EnergyPoint Oilfield Note

QUARTERLY COMMENTARY

“Because the right partners can make all the difference . . .”

Third Qtr 2009

EnergyPoint
RESEARCH

Precision Drilling [JULY 27, 2009]

All things being equal, it’s always better to have the winds of history at your back than in your face. For the most part, history should be on the side of Precision Drilling (PDS), even in these darker days of the oil patch. The company’s reputation as a capable drilling contractor and oilfield supplier –- a standing corroborated in independent customer satisfaction surveys conducted by EnergyPoint Research going back to 2004 –- will likely prove advantageous as it, like all North American land drillers, attempts to navigate what is almost certain to be a seller’s market for the foreseeable future. Put simply, because customers are more inclined to work with contactors that have effectively met their needs in the past, Precision’s likely got a step up on peers such as Nabors Industries (NBR) and Patterson-UTI (PTEN).

So, what exactly are Precision’s strengths? According to our data, the company is especially well regarded for its ability to complete jobs on schedule and as specified. The quality and reliability of its field personnel also stands out. Of course, management has its work cut out for it going forward. In its 28-page 2nd Quarter 2009 earnings release (yes, you read that right… the company’s quarterly press release was 28 pages long!!), Precision reported an average 77 drilling rigs as working during the quarter. With a fleet of 388, this equates to an unusually paltry utilization of 19.8%. This is down from 167 working rigs and a 43.0% utilization in the prior quarter, with declines driven by spring break-up in Canada and overall weak demand.

Of course, timing is everything, and Precision acquired Grey Wolf close to the top of the last cycle in late 2008. Thus, despite having undoubtedly longer-term and strategic reasons for the acquisition, the company currently finds itself faced with considerable challenges. Not only is it asset-heavy in what management itself admits is a “dismal” market, our data suggests there’s work to be done with Grey Wolf as survey respondents fell out of love with the company during the last upcycle. Accordingly, we suspect Precision will need some time to upgrade that side of the organization. In short, Precision clearly has plenty on its plate; but these guys are seen as being good at what they do -- or, at least they have been in the past. And in the end, that’s a nice history to have.

Click here to read other EnergyPoint reports on Grey Wolf.

Gardner Denver [AUGUST 13, 2009]

Reading through Gardner Denver’s (GDI) 2008 annual report recently, we noticed something worth mentioning. In the first 23 pages of the report –- the glossy portion of the report that includes the CEO’s letter to readers and a discussion of the company’s culture and its plans for the future –- the word “customer” was used a total of 56 times by our count. That’s twice per page. Moreover, of these mentions, over 40% were in the closely watched CEO’s letter.

So why do we believe this is significant? It’s simple. Our experience is that companies that willingly and whole-heartedly place customers at the center of their stated strategies tend to register greater customer satisfaction and loyalty over time. Essentially, by upping the bar on themselves, they in effect leave left less room for underperformance, excuses, self-denial, etc.

Of course, just because a company and its management invoke the word “customer” does not mean everything just falls in to place. Like most things, achieving high-levels of customer satisfaction over time requires hard work. It also requires the genuine commitment of upper management.

To be clear, EnergyPoint Research’s independent customer satisfaction surveys don’t suggest Gardner Denver is starting from the back of the pack when it comes to oil and gas industry. While the company does have a ways to go to meet the lofty expectations ostensively set in its latest annual report, its customer satisfaction rating in our surveys since 2005 is close to the industry mean. Maybe more important, Gardner Denver’s ratings outshine at least one of its peers, industry giant National Oilwell Varco (NOV). Click here to read other notes on NOV.

Although Gardner Denver is not solely focused on the oil and gas industry -- the industry represented 21% of revenues in 2008, down from an estimated 23% a year earlier -- its products are well known and heavily used across the oilfield. Overall, pricing (especially pricing versus competitors) and its products’ performance in deepwater applications appear to be relative strengths. At the same time, our data pointedly suggest the company could stand some improvement when it comes to the performance of its personnel. This is especially the case when it comes to technical functions. But to the extent the company can shore up ratings in these essential areas, other elements of satisfaction have a good chance of following suit.

