SMITH INTERNATIONAL [APR 24, 2008]

It's difficult to dispute the contention that a company that performs well for customers also tends to perform well for its investors. One oilfield supplier that clearly enjoys the confidence of its customers to an almost unmatched degree – and whose stock price has outperformed the benchmark Philadelphia Oil Service Index (OSX) over the last one, three and five years – is Smith International (SII).

Smith does not garner clients' accolades by simply talking a good game. Our belief is that the company maintains one of the best reputations in the industry in part by carefully choosing the segments in which it knows it can effectively add value (while avoiding most others). Within its 1st Qtr 2008 earnings announcement, there's another sign that there's something special about Smith. Its oilfield segment operating margins actually increased by 20 basis points versus last year.

Normally, this would not be big news; however, consider that comparable margins for Baker Hughes (BHI), Halliburton (HAL), Schlumberger (SLB) and Weatherford (WFT) fell by over 300 basis points on average during the quarter. To be sure, our research continues to indicate that oilfield customers will in fact pay up for products and services they believe will lead to incremental production in cost-effective manners. In our opinion, Smith's ability to buck the industry trend when it comes to operating margins speaks directly to the perceived value of its products and services.

Want more specific evidence of Smith's unique ability to satisfy finicky oilfield customers? Alright, here you go: In EnergyPoint's independently-conducted 2007 Drilling / Wellsite Equipment & Materials Survey, which captured the views of over 630 oil and gas industry professionals, no company garnered more first-place customer satisfaction ratings than Smith. Among the "big six" integrated multinational oil service suppliers –- Schlumberger (SLB), Halliburton (HAL), Baker Hughes (BHI), Weatherford International (WFT), Smith, and BJ Services (BJS) –- Smith rated first in all seven of the survey's key attributes and rated first in 23 of the survey's 24 sub-attributes. Overall, a very heady showing for Smith indeed.

GREY WOLF & BASIC ENERGY SERVICES [APR 25, 2008]

To some extent, we view it as our role to worry about all things oilfield. So, when Grey Wolf (GW) and Basic Energy Services (BAS) announced earlier this week that the two would combine in a friendly deal billed as a merger of equals, but seen by many as an acquisition of BAS by GW, our "worrier instincts" kicked into high gear. This is not to say we believe the merger can't end up being a positive event for both companies and their stakeholders, including their customers; it very well may. It's just that after having analyzed for several years what operators want from their oilfield suppliers, we can't help but view the transaction as a potential distraction from what matters most in today's market place.

Our concern is a simple one: these kinds of transformational transactions tend to soak up too much in the way of time and organizational resources. Moreover, they tend to result, at least during (and often after) the integration period, in a less productive and more inwardly focused supplier. Typically, customers are asked to be patient as managers and employees toil on teams to create, and then implement, a new organizational structure. When new debt is part of the deal, in this case to help fund a $600 MM return of capital to shareholders, short-term cost cutting rather than longer-term investment often becomes the internal mantra. The mission of satisfying customers and making sure quality products and services are reliably provided is often given token lip service, but in reality, relegated to the back burner.

From what we can see, neither GW nor BAS have been particularly notable standouts with customers as of late. In our most recent customer survey covering drillers and service providers, both ranked in the bottom third in terms of overall satisfaction (although GW's low rating contrasted with a much stronger rating two years earlier). BAS ranked modestly higher than GW in most attributes, with completion services enjoying higher marks than its well servicing and fishing segments. GW rated modestly lower than BAS overall, as did other U.S. land drillers Nabors Industries (NBR), Unit Drilling (UNT) and Patterson-UTI (PTEN). We should note that initiatives designed to result in more consistent service experiences for customers are underway at GW, and we hope these positive efforts survive the merger.

The transaction seems to us to be mostly about gaining mass. The combination will create a larger and more integrated provider, with approximately half of its revenues coming from land drilling and half from well servicing, fluids services, completion-related and other services. Unfortunately, while our research does suggest size and scope are growing in importance with customers, service and job quality along with reliability are still the primary drivers of satisfaction. In other words, while bulk might gain the attention of customers, the more important metric will still be how well the company performs for customers. Maybe the merger is just the catalyst to propel GW and BAS into the big leagues. Then again, maybe it will simply result in a larger, less focused version of GW and BAS as they exist today.

