

KEY ENERGY SERVICES INC

Form 10-K

February 25, 2014

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2013

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number 001-08038

KEY ENERGY SERVICES, INC.

(Exact name of registrant as specified in its charter)

Maryland

(State or other jurisdiction of incorporation or organization)

1301 McKinney Street

Suite 1800

Houston, Texas 77010

(Address of principal executive offices, including Zip Code)

(713) 651-4300

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class

Common Stock, \$0.10 par value

Securities registered pursuant to Section 12(g) of the Act:

Title of Class

None

Indicate by check mark if the registrant is a well-known seasoned issuer (as defined in Rule 405 of the Securities Act). Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.) Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The aggregate market value of the common stock of the registrant held by non-affiliates as of June 30, 2013, based on the \$5.95 per share closing price for the registrant’s common stock as quoted on the New York Stock Exchange on such date, was \$778.9 million (for purposes of calculating these amounts, only directors, officers and beneficial owners of 10% or more of the outstanding common stock of the registrant have been deemed affiliates).

As of February 17, 2014, the number of outstanding shares of common stock of the registrant was 152,928,294.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant’s definitive proxy statement to be filed pursuant to Regulation 14A under the Securities Exchange Act of 1934 with respect to the 2014 Annual Meeting of Stockholders are incorporated by reference into Part III of this Form 10-K.

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

In addition to statements of historical fact, this report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Statements that are not historical in nature or that relate to future events and conditions are, or may be deemed to be, forward-looking statements. These “forward-looking statements” are based on our current expectations, estimates and projections about Key Energy Services, Inc. and its wholly owned and controlled subsidiaries, our industry and management’s beliefs and assumptions concerning future events and financial trends affecting our financial condition and results of operations. In some cases, you can identify these statements by terminology such as “may,” “will,” “should,” “predicts,” “expects,” “believes,” “anticipates,” “projects,” “potential,” “continue” or the negative of such terms and other comparable terminology. These statements are only predictions and are subject to substantial risks and uncertainties and are not guarantees of performance. Future actions, events and conditions and future results of operations may differ materially from those expressed in these statements. In evaluating those statements, you should carefully consider the risks outlined in “Item 1A. Risk Factors.”

We undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date of this report except as required by law. All of our written and oral forward-looking statements are expressly qualified by these cautionary statements and any other cautionary statements that may accompany such forward-looking statements.

Important factors that may affect our expectations, estimates or projections include, but are not limited to, the following:

- conditions in the oil and natural gas industry, especially oil and natural gas prices and capital expenditures by oil and natural gas companies;
- volatility in oil and natural gas prices;
- our ability to finance future growth of our operations or future acquisitions;
- our ability to implement price increases or maintain pricing on our core services;
- industry capacity;
- increased labor costs or unavailability of skilled workers;
- asset impairments or other charges;
- the periodic low demand for our services and resulting operating losses;
- our highly competitive industry as well as operating risks, which are primarily self-insured, and the possibility that our insurance may not be adequate to cover all of our losses or liabilities;
- the economic, political and social instability risks of doing business in certain foreign countries;
- our historically high employee turnover rate and our ability to replace or add workers;
- our ability to incur debt or long-term lease obligations or to implement technological developments and enhancements;
- significant costs and liabilities resulting from environmental, health and safety laws and regulations, including those relating to hydraulic fracturing;
- severe weather impacts on our business;
- our ability to successfully identify, make and integrate acquisitions;
- the loss of one or more of our larger customers;
- the impact of compliance with climate change legislation or initiatives;
- our ability to generate sufficient cash flow to meet debt service obligations;
- the amount of our debt and the limitations imposed by the covenants in the agreements governing our debt;
- an increase in our debt service obligations due to variable rate indebtedness; and
- other factors affecting our business described in “Item 1A. Risk Factors.”

