

PATTERSON UTI ENERGY INC

Form 10-K

February 19, 2009

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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, 2008
- or
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from _____ to _____

Commission File Number 0-22664

Patterson-UTI Energy, Inc.

(Exact name of registrant as specified in its charter)

Delaware

*(State or other jurisdiction of
incorporation or organization)*

450 Gears Road, Suite 500, Houston, Texas

(Address of principal executive offices)

75-2504748

*(I.R.S. Employer
Identification No.)*

77067

(Zip Code)

Registrant's telephone number, including area code:

(281) 765-7100

Securities Registered Pursuant to 12(b) of the Act:

None

Securities Registered Pursuant to 12(g) of the Act:

(Title of class)

Common Stock, \$.01 Par Value

Preferred Share Purchase Rights

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

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Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes or 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the 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 10-K.

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 Act). Yes No

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of June 30, 2008, the last business day of the registrant's most recently completed second fiscal quarter, was \$5,581,179,402, calculated by reference to the closing price of \$36.13 for the common stock on the Nasdaq National Market on that date.

As of February 16, 2009, the registrant had outstanding 153,098,601 shares of common stock, \$.01 par value, its only class of common stock.

Documents incorporated by reference:

Definitive Proxy Statement for the 2009 Annual Meeting of Stockholders (Part III).

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FORWARD-LOOKING STATEMENTS AND CAUTIONARY STATEMENTS FOR PURPOSES OF THE SAFE HARBOR PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

Certain statements made in this Annual Report on Form 10-K and in other public filings and press releases by us contain forward-looking information (as defined in the Private Securities Litigation Reform Act of 1995) that involves risk and uncertainty. These forward-looking statements include, without limitation, statements relating to: liquidity; financing of operations; continued volatility of oil and natural gas prices; source and sufficiency of funds required for immediate capital needs and additional rig acquisitions (if further opportunities arise); impact of inflation; and other matters. Our forward-looking statements can be identified by the fact that they do not relate strictly to historic or current facts and often use words such as believes, budgeted, expects, estimates, project, will, could, may, intends, strategy, or anticipates, and other words and expressions of similar meaning. The forward-looking statements are based on certain assumptions and analyses we make in light of our experience and our perception of historical trends, current conditions, expected future developments and other factors we believe are appropriate in the circumstances. Although we believe that the expectations reflected in such forward-looking statements are reasonable, we can give no assurance that such expectations will prove to have been correct. Forward-looking statements may be made by management orally or in writing, including, but not limited to, Management's Discussion and Analysis of Financial Condition and Results of Operations included in this Annual Report on Form 10-K and other sections of our filings with the United States Securities and Exchange Commission (the SEC) under the Securities Exchange Act of 1934 and the Securities Act of 1933.

Forward-looking statements are not guarantees of future performance and a variety of factors could cause actual results to differ materially from the anticipated or expected results expressed in or suggested by these forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to, deterioration of global economic conditions, declines in oil and natural gas prices that could adversely affect demand for our services and their associated effect on day rates, rig utilization and planned capital expenditures, excess availability of land drilling rigs, including as a result of the reactivation or construction of new land drilling rigs, adverse industry conditions, adverse credit and equity market conditions, difficulty in integrating acquisitions, demand for oil and natural gas, shortages of rig equipment and ability to retain management and field personnel. Refer to Risk Factors contained in Part 1 of this Annual Report on Form 10-K for a more complete discussion of these and other factors that might affect our performance and financial results. These forward-looking statements are intended to relay our expectations about the future, and speak only as of the date they are made. We undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

PART I

Item 1. Business

Available Information

This Annual Report on Form 10-K, along with our Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, are available free of charge through our Internet website (www.patenergy.com) as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. The information contained on our website is not part of this Report or other filings that we make with the SEC. You may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an internet site (www.sec.gov) that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC.

Overview

Based on publicly available information, we believe we are the second largest operator of land-based drilling rigs in the United States. The Company was formed in 1978 and reincorporated in 1993 as a Delaware corporation.