Weatherford International [AUGUST 19, 2009]

The pursuit of growth appears almost irrevocably embedded in the organizational DNA of Weatherford International (WFT). Whether through acquisition or organic means, the company seems forever intent on expanding its scope, scale and market share in the global oilfield. Accordingly, revenues rose an astonishing 271% over the five years ending 2008, almost two-and-a-half times the average growth recorded by its competitors Baker Hughes (BHI), BJ Services (BJS), Halliburton (HAL), Smith International (SII) and Schlumberger (SLB) over the same period. At this rate, in the not-too-distant-future the term “Big Four” may in fact supplant “Big Three” in industry’s lexicon for referring to the industry's largest integrated suppliers [click here to read our latest thoughts on the industry’s Big Three].

Clearly, Weatherford remains on the move. It is, however, another question altogether as to whether this pace of growth is necessarily the best thing for customers. Our view is that its lower ratings in EnergyPoint Research’s independent customer satisfaction surveys over the years are, at least in part, the result of the kinds of organizational disruptions and disconnects that can often accompany unrelenting expansion.

Since EnergyPoint performed its first survey in 2004, we’ve collected over 650 customer evaluations on Weatherford and another 4,100+ evaluations on its peers. Our analysis of these results suggests Weatherford is still viewed by some in the industry as an amalgamation of acquired companies that lacks the consistency in quality, service and culture of some of its peers. Below are comments from survey respondents over these years that seem to support this contention.

Manager at supermajor, 2004:

Weatherford is suffering from the buy-out blues. They have bought several companies and do not service many of them well especially on liner hanger side of things. They need to standardize on a few things and staff to meet the customer's needs. They are totally understaffed at present.

Engineer at supermajor, 2005:

Since Weatherford undertook the purchasing of many competitor companies, staff from those companies appear to have become very disillusioned and the quality of certain product lines is not what it has been. It appears that instead of prices dropping, they have increased due to larger parent company overheads.

Engineer / specialist at supermajor, 2006:

Weatherford suffers from a lack of experience and training in their core fields. Whilst purchasing companies they seem to have lost sight of one of the most important things of a business -- looking after and retaining staff (their most important asset). They also lack vision in certain areas where their facilities and equipment are not up to our standards. As they lose staff they do not have trained/experienced staff to train them.

Engineer / specialist at supermajor, 2007:

I believe that Weatherford (like many other large companies) has grown too fast and does not fully realize what they have taken on. Staff are moved into areas that they are not familiar with…and as such the service to the customer slips. There doesn't appear to be the same control of the company that there was in the past.

Engineer / specialist at supermajor, 2008:

The organization is still spread too thin with poor morale. Needs to consolidate and focus their efforts before going off and buying other companies.

Manager at major, 2009:

Will use Weatherford on non-critical jobs. Too much turnover and "mix and match" approach to make them the vendor-of-choice for more demanding jobs. Never really sure if they are doing what's best for them or for me. Company is getting too big to manage.

When it comes to its ratings and rankings versus peers, Weatherford's hint of improvement -- something we thought we detected, and even reported on, several months ago -- seems to have evaporated as of late [click here to read all EnergyPoint reports on WFT]. For example, the company's overall indexed scores in the category of performance and reliability appear to have stagnated as of late. In addition, although Weatherford's international operations represented virtually all of its growth in operating earnings in the two years ending 2008, the survey data unfortunately indicate the satisfaction of at least some of its customers in these high-growth markets has a ways to go. This is the case whether compared to peers in international markets or to its own ratings in the U.S. & Canadian markets.