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PART I

ITEM 1. BUSINESS

General Description of Business

Key Energy Services, Inc. (NYSE: KEG), a Maryland corporation, is the largest onshore, rig-based well servicing contractor based on the number of rigs owned. References to “Key,” the “Company,” “we,” “us” or “our” in this report refer to Key Energy Services, Inc., its wholly owned subsidiaries and its controlled subsidiaries. We were organized in April 1977 and commenced operations in July 1978 under the name National Environmental Group, Inc. In December 1992, we became Key Energy Group, Inc. and we changed our name to Key Energy Services, Inc. in December 1998. We provide a full range of well services to major oil companies, foreign national oil companies and independent oil and natural gas production companies. Our services include rig-based and coiled tubing-based well maintenance and workover services, well completion and recompletion services, fluid management services, fishing and rental services and other ancillary oilfield services. Additionally, certain of our rigs are capable of specialty drilling applications. We operate in most major oil and natural gas producing regions of the continental United States, and we have operations in Mexico, Colombia, Ecuador, the Middle East and Russia. In addition, we have a technology development and control systems business based in Canada.

The following is a description of the various products and services that we provide and our major competitors for those products and services.

Service Offerings

Our reportable segments are U.S. and International. We also have a “Functional Support” segment associated with overhead costs in support of our reportable segments. The U.S. reporting segment includes our domestic rig-based services, fluid management services, fishing and rental services, and coiled tubing services. The International reportable segment includes our operations in Mexico, Colombia, Ecuador, Russia, Bahrain and Oman. Our Canadian subsidiary is also reflected in our International reportable segment. We evaluate the performance of our operating segments based on gross margin measures. All inter-segment sales pricing is based on current market conditions. The following is a description of the segments: See “Note 23. Segment Information” in “Item 8. Financial Statements and Supplementary Data” for additional financial information about our reportable business segments and the various geographical areas where we operate.

U.S. Segment

Rig-Based Services

Our rig-based services include the completion of newly drilled wells, workover and recompletion of existing oil and natural gas wells, well maintenance, and the plugging and abandonment of wells at the end of their useful lives. We also provide specialty drilling services to oil and natural gas producers with certain of our larger rigs that are capable of providing conventional and horizontal drilling services. Our rigs encompass various sizes and capabilities, allowing us to service all types of wells with depths up to 20,000 feet. Many of our rigs are outfitted with our proprietary KeyView® technology, which captures and reports well site operating data and provides safety control systems. We believe that this technology allows our customers and our crews to better monitor well site operations, improves efficiency and safety, and adds value to the services that we offer.

The completion and recompletion services provided by our rigs prepare wells for production, whether newly drilled, or recently extended through a workover operation. The completion process may involve selectively perforating the well casing to access production zones, stimulating and testing these zones, and installing tubular and downhole equipment. We typically provide a well service rig and may also provide other equipment to assist in the completion process. Completion services vary by well and our work may take a few days to several weeks to perform, depending on the nature of the completion.

The workover services that we provide are designed to enhance the production of existing wells and generally are more complex and time consuming than normal maintenance services. Workover services can include deepening or extending wellbores into new formations by drilling horizontal or lateral wellbores, sealing off depleted production zones and accessing previously bypassed production zones, converting former production wells into injection wells for enhanced recovery operations and conducting major subsurface repairs due to equipment failures. Workover

services may last from a few days to several weeks, depending on the complexity of the workover. Maintenance services provided with our rig fleet are generally required throughout the life cycle of an oil or natural gas well. Examples of these maintenance services include routine mechanical repairs to the pumps, tubing and other equipment, removing debris and formation material from wellbores, and pulling rods and other downhole equipment from wellbores to identify and resolve production problems. Maintenance services are generally less complicated than completion and workover related services and require less time to perform.