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Our contract drilling business operates primarily in Texas, New Mexico, Oklahoma, Arkansas, Louisiana, Mississippi, Alabama, Colorado, Arizona, Utah, Wyoming, Montana, North Dakota, South Dakota, Pennsylvania, West Virginia and western Canada.

As of December 31, 2008, we had a drilling fleet that consisted of 344 marketable land-based drilling rigs. A drilling rig includes the structure, power source and machinery necessary to cause a drill bit to penetrate the earth to a depth desired by the customer. A drilling rig is considered marketable at a point in time if it is operating or can be made ready to operate without significant capital expenditures. We also have a substantial inventory of drilling rig components and equipment.

We provide pressure pumping services to oil and natural gas operators primarily in the Appalachian Basin. These services consist primarily of well stimulation and cementing for completion of new wells and remedial work on existing wells. We provide drilling fluids, completion fluids and related services to oil and natural gas operators offshore in the Gulf of Mexico and on land in Texas, New Mexico, Oklahoma and Louisiana. Drilling and completion fluids are used by oil and natural gas operators to control pressure when drilling and completing oil and natural gas wells. We own and invest in oil and natural gas assets as a working interest owner. Our oil and natural gas interests are located primarily in Texas, New Mexico, Mississippi and Louisiana.

Industry Segments

Our revenues, operating profits and identifiable assets are primarily attributable to four industry segments:

- contract drilling,
- pressure pumping services,
- drilling and completion fluids services, and
- oil and natural gas exploration and production.

All of our industry segments had operating profits in 2008, 2007 and 2006, except that in 2008 our drilling and completion fluids services segment reported an operating loss due to a non-cash charge recognized for the impairment of goodwill in that segment.

See Management's Discussion and Analysis of Financial Condition and Results of Operations and Note 14 of Notes to Consolidated Financial Statements included as a part of Items 7 and 8, respectively, of this Report for financial information pertaining to these industry segments.

Contract Drilling Operations

General We market our contract drilling services to major and independent oil and natural gas operators. As of December 31, 2008, we had 344 marketable land-based drilling rigs which were based in the following regions:

- 93 in west Texas and southeastern New Mexico,
- 92 in north central and eastern Texas, northern Louisiana, Mississippi and Alabama,
- 56 in the Rocky Mountain region (Colorado, Arizona, Utah, Wyoming, Montana, North Dakota and South Dakota),

50 in south Texas and southern Louisiana,

27 in the Texas panhandle, Oklahoma and Arkansas,

6 in the Appalachian Basin, and

20 in western Canada.

Our marketable drilling rigs have rated maximum depth capabilities ranging from 5,000 feet to 30,000 feet. Eighty seven of these drilling rigs are electric rigs and 257 are mechanical rigs. An electric rig differs from a mechanical rig in that the electric rig converts the diesel power (the sole energy source for a mechanical rig) into

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electricity to power the rig. We also have a substantial inventory of drilling rig components and equipment which may be used in the activation of additional drilling rigs or as replacement parts for marketable rigs.

Drilling rigs are typically equipped with engines, drawworks, masts, pumps to circulate the drilling fluid, blowout preventers, drill pipe and other related equipment. Over time, components on a drilling rig are replaced or rebuilt. We spend significant funds each year as part of a program to modify, upgrade and maintain our drilling rigs to ensure that our drilling equipment is competitive. We have spent \$1.4 billion during the last three years on capital expenditures to (1) build new land drilling rigs and (2) modify, upgrade and maintain our drilling fleet. During fiscal years 2008, 2007 and 2006, we spent approximately \$361 million, \$540 million and \$531 million, respectively, on these capital expenditures.

Depth and complexity of the well and drill site conditions are the principal factors in determining the size of drilling rig used for a particular job. Our rigs are capable of vertical or horizontal drilling.

Our contract drilling operations depend on the availability of drill pipe, drill bits, replacement parts and other related rig equipment, fuel and qualified personnel. Some of these have been in short supply from time to time.