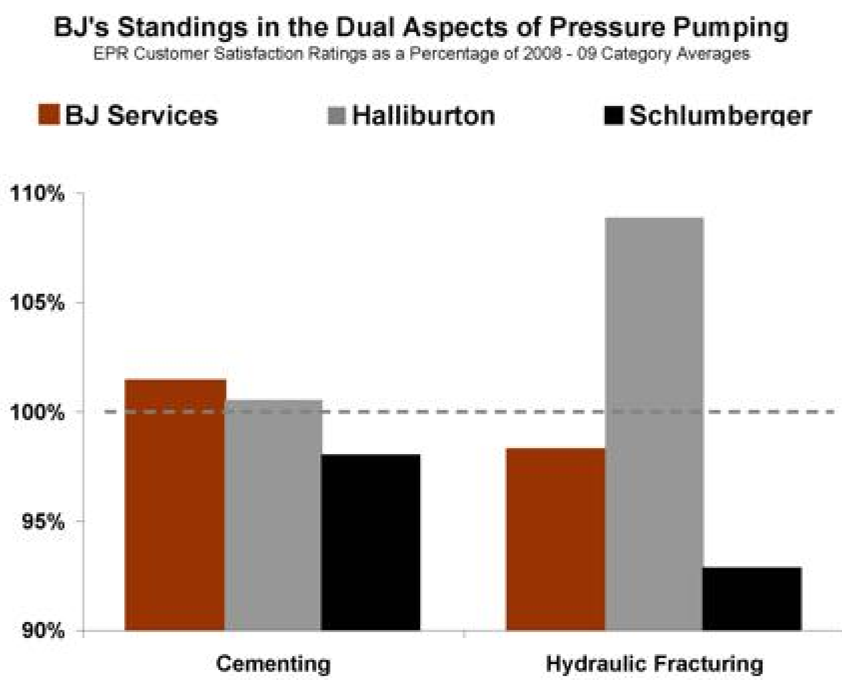
Baker Hughes' Acquisition of BJ Services [September 1, 2009]

Baker Hughes' (BHI) announced acquisition of BJ Services (BJS) is all about BJ Services' pressure pumping business. Apparently, Baker Hughes has decided the lack of such services represents a material hole in its portfolio, especially given the fact both the financial and oilfield markets view the company as a primary competitor of highly integrated Halliburton and Schlumberger –- both of which provide pressure pumping services globally. There's also an argument that Baker Hughes' lack of pressure pumping (and possibly other services) has contributed to its less-than-stellar record as of late when it comes to winning integrated project management contracts (IPM).

IPM contacts have been in the news as of late as Schlumberger (SLB), Weatherford (WFT) and Halliburton (HAL) have all won contracts of these types. That said, we are somewhat skeptical that in the long run the industry will continue it move toward integrated service contracts. The admittedly limited ratings information we have on IPM does not suggest to us that clients are particularly satisfied with what they have been receiving when it comes to IPM. Click on the following to read other EnergyPoint reports on each of these suppliers: BHI BJS HAL SLB WFT .

In general, BJ Services should represent a relatively good fit with Baker Hughes. BJ rates well overall in EnergyPoint Research's independent customer satisfaction surveys, especially in the domestic North American markets. As a reminder, pressure pumping is comprised of two primary services: cementing and hydraulic fracturing. BJ offers both, while Baker Hughes –- for all intents and purposes -- currently offers neither. In cementing services, BJ Services currently rates just ahead of Halliburton as the leader in EnergyPoint's customer satisfaction surveys, while Schlumberger is rated third.

However, in terms of hydraulic fracturing, a service that has become very important in unlocking the potential of the domestic shale gas plays, BJ is rated second in our surveys -- it's rating trails Halliburton by a relatively large margin. The point here is that although BJ is a pressure pumping player, it's more well regarded by customers for its cementing than fracturing services. And unfortunately, cementing is not viewed to be nearly as much of a value-add service as fracturing is these days.



It should be noted that with BJ's pressure pumping services, Baker Hughes is adding a relatively cyclical business to its portfolio. There's significant over capacity in the domestic market, and expectations are that it will take several more quarters before the market recovers. In addition, our data suggest BJ's international ratings performance is not as strong as its North American operations. Unfortunately, Baker Hughes has struggled with its own international performance. As a result, there's a question as to whether two companies with weaker international operations can make a more effective combination in those markets.

While in the long run one would have to assume the combination has the potential to be an incremental plus for Baker Hughes's international business, there's still no guarantee that it will. Furthermore, it will clearly require that Baker Hughes figure out how to do some things with BJ Services in international markets that heretofore it has not been able to do with its own business.

Finally, we note that both Baker Hughes customer satisfaction trends have been somewhat troubling over the last few years (BJ Services' ratings have also begun to weaken as of late). In 2004 and 2005, Baker Hughes typically rated ahead of both Halliburton and Schlumberger in our surveys, in large part because of a well defined culture and a very focused approach to its business. However, over the last few years, the company has seen its ratings lead evaporate. In fact, in some markets, the company is now rated closer to the middle of the pack in key product and service categories.

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