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First Qtr 2010

EnergyPoint
RESEARCH

DRIL-QUIP [JAN 5, 2010]

To a large extent, the concept of "under-promise and over-deliver" is an outdated notion with most of today's oilfield suppliers. Instead, it's been replaced by increasingly slick marketing programs and technological claims intended to create the impression of success even before the first order has been placed or job completed. However, what has not changed, and never will, is the need for oilfield suppliers to in fact deliver on their promises.

To this end, Dril-Quip (DRQ) appears to be an emerging leader. Since 2005, respondents to EnergyPoint Research's independent customer satisfaction surveys have rated the company number one among major competitors -- Aker Solutions (AKSO.OL), Cameron International (CAM), FMC Technologies (FTI), Vetco Gray/GE Oil & Gas (GE) and Wood Group (WG.L) -- in terms of its products' abilities to perform to specifications and expectations.

Note: Click on the following links to read more from EnergyPoint regarding [Dril-Quip](#), [Cameron International](#) and [FMC Technologies](#).

Walking into Dril-Quip's corporate headquarters in Houston, few would guess it to be a company on the move. Understated by nature and slow to call attention to itself, the no-nonsense provider of offshore drilling and production equipment sends out a vibe that's more about the nuts and bolts of heavy hardware than the practice of putting on airs. The organization is reserved in just about everything it does in the public realm and seems determined to avoid distractions.

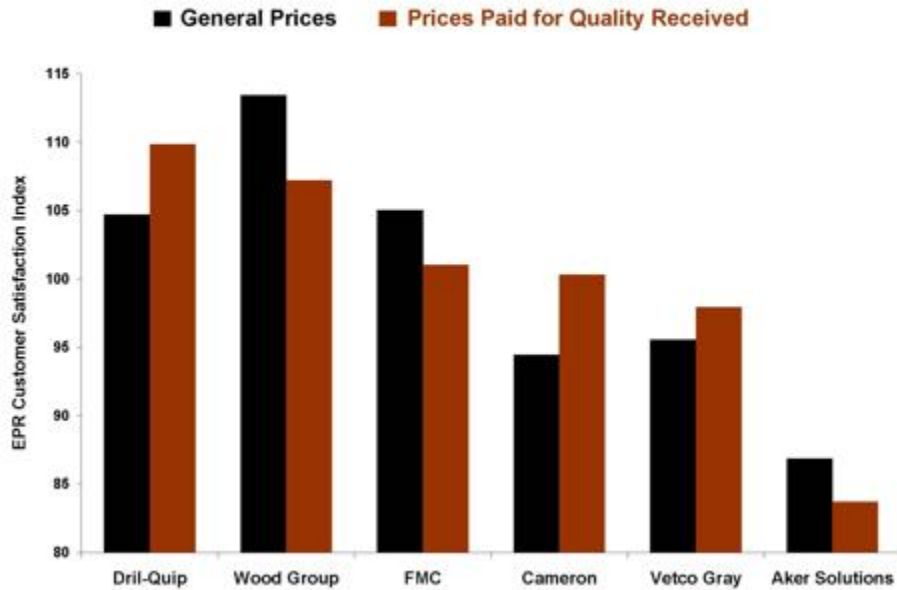
For instance, company management holds no quarterly earnings conference calls, opting instead for brief to-the-point press releases. Nonetheless, we're pretty sure investors are okay with the company's unorthodox style. It's stock price has risen 37.6% on an annualized basis over the last five years, compared to 11.2% for the Philadelphia Oil Service Sector Index (OSX).

So what's going on here? We believe Dril-Quip's apparent ability to better meet the expectations of its customers goes hand-in-hand with its throwback philosophy of walking the walk more than talking the talk. The company's approach certainly works well from a strategic-positioning standpoint. Since 2005, it has garnered segment-leading marks for value, defined in EnergyPoint's surveys as the relationship between the quality customers believe they receive and the prices they pay.