Drilling Contracts Most of our drilling contracts are with established customers on a competitive bid or negotiated basis. Our drilling contracts are either on a well-to-well basis or a term basis. Well-to-well contracts are generally short-term in nature and cover the drilling of a single well or a series of wells. Term contracts are entered into for a specified period of time (frequently one to three years) and provide for the use of the drilling rig to drill multiple wells. During 2008, our average number of days to drill a well (which includes moving to the drill site, rigging up and rigging down) was approximately 22 days.

The drilling contracts obligate us to provide and operate a drilling rig and to pay certain operating expenses, including wages of drilling personnel and necessary maintenance expenses. Most drilling contracts are subject to termination by the customer on short notice and may or may not contain provisions for the payment of an early termination fee to us in the event that the contract is terminated by the customer. We generally indemnify our customers against claims by our employees and claims that might arise from surface pollution caused by spills of fuel, lubricants and other solvents within our control. The customers generally indemnify us against claims that might arise from other surface and subsurface pollution, except claims that might arise from our gross negligence. Each drilling contract will contain the actual terms setting forth our rights and obligations and those of the particular customer.

The contracts provide for payment on a daywork, footage, or turnkey basis, or a combination thereof. In each case, we provide the rig and crews. All of our contracts during the years ended December 31, 2008, 2007 and 2006 provided for payment on a daywork basis. Our bid for each contract depends upon location, depth and anticipated complexity of the well, on-site drilling conditions, equipment to be used, estimated risks involved, estimated duration of the job, availability of drilling rigs and other factors particular to each proposed well.

Daywork Contracts

Under daywork contracts, we provide the drilling rig and crew to the customer. The customer supervises the drilling of the well. Our compensation is based on a contracted rate per day during the period the drilling rig is utilized. We often receive a lower rate when the drilling rig is moving, or when drilling operations are interrupted or restricted by adverse weather conditions or other conditions beyond our control. Daywork contracts typically provide separately for mobilization of the drilling rig. All of our drilling contracts in 2006, 2007 and 2008 were daywork contracts.

Footage Contracts

Under footage contracts, we contract to drill a well to a certain depth under specified conditions for a fixed price per foot. The customer provides drilling fluids, casing, cementing and well design expertise. These contracts require us to bear the cost of services and supplies that we provide until the well has been drilled to the agreed depth. If we drill the well in less time than estimated, we have the opportunity to improve our profits over those that would be attainable under a daywork contract. Profits are reduced and losses may be incurred if the well requires more days to drill to the contracted depth than estimated. Footage contracts generally contain greater risks for a drilling

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contractor than daywork contracts. Under footage contracts, the drilling contractor typically assumes certain risks associated with loss of the well from fire, blowouts and other risks. We did not enter into any footage contracts in the past three years.

Turnkey Contracts

Under turnkey contracts, we contract to drill a well to a certain depth under specified conditions for a fixed fee. In a turnkey arrangement, we are required to bear the costs of services, supplies and equipment beyond those typically provided under a footage contract. In addition to the drilling rig and crew, we are required to provide the drilling and completion fluids, casing, cementing, and the technical well design and engineering services during the drilling process. We also typically assume certain risks associated with drilling the well such as fires, blowouts, cratering of the well bore and other such risks. Compensation occurs only when the agreed scope of the work has been completed, which requires us to make larger up-front working capital commitments prior to receiving payments under a turnkey drilling contract. Under a turnkey contract, we have the opportunity to improve our profits if the drilling process goes as expected and there are no complications or time delays. Given the increased exposure we have under a turnkey contract, however, profits can be significantly reduced and losses can be incurred if complications or delays occur during the drilling process. Turnkey contracts generally involve the highest degree of risk among the three different types of drilling contracts. We did not enter into any turnkey contracts in the past three years.

