimpse of what can be expected from the offshore driller's new leadership. True, the recent naming of David Williams -- an industry veteran who unquestionably knows his way around the offshore drilling business -- as CEO surprised few in the industry. And most followers of the company believe Williams' transition to the corner office will be a relatively smooth one. Nevertheless, whenever there is change at the top, observers inevitably want to understand the implications for the future.

While we don't pretend to know what Noble's specific path going forward will be under Williams, we do believe Noble's customers are likely hoping for as little divergence from the past as possible. To be sure, Noble has fared extremely well in EnergyPoint's customer satisfaction surveys covering drilling contractors and oilfield service providers. In fact, in our most recent study, the company rated number one in both international markets and deepwater applications, two of the industry's most high-profile and high-growth areas. Field personnel, job planning and design, and safety and environmental performance were all areas in which the company was seen as an especially attractive supplier.

While this strong performance with customers is arguably a function of certain institutionalized and widespread factors within Noble, it was nonetheless achieved under the leadership of two men -- Jim Day and Mark Jackson -- who are no longer with the company. While we have no doubt Williams will look to put his own stamp on the company as he searches for ways to advance Noble's stock price, we also believe the company's culture, including its performance- and customer-centric approach to its business, is a strong differentiator in the market place that's worth protecting. Clearly, Williams has inherited a competent organization that by all accounts has the people, assets and capabilities to perform very well for both customers and investors. Time will tell what he can make of it.

WEATHERFORD'S SUBTLE GAINS [JAN 28, 2008]

Weatherford International (WFT) released fourth quarter 2007 financial results that were highlighted by better-than-expected growth in revenues, both on the domestic and international sides of its business. The company's results are notable since only weeks ago most industry prognosticators would not have guessed that such revenue upside was in store for the company's domestic operations. While stronger home-grown growth is undoubtedly the result of myriad factors -- including the impact of seemingly more aggressive pricing practices -- it looks to us that a subtle but nascent shift in domestic customers' attitudes towards the company might have played a role as well.

Long-time followers of EnergyPoint's surveys know that Weatherford has not fared particularly well in our industry-wide polls. In fact, since 2004 the company has consistently ranked at or near the bottom when compared to its major competitors -– Schlumberger (SLB), Halliburton

(HAL), Baker Hughes (BHI), Smith Int'l (SII) and BJ Services (BJS) -- in many of the product and service areas in which it competes. Having pushed its way onto the scene through a series of acquisitions over the years, Weatherford's suite of offerings, while appearing great on paper, have left many of those participating in our surveys feeling less-than-enthused. Quality and performance have generally lacked the kind of consistency many buyers look for, causing some to question whether the company will ever realize its full potential.

But recently we have detected a change in how domestic customers might be viewing the company. Upon examination of what at first glance is a relatively unremarkable set of customer satisfaction results for the company over the last few years, there is evidence that clients in the U.S. & Canada might be developing a bit of newfound admiration for the company's products and services. For better or worse, part of this appeal is due to attractive pricing, especially relative to the premium-priced offerings of industry juggernaut Schlumberger. But changes in customers' attitudes also reflect perceived incremental improvements in performance, reliability and post-sale support –- all important areas in today's oilfield.

There's little question that Weatherford has ways to go before it reaches the overall customer satisfaction levels enjoyed by companies such as Smith and Grant Prideco (GRP). And like so many other things with Weatherford, these recent positives are partially offset by some lingering negatives, in this case lower satisfaction ratings in its international business. Furthermore, although lower domestic pricing might lead to market share gains and incremental improvements in overall satisfaction in the short term, price-driven strategies can establish some sticky precedents and expectations in the long run. So, the real question is whether Weatherford can continue to gain ground with customers in areas outside of pricing. If so, even greater surprises might be in store for the future.

HALLIBURTON'S IMPROVED COMPETITIVENESS [JAN 30, 2008]

To even the sharpest-eyed observers, progress at today's largest corporations can sometimes prove frustratingly imperceptible. Accordingly, one could be forgiven for viewing Halliburton's fourth quarter 2007 earnings as falling somewhere between average and middle-of-the-road. However, if you look at the larger picture and at the right data, there's evidence that more progress than meets the eye might be underway at the global oilfield giant. With the spin-off of KBR and its nagging asbestos affair now firmly in the rearview mirror, the company seems to have a little more bounce in its step these days. Certainly, its decision to relocate its CEO to Dubai signals a fresh willingness to compete head on with archrival Schlumberger (SLB) for lucrative business in the promising Eastern Hemisphere.