Furthermore, its ratings appear driven more by a perception of higher quality than by lower prices. The upshot is one of the most powerful and cost-effective promotional programs any company could hope for: customers who are both loyal and inclined to recommend its products to others.

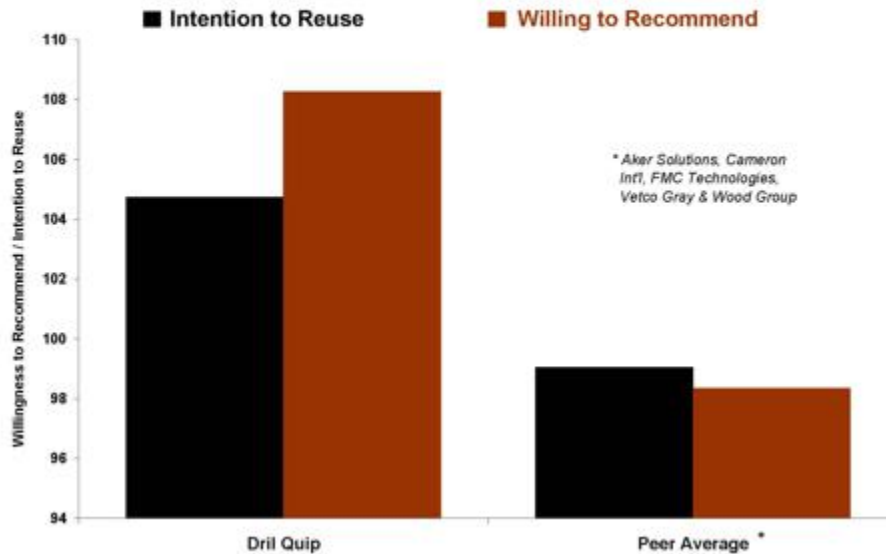
A Leader When It Comes to Value and...

Customer Satisfaction Ratings as % of 2005 - 09 L-T Industry Average



...Customers Who Tend to Both Return & Tell Their Friends

Ratings as % of 2008 - 09 L-T Industry Average

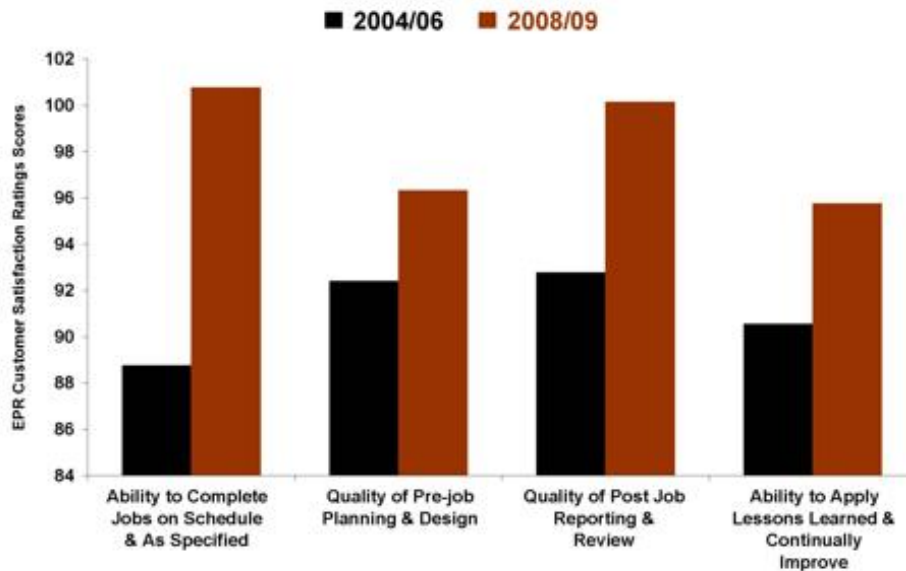


PRIDE INTERNATIONAL [JAN 12, 2010]

Based on metrics from EnergyPoint Research's independent customer satisfaction surveys, Pride International (PDI) appears to have succeeded in its efforts to reorganize, refocus and revitalize its business over the last few years. As evidence, the company's ratings are up across-the-board for the job-quality related attributes we track in our surveys (see chart below, click to enlarge).