Contract Drilling Activity Information regarding our contract drilling activity for the last three years follows:

	Year Ended December 31,		
	2008	2007	2006
Average rigs operating(1)	254	244	296
Number of rigs operated	315	338	331
Number of wells drilled	4,218	4,237	5,050
Number of operating days	93,068	89,095	108,221

(1) A rig is considered to be operating if it is earning revenue pursuant to a contract on a given day.

Drilling Rigs and Related Equipment We estimate the depth capacity with respect to our marketable rigs as of December 31, 2008 to be as follows:

Depth Rating (Ft.)	Number of Rigs		
	U.S.	Canada	Total
5,000 to 7,999		3	3
8,000 to 11,999	65	9	74
12,000 to 15,999	197	8	205
16,000 to 30,000	62		62
Totals	324	20	344

At December 31, 2008, we owned and operated 308 trucks and 405 trailers used to rig down, transport and rig up our drilling rigs. Our ownership of trucks and trailers reduces our dependency upon third parties for these services and enhances the efficiency of our contract drilling operations, particularly in periods of high drilling rig utilization.

Most repair and overhaul work to our drilling rig equipment is performed at our yard facilities located in Texas, New Mexico, Oklahoma, Wyoming, Utah and western Canada.

Pressure Pumping Operations

General We provide pressure pumping services to oil and natural gas operators primarily in the Appalachian Basin. Pressure pumping services are primarily well stimulation and cementing for the completion

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of new wells and remedial work on existing wells. Most wells drilled in the Appalachian Basin require some form of fracturing or other stimulation to enhance the flow of oil and natural gas by pumping fluids under pressure into the well bore. Generally, Appalachian Basin wells require cementing services before production commences. The cementing process inserts material between the wall of the well bore and the casing to center and stabilize the casing.

Equipment Our pressure pumping equipment at December 31, 2008 includes:

- 42 cement pumper trucks,
- 66 triplex pumper trucks,
- 54 nitrogen pumper trucks,
- 5 quintiplex pump trailers,
- 31 blender trucks,
- 28 bulk acid trucks/acid pumper trucks,
- 47 bulk cement trucks,
- 27 bulk nitrogen trucks,
- 6 bulk nitrogen tractor trailer combinations,
- 69 bulk sand trucks,
- 14 sand pneumatic trucks,
- 7 sand pneumatic trailers,
- 9 flatbed material trucks,
- 24 connection trucks,
- 2 shale fracturing manifold trailers,
- 1 shale fracturing iron trailer,
- 8 shale fracturing sand field bins with conveyors,
- 2 shale fracturing large conveyors, and
- 21 tractors.

Drilling and Completion Fluids Operations

General We provide drilling fluids, completion fluids and related services to oil and natural gas operators offshore in the Gulf of Mexico and on land in Texas, New Mexico, Oklahoma and Louisiana. We serve our offshore customers

through six stockpoint facilities located along the Gulf of Mexico in Texas and Louisiana and our land-based customers through fourteen stockpoint facilities in Texas, Louisiana, Oklahoma and New Mexico.

Drilling Fluids Drilling fluid products and systems are used to cool and lubricate the bit during drilling operations, contain formation pressures (thereby minimizing blowout risk), suspend and remove rock cuttings from the hole and maintain the stability of the wellbore. Technical services are provided to promote effective application of the products and systems used to optimize drilling operations.

Completion Fluids After a well is drilled, the well casing is set and cemented into place. At that point, the drilling fluid services are complete and the drilling fluids are circulated out of the well and replaced with completion fluids. Completion fluids, also known as clear brine fluids, are solids-free, clear salt solutions that have high specific gravities. Combined with a range of specialty chemicals, these fluids are used to control bottom-hole pressures and to meet specific corrosion, inhibition, viscosity and fluid loss requirements.

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Raw Materials The profitability of our drilling and completion fluids operations is affected by the availability and pricing of the following raw materials:

Drilling

barite and bentonite

Completion

calcium chloride, calcium bromide and zinc bromide

We obtain these raw materials through purchases made on the spot market and supply contracts we have with producers of these raw materials.