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Our rig fleet is also used in the process of permanently shutting-in oil or natural gas wells that are at the end of their productive lives. These plugging and abandonment services generally require auxiliary equipment in addition to a well servicing rig. The demand for plugging and abandonment services is not significantly impacted by the demand for oil and natural gas because well operators are required by state regulations to plug wells that are no longer productive. We believe that the largest competitors for our U.S. rig-based services include Nabors Industries Ltd., Basic Energy Services, Inc., Superior Energy Services, Inc., Forbes Energy Services Ltd. and Pioneer Energy Services Corp. Numerous smaller companies also compete in our rig-based markets in the United States.

Fluid Management Services

We provide transportation and well-site storage services for various fluids utilized in connection with drilling, completions, workover and maintenance activities. We also provide disposal services for fluids produced subsequent to well completion. These fluids are removed from the well site and transported for disposal in saltwater disposal (“SWD”) wells owned by us or a third party. Demand and pricing for these services generally correspond to demand for our well service rigs.

We believe that the largest competitors for our domestic fluid management services include Basic Energy Services, Inc., Superior Energy Services, Inc., Nabors Industries Ltd., Heckmann Water Resources Corporation (owned by Nuverra Environmental Solutions) and Stallion Oilfield Services Ltd. Numerous smaller companies also compete in the fluid management services market in the United States.

Coiled Tubing Services

Coiled tubing services involve the use of a continuous metal pipe spooled onto a large reel which is then deployed into oil and natural gas wells to perform various applications, such as wellbore clean-outs, nitrogen jet lifts, through-tubing fishing, and formation stimulations utilizing acid and chemical treatments. Coiled tubing is also used for a number of horizontal well applications such as milling temporary isolation plugs that separate frac zones and various other pre- and post-hydraulic fracturing well preparation services.

Our primary competitors in the coiled tubing services market include Schlumberger Ltd., Baker Hughes Incorporated, Halliburton Company and Superior Energy Services, Inc. Numerous smaller companies also compete in our coiled tubing services markets in the United States.

Fishing and Rental Services

We offer a full line of fishing services and rental equipment designed for use in providing both onshore and offshore drilling and workover services. Fishing services involve recovering lost or stuck equipment in the wellbore utilizing a broad array of “fishing tools.” Our rental tool inventory consists of drill pipe, tubulars, handling tools (including our patented Hydra-Walk[®] pipe-handling units and services), pressure-control equipment, pumps, power swivels, reversing units and foam air units.

As a result of the 2011 acquisition of Edge Oilfield Services, LLC and Summit Oilfield Services, LLC (collectively, “Edge”), our rental inventory also includes frac stack equipment used to support hydraulic fracturing operations and the associated flowback of frac fluids, proppants, oil and natural gas. We also provide well testing services.

Demand for our fishing and rental services is also closely related to capital spending by oil and natural gas producers, which is generally a function of oil and natural gas prices.

Our primary competitors for our fishing and rental services include Baker Oil Tools (owned by Baker Hughes Incorporated), Weatherford International Ltd., Basic Energy Services, Inc., Smith Services (owned by Schlumberger), Superior Energy Services, Inc., Quail Tools (owned by Parker Drilling Company) and Knight Oil Tools. Numerous smaller companies also compete in our fishing and rental services markets in the United States.

International Segment

Our International segment includes operations in Mexico, Colombia, Ecuador, the Middle East and Russia. In addition, we have a technology development and control systems business based in Canada. Also, prior to the sale of our Argentina business in the third quarter of 2012, we operated in Argentina. We are reporting the results of our Argentina business as discontinued operations for the 2011 and 2012 periods. We provide rig-based services such as the maintenance, workover, and recompletion of existing oil wells, completion of newly-drilled wells, and plugging and abandonment of wells at the end of their useful lives in each of our international markets.

In addition, in Mexico we provide drilling, coiled tubing, wireline and project management and consulting services. Our work in Mexico also requires us to provide third-party services, which vary in scope by project.