In the Area of Job Quality, Pride's Ratings Are Up on All Counts

Customer Satisfaction Ratings as % of Offshore Driller Average

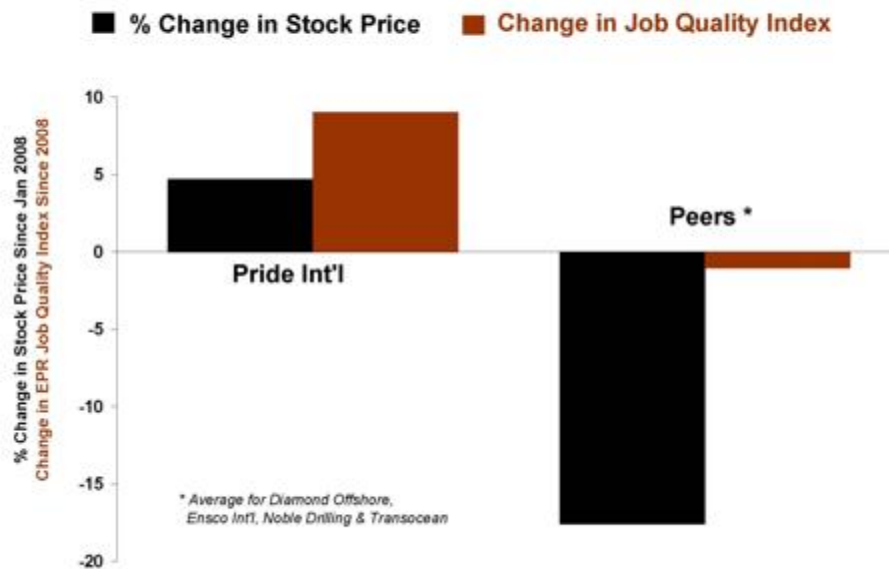


This pop in performance is no doubt a function of numerous constructive actions taken by current management. However, we see the company's prescient decision to focus on burgeoning deepwater drilling opportunities -- while jettisoning its international land drilling, upstream services and mat jackup rig businesses -- as a particularly well crafted, and deftly executed, move.

Pride's deepwater ambitions have certainly gained the company considerable attention. But its progress in the eyes of our survey respondents reflects more than just its change in strategy and market focus. We believe the company has developed a more performance-oriented mindset across its organization in general, supported by improved customer ratings for its shallow-water drilling operations. Whatever the origins of the improvements, shareholders have taken note. Over the last 24 months, Pride has seen its stock price rise 4.7% compared to an average 17.6% decline for the industry's largest offshore drillers -- Diamond Offshore, EnSCO International, Noble and Transocean.

While Pride and its stakeholders clearly have reason to be encouraged concerning the direction of the company, there are (as always) opportunities for improvement. To this end, at least one respondent would like to see the company become more reactive, commenting "*It's difficult for [Pride] to attend to our requests without serious discussions.*" It's also important to note that Pride's competitors are, in our opinion, some of the best managed contractors in the oilfield. In fact, at the height of the last industry upcycle in 2008, ratings for offshore drillers as a whole were highest of all service categories covered in our surveys [[click here to read more](#)]. That said, we suspect having now completed its transformation, Pride will prove itself a worthy competitor.