Barite Grinding Facility We operate a barite grinding facility with two barite grinding mills in Houma, Louisiana. This facility allows us to grind raw barite into the powder additive used in drilling fluids.

Other Equipment We own and operate 13 trucks and 141 trailers and lease another 34 trucks which are used to transport drilling and completion fluids and related equipment.

Oil and Natural Gas Operations

General We have been engaged in the development, exploration, acquisition and production of oil and natural gas. Through October 31, 2007, we served as operator with respect to several properties and were actively involved in the development, exploration, acquisition and production of oil and natural gas. Effective November 1, 2007, we sold the related operations portion of our exploration and production business, which was the portion of that business that actively managed the development, exploration, acquisition and production of oil and natural gas. We continue to own and invest in oil and natural gas assets as a working interest owner. Our oil and natural gas interests are located primarily in producing regions of Texas, New Mexico, Mississippi and Louisiana.

Customers

The customers of each of our three oil service business segments are oil and natural gas operators. Our customer base includes both major and independent oil and natural gas operators. During 2008, no single customer accounted for 10% or more of our consolidated operating revenues.

Competition

Contract Drilling and Pressure Pumping Businesses Our land drilling and pressure pumping businesses are highly competitive. At times, available land drilling rigs and pressure pumping equipment exceed the demand for such equipment. The equipment can also be moved from one market to another in response to market conditions.

Drilling and Completion Fluids Business The drilling and completion fluids industry is highly competitive and price is generally the most important factor. Other competitive factors include the availability of chemicals and experienced personnel, the reputation of the fluids services provider in the drilling industry and relationships with customers. Some of our competitors have substantially more resources and longer operating histories than we have.

Government and Environmental Regulation

All of our operations and facilities are subject to numerous Federal, state, foreign, and local laws, rules and regulations related to various aspects of our business, including:

drilling of oil and natural gas wells,

containment and disposal of hazardous materials, oilfield waste, other waste materials and acids,

use of underground storage tanks, and

use of underground injection wells.

To date, applicable environmental laws and regulations have not required the expenditure of significant resources. We do not anticipate any material capital expenditures for environmental control facilities or extraordinary expenditures to comply with environmental rules and regulations in the foreseeable future. However,

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compliance costs under existing laws or under any new requirements could become material, and we could incur liability in any instance of noncompliance.

Our business is generally affected by political developments and by Federal, state, foreign, and local laws and regulations that relate to the oil and natural gas industry. The adoption of laws and regulations affecting the oil and natural gas industry for economic, environmental and other policy reasons could increase costs relating to drilling and production. They could have an adverse effect on our operations. State and Federal environmental laws and regulations currently apply to our operations and may become more stringent in the future.

We believe we use operating and disposal practices that are standard in the industry. However, hydrocarbons and other materials may have been disposed of or released in or under properties currently or formerly owned or operated by us or our predecessors. In addition, some of these properties have been operated by third parties over whom we have no control of their treatment of hydrocarbon and other materials or the manner in which they may have disposed of or released such materials.

The Federal Comprehensive Environmental Response Compensation and Liability Act of 1980, as amended, commonly known as CERCLA, and comparable state statutes impose strict liability on:

owners and operators of sites, and

persons who disposed of or arranged for the disposal of hazardous substances found at sites.

The Federal Resource Conservation and Recovery Act (RCRA), as amended, and comparable state statutes govern the disposal of hazardous wastes. Although CERCLA currently excludes petroleum from the definition of hazardous substances, and RCRA also excludes certain classes of exploration and production wastes from regulation, such exemptions by Congress under both CERCLA and RCRA may be deleted, limited, or modified in the future. If such changes are made to CERCLA and/or RCRA, we could be required to remove and remediate previously disposed of materials (including materials disposed of or released by prior owners or operators) from properties (including ground water contaminated with hydrocarbons) and to perform removal or remedial actions to prevent future contamination.

The Federal Water Pollution Control Act and the Oil Pollution Act of 1990, as amended, and implementing regulations govern:

the prevention of discharges, including oil and produced water spills, and

liability for drainage into waters.