But the real key to understanding the improved competitiveness we see at Halliburton lies in the gains the company is enjoying with customers. Since 2004, Halliburton's customer satisfaction ratings, as measured by EnergyPoint's annual independent surveys, have suggested the company is not only holding its own in the minds of customers, it's now gaining some valuable ground when compared to key rivals. For example, in our most recent survey, respondents utilizing both Halliburton and Schlumberger's drilling and wellsite products rated Halliburton higher overall, both from the standpoint of satisfaction and in terms of their willingness to recommend the company to others. This compares to only a few years ago when such direct comparisons showed little in the way of differences in these two areas.

So what's specifically driving Halliburton's improved competitiveness? While it's true that differences in the two companies' pricing produced the highest gaps, Halliburton also outperformed when it came to product availability and delivery, as well as in the categories of downhole completion equipment and oilfield fluids and chemicals. For its part, Schlumberger stood out in terms of the technical soundness and sophistication of its products, along with the depth and breadth of its offerings. Nevertheless, on balance, Halliburton appears to hold the momentum as it emerges as an increasingly viable alternative to Schlumberger in many areas. And who knows, if trends continue, we might even see that bounce in Halliburton's step replaced by some good old-fashioned swagger.

HELMERICH & PAYNE'S RECIPE FOR SUCCESS [FEB 5, 2008]

Although most would not characterize the current domestic drilling market as being in a period of bust, it is certainly much looser than it was only 12 – 18 months ago. Yet during this softening period, Helmerich & Payne (HP) has well outperformed its peers, both in terms of profit growth and stock price. Consistent with its recent momentum, H&P reported earnings recently that beat Wall Street's estimates by several cents. The results were highlighted by the continued high utilization of its domestic land rig fleet, as well as the announcement of plans to construct additional FlexRig drilling rigs for both at-home and international applications. Notably, these newbuilds are to be supported by longer-term contracts providing healthy returns on investment.

Among the factors we believe behind H&P's breakaway performance and market share gains is the ability to consistently satisfy a forever-demanding group of customers. To be sure, the company's proprietary FlexRigs are a primary reason for such satisfaction, driving H&P's No. 1 rating in terms of the quality, reliability, and condition of its equipment in EnergyPoint's most recent oilfield services survey. The rigs also led the way to top ratings in all three dimensions of technology covered in the survey, including responsiveness to requests for new technology, the ability to develop value-creating technology, and the ability to apply in-house and third-party technologies. Its safety and environmental satisfaction ratings were also tops among land drillers, in part reflecting safety features designed into their rigs.

But the real story is the uniquely virtuous cycle that H&P now enjoys. Because the company has consistently delivered for customers over a number of years now, it is able to continue to extract unusually long contracts from customers even as conditions soften. Such contracts in turn provide it with a visibility that allows management to operate more proactively, efficiently and with an eye toward the long term. Personnel churn that occurs as rig utilization rates vacillate is not nearly the issue for H&P as it is for some of its peers. And because the company manages its rig assembly process in-house, delays from third-party rig fabricators have been removed from its rig-delivery equation. The result: great rigs, on-time delivery, and skilled crews to operate them. And that's a powerful recipe for success.

IS BAKER HUGHES LOSING ITS TOUCH? [FEB 5, 2008]

Today's fourth quarter earnings release by Baker Hughes (BHI) is likely to prompt some to ask whether the company is losing some of its star power as a provider of oilfield products and services. While Baker has admittedly had a little steeper hill to climb in terms of building out its international infrastructure and broadening its technology base than its larger peers, the company continues to struggle to find its rhythm. Unfortunately, EnergyPoint's latest independent customer satisfaction research does not show much that would suggest to us that the company's trajectory with customers is materially different than that of its financial results.

Baker Hughes saw its overall customer satisfaction ranking -- as measured in EnergyPoint's oilfield products survey -- fall from the second quartile in 2005 to the third quartile in 2007. The largest declines in satisfaction, outside of the category of pricing and contract terms, were in areas related to the firm's size, scope and global capabilities (seemingly confirming management's contention that in these areas the company is playing catch-up as a result of past underinvestment). Ratings for Hughes Christensen drill bits, while respectable, showed some minor declines in satisfaction as well. Slightly offsetting the lower ratings in these and other areas, the company's fluids and chemicals rated materially higher than two years ago.