FMC TECHNOLOGIES [MAY 1, 2008]

Oilfield equipment maker FMC Technologies (FTI) has been on a roll as of late, at least when it comes to its financial performance. The company added to its momentum with first quarter 2008 earnings that were up almost 40% from the year-earlier period. In addition, management bumped up slightly its full-year 2008 earnings guidance. These strong results come on top of a string of announced contract wins from several heavyweight customers, ostensibly solidifying FMC’s market leadership position on the ocean floor. It also comes as the kinds of technically challenging offshore projects in which the company specializes continue to grow both in terms of contribution to global oil and gas production as well as overall spend by operators.

However, our data also suggest it has not been entirely smooth sailing for the headline-grabbing supplier, as steep growth appears to have contributed to a decline in the company’s ratings in EnergyPoint’s latest customer satisfaction survey. The company rated 25th out of 32 vendors in terms of total satisfaction in our 2007 Drilling / Wellsite Equipment & Materials Customer Satisfaction Survey, down from 9th out of 30 vendors just two years earlier. The largest ratings declines for the company were in the areas of i) performance / reliability, ii) engineering / design, iii) availability / delivery, and iv) personnel. In general, FMC’s rank appeared hamstrung less by ratings for its bread-and-butter wellheads and more by the marks it received for equipment and systems used in connecting and controlling sub-sea wellheads and production flows.

It should be noted that FMC is not alone in recording lower ratings with our survey participants. In a sign of the times, Aker Solutions, Technip-Coflexip, Oil States International (OIS) and Vetco Gray (a unit of GE Oil & Gas) all rated at or below FMC’s level in the 2007 survey. However, none experienced a decline from 2005 of the magnitude of FMC. Furthermore, two of FMC’s primary competitors, Dril-Quip (DRQ) and Cameron International (CAM), saw their overall rankings rise to 10th and 17th, respectively.

Thus, while the drop in FMC's ratings might in the end prove to be transitory, because the company is involved in some of the industry's most high-profile projects and applications, we'll be watching closely to see if it can regain its prior form.

EXPRO INTERNATIONAL, HALLIBURTON AND CANDOVER INVESTMENTS [MAY 21, 2008]

UK-based oilfield service provider Expro International Group [EXR.L] appears officially "in play". Candover Investments [CDI.L] and Goldman Sachs (GS) kicked things off last month with a £1.6bn (~ $3.2 billion) cash offer for the fast-growing provider of flow assurance equipment and wellsite services. The offer represents a 50%+ premium to Expro's stock price prior to management's indication that an offer had been made for the company. But before the ink could dry on the news of the offer by Candover / GS, Halliburton (HAL) announced it was in talks to purchase the company as well, presumably at some premium to the price offered by Candover / GS. From what we can glean, Halliburton is still kicking the tires and / or in the process of preparing its own bid.

Which suitor wins out could hold material implications for Expro customers. Why? Candover / GS would be a financial (i.e., presumably shorter-term) owner, while Halliburton would have more of a long-term strategic interest in the company. To more fully understand why this is important, one has only to hearken back to Candover's 2004 purchase of Vetco International from ABB Oil & Gas, an acquisition that included wellsite equipment maker Vetco Gray. While Candover, along with partner JP Morgan (JPM), turned a tidy profit in the three years in which it owned Vetco Gray (Vetco Gray was sold to GE in 2007 for almost $2 billion), EnergyPoint's data suggest customers' satisfaction with Vetco Gray's performance fell meaningfully during the time the company was owned by Candover.

It's not unreasonable to suggest history could repeat itself in the case of Expro. Candover / GS, in an effort to maximize cash flow, would seem more inclined to limit Expro investments to initiatives offering only the highest returns and the quickest paybacks. Such is the modus operandi of many financial buyers. The firm might even roll back investments and initiatives that current Expro management has in place to enhance operational performance -- initiatives we view as duly warranted. In the end, while Candover / GS might spin more gold for themselves and their investors out of an acquisition of Expro, Halliburton seems better positioned to make Expro shine for customers. Regardless of which suitor triumphs, the victor will inherit a fast-growing supplier with plenty of opportunities for improvement.

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