The Oil Pollution Act is more comprehensive and stringent than previous oil pollution liability and prevention laws. It imposes strict liability for a comprehensive and expansive list of damages from an oil spill into waters from facilities. Liability may be imposed for oil removal costs and a variety of public and private damages. Penalties may also be imposed for violation of Federal safety, construction and operating regulations, and for failure to report a spill or to cooperate fully in a clean-up.

The Oil Pollution Act also expands the authority and capability of the Federal government to direct and manage oil spill clean-up and operations, and requires operators to prepare oil spill response plans in cases where it can reasonably be expected that substantial harm will be done to the environment by discharges on or into navigable waters. We have spill prevention control and countermeasure plans in place for our oil and natural gas properties in each of the areas in which we operate and for each of the stockpoints operated by our drilling and completion fluids business. Failure to comply with ongoing requirements or inadequate cooperation during a spill event may subject a

responsible party, such as us, to civil or criminal actions. Although the liability for owners and operators is the same under the Federal Water Pollution Act, the damages recoverable under the Oil Pollution Act are potentially much greater and can include natural resource damages.

Our operations are also subject to Federal, state and local regulations for the control of air emissions. The Federal Clean Air Act, as amended, and various state and local laws impose certain air quality requirements on us. Amendments to the Clean Air Act revised the definition of major source such that emissions from both wellhead and associated equipment involved in oil and natural gas production may be added to determine if a source is a

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major source. As a consequence, more facilities may become major sources and thus would be required to obtain operating permits. This permitting process may require capital expenditures in order to comply with permit limits.

Risks and Insurance

Our operations are subject to the many hazards inherent in the drilling business, including:

- accidents at the work location,
- blow-outs,
- cratering,
- fires, and
- explosions.

These hazards could cause:

- personal injury or death,
- suspension of drilling operations, or
- serious damage or destruction of the equipment involved and, in addition to environmental damage, could cause substantial damage to producing formations and surrounding areas.

Damage to the environment, including property contamination in the form of either soil or ground water contamination, could also result from our operations, particularly through:

- oil or produced water spillage,
- natural gas leaks, and
- fires.

In addition, we could become subject to liability for reservoir damages. The occurrence of a significant event, including pollution or environmental damages, could materially affect our operations, cash flows and financial condition.

As a protection against operating hazards, we maintain insurance coverage we believe to be adequate, including:

- all-risk physical damages,
- employer's liability,
- commercial general liability, and
- workers compensation insurance.

We believe that we are adequately insured for bodily injury and property damage to others with respect to our operations. Such insurance, however, may not be sufficient to protect us against liability for all consequences of:

personal injury,

well disasters,

extensive fire damage,

damage to the environment, or

other hazards.

We also carry insurance to cover physical damage to, or loss of, our drilling rigs. Such insurance does not, however, cover the full replacement cost of the rigs, and we do not carry insurance against loss of earnings resulting

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from such damage. In view of the difficulties that may be encountered in renewing such insurance at reasonable rates, no assurance can be given that:

we will be able to maintain the type and amount of coverage that we believe to be adequate at reasonable rates, or

any particular types of coverage will be available.

In addition to insurance coverage, we also attempt to obtain indemnification from our customers for certain risks. These indemnity agreements typically require our customers to hold us harmless in the event of loss of production or reservoir damage. These contractual indemnifications, if obtained, may not be supported by adequate insurance maintained by the customer.

Employees

We had approximately 6,600 full-time employees at December 31, 2008. The number of employees fluctuates depending on the current and expected demand for our services. We consider our employee relations to be satisfactory. None of our employees are represented by a union.

Seasonality

Seasonality does not significantly affect our overall operations. However, our drilling operations in Canada, and our pressure pumping division in the Appalachian Basin to a lesser extent, are subject to slow periods of activity during the Spring thaw.