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In the Middle East, we operate in the Kingdom of Bahrain and Oman. On August 5, 2013, we agreed to the dissolution of AlMansoori Key Energy Services, LLC, a joint venture formed under the laws of Abu Dhabi, UAE, and the acquisition of the underlying business for \$5.1 million. See “Note 2. Acquisitions” in “Item 8. Financial Statements and Supplementary Data” for further discussion.

Our Russian operations provide drilling, workover, and reservoir engineering services. On April 9, 2013, we completed the acquisition of the remaining 50% noncontrolling interest in OOO Geostream Services Group (“Geostream”), a limited liability company incorporated in the Russian Federation, for \$14.6 million. We now own 100% of Geostream. See “Note 2. Acquisitions” in “Item 8. Financial Statements and Supplementary Data” for further discussion.

Our technology development and control systems business based in Canada is focused on the development of hardware and software related to oilfield service equipment controls, data acquisition and digital information flow.

Functional Support Segment

Our Functional Support segment includes unallocated overhead costs associated with sales, safety and administrative support for our U.S. and International reporting segments.

Equipment Overview

We categorize our rigs and equipment as marketed or stacked. We consider a marketed rig or piece of equipment to be a unit that is working, on standby, or down for repairs but with work orders assigned to it or that is available for work. A stacked rig or piece of equipment is a unit that is in the remanufacturing process and could not be put to work without significant investment in repairs and additional equipment or we intend to salvage the unit for parts, sell the unit or scrap the unit. The definitions of marketed and stacked are used for the majority of our equipment.

Rigs

As mentioned above, our fleet is diverse and allows us to work on all types of wells, ranging from very shallow wells to wells as deep as 20,000 feet. The following table classifies our rigs based on horsepower (“HP”). Typically, higher HP rigs will be utilized on deep wells while lower HP rigs will be used on shallow wells. In most cases, these rigs can be reassigned to other regions should market conditions warrant the transfer of equipment.

| | Horse Power | | Total |
|----------|-------------|----------|-------|
| | < 450 HP | ≥ 450 HP | |
| Marketed | 638 | 160 | 798 |
| Stacked | 169 | 20 | 189 |
| Total | 807 | 180 | 987 |

Coiled Tubing

Coiled tubing uses a spooled continuous metal pipe that is injected downhole in oil and gas wells in order to convey tools, log, stimulate, clean-out and perform other intervention functions. Typically, larger diameter coiled tubing is able to service longer lateral horizontal wells. The table below summarizes our coiled tubing fleet by pipe diameter as of December 31, 2013:

| | Pipe Diameter | | Total |
|----------|---------------|------|-------|
| | < 2" | ≥ 2" | |
| Marketed | 17 | 27 | 44 |
| Stacked | 3 | 4 | 7 |
| Total | 20 | 31 | 51 |

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Fluid Management Services

We have an extensive and diverse fleet of oilfield transportation service vehicles. We broadly define an oilfield transportation service vehicle as any heavy-duty, revenue-generating vehicle weighing over one ton. Our transportation fleet includes vacuum trucks, winch trucks, hot oilers and other vehicles, including kill trucks and various hauling and transport trucks. The table below summarizes our fluid management services fleet as of December 31, 2013:

| | Marketed | Stacked | Total |
|----------------|----------|---------|-------|
| Truck Type | | | |
| Vacuum Trucks | 673 | 149 | 822 |
| Winch Trucks | 96 | 27 | 123 |
| Hot Oil Trucks | 60 | 9 | 69 |
| Other | 111 | 41 | 152 |
| Total | 940 | 226 | 1,166 |

Disposal Wells

As part of our fluid management services, we provide disposal services for fluids produced subsequent to well completion. These fluids are removed from the well site and transported for disposal in SWD wells. The table below summarizes our SWD facilities, and brine and freshwater stations by state as of December 31, 2013:

| | Owned | Leased | Total |
|-----------|-------|--------|-------|
| Location | | | |
| Arkansas | 1 | 1 | 2 |
| Louisiana | 2 | — | 2 |
| Montana | — | | |