Performance Has Been Moving in the Right Direction Since 2008



SCHLUMBERGER – SMITH MERGER [FEB 23, 2010]

Schlumberger has confirmed reports that it intends to acquire Smith International in an all-stock transaction that values Smith at approximately \$11 billion. This equates to a premium of 37.5% over Smith's closing share price less than a week earlier and 114.0% above its share price one year ago. The two companies, which have been rumored to have been in on-again off-again discussions regarding a merger for several quarters, are far from strangers. Not only are they the inclusive joint-owners of M-I SWACO, the industries' largest provider of drilling and completion fluids services, Smith's CEO and CFO were both Schlumberger executives in past lives (click on the following to read more from EnergyPoint regarding: [Schlumberger](#), [Smith](#) and [M-I SWACO](#)).

In general, we'd characterize the deal as an opportunistic, although expensive, acquisition of one of the oilfield supply sector's most highly regarded players at what appears to be a nice premium for shareholders. From a competitive-pressure standpoint, we doubt the recent Baker Hughes – BJ Services merger was much of a factor in this deal materializing. Nonetheless, it may very well be that the deals happened for similar reasons: the belief on the seller's part that it needs to be part of a larger organization that has both the ability to bundle its products and services with a host of other offerings and a larger geographic footprint over which to distribute such; and the belief on the purchaser's part that the deal fills a meaningful hole in its portfolio of offerings -- in this case, drill bits.

Strategically, it's clear that Schlumberger sees considerable value in Smith's drill bits business, particularly when it comes to the kind of technology that it refers to as "engineered drilling systems that optimize all the components of the drillstring." As EnergyPoint wrote about in 2009 (click [here](#) to read), we believe Schlumberger is fully on target in its assessment, as these kinds of integrated downhole solutions -- particularly Smith's IDEAS (Integrated Dynamic Engineering Analysis System) and i-DRILL technologies -- are clearly seen by customers as adding considerable value.

Baker Hughes, Halliburton and National Oilwell Varco offer similar simulation-based bit solutions. However, Smith's success in selling its particular bit technology has been, at least in part, predicated on its willingness to recommend whatever equipment is shown to optimize results for customers -- even if the optimal equipment is that of a competitor. The question for customers going forward is whether this same supplier-agnostic approach will be continued under Schlumberger. It seems doubtful that it will, at least to the degree it has under Smith, given the deal's price tag and Schlumberger's readily available portfolio of downhole drilling and related equipment. If this is the case, the benefits customers enjoyed with IDEAS and i-DRILL in the past could be in question going forward.

Smith's other crown jewel is the company's 60% ownership of M-I SWACO (Schlumberger owns the remaining 40%). To be clear, M-I SWACO, which is operated by Smith, is no small catch. The company ranked number one overall in customer satisfaction in EnergyPoint's latest oilfield customer satisfaction survey (read more [here](#)). In addition, it placed first in numerous global regions, as well as in offshore, high-pressure high temperature (HPHT) and non-vertical applications. Although Schlumberger might be tempted to roll M-I SWACO into its own organization (as we expect it will do with all or most of Smith's other units, except Wilson Supply and PathFinder), given M-I SWACO's strong standing with customers, the best move for Schlumberger might be to simply leave M-I SWACO well enough alone.

There's relatively little overlap between the two companies in terms of the products and services they offer. Schlumberger does not currently compete in the category of drill bits, which is Smith's highest-profile product line. In terms of various and sundry other products, there is some overlap, but not in a big way. In M-I SWACO, Smith owns the 60% that Schlumberger does not own. In time, we believe Schlumberger will jettison Wilson Supply, which is too low-margin of a business for Schlumberger's long-term tastes.