Raw Materials and Subcontractors

We use many suppliers of raw materials and services. These materials and services have historically been available, although there is no assurance that such materials and services will continue to be available on favorable terms or at all. We also utilize numerous independent subcontractors from various trades.

Item 1A. *Risk Factors.*

You should consider each of the following factors as well as the other information in this Report in evaluating our business and our prospects. Additional risks and uncertainties not presently known to us or that we currently consider immaterial may also impair our business operations. If any of the following risks actually occur, our business and financial results could be harmed. You should also refer to the other information set forth in this Report, including our financial statements and the related notes.

Global Economic Conditions May Adversely Affect Our Operating Results.

During recent months, there has been a significant decline in oil and natural gas prices. During this time there has also been a significant deterioration in the global economic environment. As part of this deterioration, there has been significant uncertainty in the capital markets and access to financing has been reduced. As a result of these conditions, customers have recently started reducing or curtailing their drilling programs, which is resulting in a significant decrease in demand for our services. Furthermore, these factors could result in certain of our customers experiencing an inability to pay suppliers, including us, if they are not able to access capital to fund their operations. These conditions could have a material adverse effect on our business, financial condition, cash flows and results of operations.

We are Dependent on the Oil and Natural Gas Industry and Market Prices for Oil and Natural Gas. Declines in Oil and Natural Gas Prices Have Adversely Affected Our Operating Results.

Our revenue, profitability and rate of growth are substantially dependent upon prevailing prices for natural gas and, to a lesser extent, oil. For many years, oil and natural gas prices and markets have been extremely volatile. Prices are affected by:

market supply and demand,

international military, political and economic conditions, and

the ability of the Organization of Petroleum Exporting Countries, commonly known as OPEC, to set and maintain production and price targets.

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All of these factors are beyond our control. During 2008, the monthly average market price of natural gas peaked in June at \$13.06 per Mcf before rapidly declining to an average of \$5.99 per Mcf in December. In January 2009, the average market price of natural gas declined further to \$5.40 per Mcf. This decline in the market price of natural gas has resulted in our customers significantly reducing their drilling activities beginning in the fourth quarter of 2008 and continuing into 2009. This reduction in demand combined with the reactivation and construction of new land drilling rigs in the United States during the last several years has resulted in excess capacity compared to demand. As a result of these factors, our average number of rigs operating has recently declined significantly. We expect oil and natural gas prices to continue to be volatile and to affect our financial condition, operations and ability to access sources of capital. Continued low market prices for natural gas will likely result in further decreases in demand for our drilling rigs and adversely affect our operating results.

A General Excess of Operable Land Drilling Rigs Adversely Affects Our Profit Margins Particularly in Times of Weaker Demand.

The North American land drilling industry has experienced periods of downturn in demand over the last decade. During these periods, there have been substantially more drilling rigs available than necessary to meet demand. As a result, drilling contractors have had difficulty sustaining profit margins during the downturn periods.

In addition to adverse effects that declines in demand could have on us, ongoing factors which could continue to adversely affect utilization rates and pricing, even in an environment of high oil and natural gas prices and increased drilling activity, include:

movement of drilling rigs from region to region,

reactivation of land-based drilling rigs, or

construction of new drilling rigs.

As a result of an increase in drilling activity and increased prices for drilling services in recent years, construction of new drilling rigs increased significantly. The addition of new drilling rigs to the market and the recent decrease in demand has resulted in excess capacity. We cannot predict either the future level of demand for our contract drilling services or future conditions in the oil and natural gas contract drilling business.

Shortages of Drill Pipe, Replacement Parts and Other Related Rig Equipment Adversely Affects Our Operating Results.

During periods of increased demand for drilling services, the industry has experienced shortages of drill pipe, replacement parts and other related rig equipment. These shortages can cause the price of these items to increase significantly and require that orders for the items be placed well in advance of expected use. These price increases and delays in delivery may require us to increase capital and repair expenditures in our contract drilling segment. Severe shortages could impair our ability to operate our drilling rigs.