Clearly, one quarter's earnings and a single survey's ratings do not tell anyone all they would want to know about the future direction of the company. However, there is no question that we are less clear as to how Baker Hughes is differentiating itself in the market place than we were when we first started collecting our benchmark ratings data on the company back in 2004. While progress can and does require letting go of the past, we harbor some suspicions that what made Baker Hughes particularly attractive to so many in the oilfield for so many years might be falling victim to reorganization, compliance requirements, and stubborn over-adherence to decentralization as an operating tenet.

NABORS' INTERNATIONAL REBIRTH [FEB 13, 2008]

With a softening North American market as a backdrop, Nabors Industries (NBR) reported 4th quarter 2007 earnings that were off compared to a year ago. The lower results were generally not a surprise as the company had duly telegraphed the slowdown in its U.S. & Canadian businesses. While its domestic fortunes are no doubt due to a number of factors, we suspect a portion of Nabors' home-based weakness reflects certain phantoms from this upcycle when a number of its customers were, let's just say, less-than-fully-satisfied as torrid growth seemed to cloud the company's ability to provide the assets and services they expected. As a result, the company finished last in EnergyPoint's survey covering providers of drilling and oilfield services during this heady period.

Where does Nabors go from here? Well, management continues to tout is prospects for growth internationally, where the supply and demand balance for drilling rigs and services, at least for the time being, is more favorable. Although based on a smaller number of evaluations than its domestic ratings, EnergyPoint's data do suggest that overseas customers likely hold a much more favorable view of the company currently. In fact, Nabors' international ratings were some of the strongest registered in our entire survey. Assuming the company is able to avoid the bad habits that weighed down its marks domestically, its considerable resources and capabilities could allow it to successfully ride a new wave of growth overseas.

Certainly, we'll be watching to see what type of equipment is made available to overseas customers. Our data suggest domestic customers were not always pleased with the iron the company provided in the past -- notwithstanding that many were fortunate to have a rig at all during the strongest points in the cycle. While it appears the company will be sending at least some newbuilds (i.e., more reliable and better performing equipment) overseas, the company will also be challenged to staff and operate these assets adequately. Since ineffective or inexperienced crews tend to go over no better with international clients than domestic ones, the hardest part of Nabors' international rebirth might have as much to do with its ability to manage the people side of its business as it does the equipment side.

SIZE ALONE WON'T BE ENOUGH FOR THE NEW TRANSOCEAN [FEB 13, 2008]

Transocean (RIG) announced normalized fourth quarter 2007 earnings of $862 million on revenues of $2.1 billion. These are eye-popping figures from what is, after last year's megamerger between Transocean and GlobalSantaFe, now the largest offshore drilling contractor in the world. Of course, when it comes to determining what the future holds for this ocean-dwelling behemoth, most observers will likely focus on the long-term demand that exists for technically capable offshore drillers possessing high-spec deepwater rigs. And with leading-edge dayrates for these opportunities in some instances exceeding $600,000 per day, one would have to be remarkably indifferent to not be at least partly intrigued by the company's prospects.

Unfortunately, lost in the discussions and analysis of the company's combined fleet, prospects for newbuilds, plans for asset sales, and impacts of financial leverage will be the merger's impact on customers, some of whom we understand were less-than-enthused to hear of the combination when it was first announced. Not only do mergers concentrate market power in the hands of fewer suppliers –- inevitably causing some providers to feel less beholden to their clients -- they can also be highly disruptive to the operations of the combining companies. As a result, customers can understandably lose confidence in contractors that are more focused on making mergers work than on meeting clients' needs.

Yet, having independently gathered customer satisfaction data on both Transocean and GlobalSantaFe since 2004, we suspect customers might find this particular merger –- at least from a cultural and operational standpoint –- to have a little better chance of enjoying smoother sailing. This is not to say there aren't apparent differences in the two companies' performance and culture. There are. The old Transocean has clearly rated higher than GlobalSantaFe in terms of total satisfaction by respondents in EnergyPoint's past surveys, driven in part by stronger marks for its equipment and technology. Transocean also rated better in deepwater and other more technically demanding applications. However, respondents saw less in the way of differences between the two in areas such as pricing and HSE.

As we see it, the real risk in this case is that the people, practices and culture that caused customers to contract with Transocean or GlobalSantaFe prior to the merger will be replaced with the kind of mediocrity and lack of focus that so often accompany these kinds of category-killer mergers. The reality is companies that acquire the size and scope of today's Transocean need to pay close attention to the level of service, professionalism, flexibility, and responsiveness they offer since most customers still prefer to work with contractors that excel in these areas -- regardless of a supplier's global prowess. One thing is for certain, if the new Transocean is to truly succeed it will need to offer customers something more than simply the opportunity to work with the world's largest offshore driller.

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