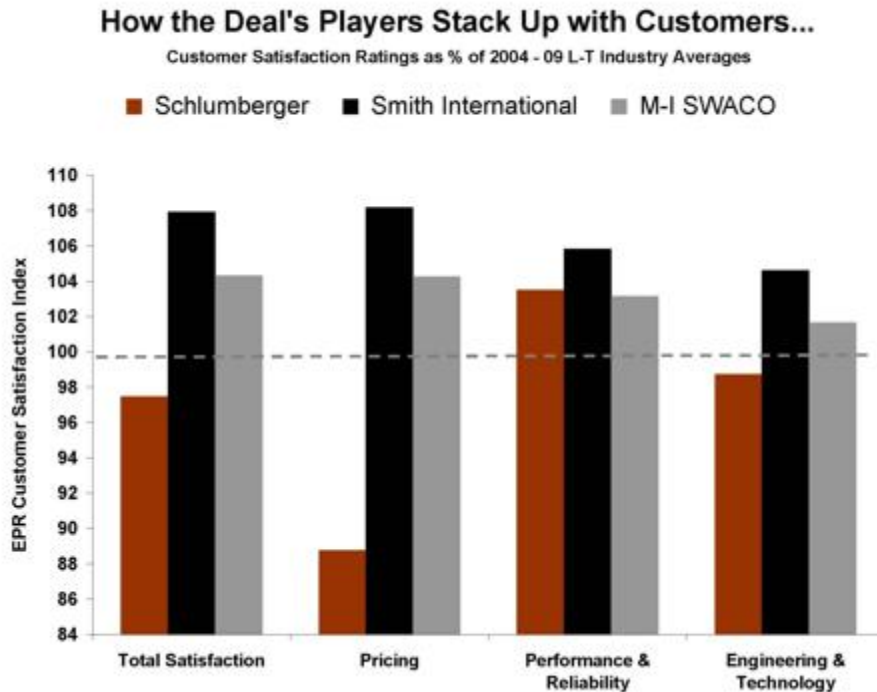
In some ways, the lack of overlap between Smith and Schlumberger conflicts a bit with Schlumberger's projections for what seems to be significant cost savings resulting from the deal. Our take is that Schlumberger might be planning a pretty serious dismantling of the Smith corporate organization. This could introduce execution risk given that Smith's culture and way of doing business are so highly regarded by customers.

Schlumberger's contention that Smith gives it greater exposure to U.S. shale plays does make sense, at least to some degree. Smith is involved at the earliest stages of planning wells, which is attractive from a market intelligence standpoint. And through its leadership position in bits and operatorship of M-I SWACO, Smith has considerable knowledge of what works and does not work when drilling shale wells. For Schlumberger to gain access to this body of knowledge and expertise clearly has value. That said, we note that Schlumberger is not exactly in the dark currently in terms of what it knows about U.S. shale. It's a large player in North America in its own right, offering services in both the drilling and completion phases of wells.

On balance, we believe Schlumberger's strong technology bent could in fact assist in the future development and strengthening of the IDEAS and i-Drill platforms; however, given the already-high ratings Smith receives for these offerings, there is also the chance that adding Schlumberger's hand to things could upset the apple cart. In the end, only time will tell.

Regular readers of EnergyPoint's reports are already aware that, when it comes to their impact on customers, we are not normally enthusiastic about these kinds of mergers. We've just seen too many ratings and read too many accounts from customers of highly rated suppliers like Smith that indicate the existing culture, personal relationships and product and service quality are not fully appreciated, and thus not maintained, by purchasers with lower customer

satisfaction ratings (see chart below comparing Smith and Schlumberger's customer satisfaction ratings across various attributes). The situation is often made worse by the deep cost cuts and steep price hikes that are often instituted at the purchased company to justify the deal financially. The purchase premium, targeted cost savings of \$320 million by 2012, and Schlumberger's reputation for pushing the upward bounds on pricing causes us to believe this transaction runs the risk of estranging at least some of Smith's long-time and more loyal customers. Accordingly, Schlumberger would be wise to embrace, rather than replace, what it can in terms of Smith's operations, culture and personnel.



Click on the following to read other EnergyPoint notes concerning other recent acquisitions/mergers in the oilfield: [ExxonMobil – XTO](#); [Baker Hughes – BJ Services](#); [Precision Drilling – Grey Wolf](#); [Grey Wolf – Basic Energy Services](#); [Halliburton – Expro](#), and; [National Oilwell Varco – GrantPrideco](#).

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