The Oil Service Business Segments in Which We Operate Are Highly Competitive with Excess Capacity, which Adversely Affect Our Operating Results.

Our land drilling and pressure pumping businesses are highly competitive. At times, available land drilling rigs and pressure pumping equipment exceed the demand for such equipment. This excess capacity has resulted in substantial competition for drilling and pressure pumping contracts. The fact that drilling rigs and pressure pumping equipment

are mobile and can be moved from one market to another in response to market conditions heightens the competition in the industry.

We believe that price competition for drilling and pressure pumping contracts will continue for the foreseeable future due to the existence of available rigs and pressure pumping equipment.

In recent years, many drilling and pressure pumping companies have consolidated or merged with other companies. Although this consolidation has decreased the total number of competitors, we believe the competition for drilling and pressure pumping services will continue to be intense.

The drilling and completion fluids services industry is highly competitive. Price is generally the most important factor. Other competitive factors include the availability of chemicals and experienced personnel, the

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reputation of the fluids services provider in the drilling industry and relationships with customers. Some of our competitors have substantially more resources and longer operating histories than we have.

Labor Shortages Adversely Affect Our Operating Results.

During periods of increasing demand for contract drilling and pressure pumping services, the industry experiences shortages of qualified personnel. During these periods, our ability to attract and retain sufficient qualified personnel to market and operate our drilling rigs and pressure pumping equipment is adversely affected, which negatively impacts both our operations and profitability. Operationally, it is more difficult to hire qualified personnel, which adversely affects our ability to mobilize inactive rigs and pressure pumping equipment in response to the increased demand for such services. Additionally, wage rates for drilling and pressure pumping personnel are likely to increase during periods of increasing demand, resulting in higher operating costs.

Continued Growth Through Rig Acquisition is Not Assured.

We have increased our drilling rig fleet in the past through mergers, acquisitions and rig construction. The land drilling industry has experienced significant consolidation, and there can be no assurance that acquisition opportunities will be available in the future. Additionally, we are likely to continue to face intense competition from other companies for available acquisition opportunities.

There can be no assurance that we will:

- have sufficient capital resources to complete additional acquisitions,
- successfully integrate acquired operations and assets,
- effectively manage the growth and increased size,
- successfully deploy idle or stacked rigs,
- maintain the crews and market share to operate drilling rigs acquired, or
- successfully improve our financial condition, results of operations, business or prospects as a result of any completed acquisition.

We may incur substantial indebtedness to finance future acquisitions and also may issue equity securities or convertible securities in connection with any such acquisitions. Debt service requirements could represent a significant burden on our results of operations and financial condition and the issuance of additional equity would be dilutive to existing stockholders. Also, continued growth could strain our management, operations, employees and other resources.

The Nature of our Business Operations Presents Inherent Risks of Loss that, if not Insured or Indemnified Against, Could Adversely Affect Our Operating Results.

Our operations are subject to many hazards inherent in the contract drilling, pressure pumping, and drilling and completion fluids businesses, which in turn could cause personal injury or death, work stoppage, or serious damage to our equipment. Our operations could also cause environmental and reservoir damages. We maintain insurance coverage and have indemnification agreements with many of our customers. However, there is no assurance that such insurance or indemnification agreements would adequately protect us against liability or losses from all consequences

of these hazards. Additionally, there can be no assurance that insurance would be available to cover any or all of these risks, or, even if available, that insurance premiums or other costs would not rise significantly in the future, so as to make the cost of such insurance prohibitive.

We have elected in some cases to accept a greater amount of risk through increased deductibles on certain insurance policies. For example, we maintain a \$1.0 million per occurrence deductible on our workers' compensation, general liability and equipment insurance coverages.

Violations of Environmental Laws and Regulations Could Materially Adversely Affect Our Operating Results.

The drilling of oil and natural gas wells is subject to various Federal, state, foreign, and local laws, rules and regulations. The cost of compliance with these laws and regulations could be substantial. A failure to comply with these requirements could expose us to substantial civil and criminal penalties. In addition, Federal law imposes a