

The Oil Services Issue

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**Basic Energy Services:
Demand profile changing
for oil service companies**

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AN INTERVIEW WITH KEN HUSEMAN,
PRESIDENT AND CEO OF BASIC ENERGY SERVICES

Shale activity drives demand for **Basic Energy Services**



Photo courtesy of Basic Energy Services.

EDITOR'S NOTE: Ken Huseman, president and CEO of Midland, Texas-based Basic Energy Services Inc., recently took time out of his busy schedule to talk with OGFJ about his company and plans for the coming year.

OIL & GAS FINANCIAL JOURNAL: Basic Energy Services provides well-site services throughout the life of the well. Talk to us about the services you provide and how you help exploration and production companies maximize returns.

KEN HUSEMAN: That's a question we get quite often. To start, Basic Energy Services is positioned within our markets to provide services to more than 80% of the existing oil and gas producing wells in the US as well as being situated in the most active drilling markets. We provide a range of services essential to exploration and production companies throughout each phase of the life of the well from the preparation of the well site prior to a new well being drilled, the services required for the drilling and completion of the well and then throughout the 40- or 50-year productive life of the well. A typical well requires periodic maintenance throughout its productive life to keep the downhole equipment intact and the well producing at its optimum capacity. We have the experienced personnel and equipment to assist our customers in keeping that production flowing.

We have an extensive fleet of equipment suited to the unique requirements of each of our markets. Our fleet includes approximately 900 fluid service trucks, more than 3,000 frac tanks, 70 disposal wells, 222 pressure pumping units aggregating more than 270,000 horsepower capacity, rental and fishing tool equipment, a fleet of 12 drilling rigs, and of course our fleet of more than 400 well servicing rigs. That diversified array of equipment and extensive network of more than 120 service locations has allowed us to be responsive to the needs of our customers as they ramp up their efforts to take advantage of historically high oil prices across the country whether in the well-established Permian Basin or the developing plays such the Eagle Ford Shale of South Texas or the Bakken Shale in North Dakota.

OGFJ: Activity in oil and liquid-rich basins has surged in recent years. Are you seeing more demand in the initial phases of development? If so, what are the positive implications for Basic Energy Services' growth profile in the years to come?

HUSEMAN: Many of the drilling and completion equipment and methods developed for use in the gas shale areas are finding applications for the same purposes in the oil and liquids rich markets and have really changed the demand profile for our services in several markets. In the Permian Basin for example, not only are we seeing a greater level of drilling, the wells being drilled are more complicated and require more services than the wells the industry was drilling in this market just a few years ago. Of course the

increased drilling activity has driven greater demand for our drilling rigs and cementing services but the multi-stage fracs being employed on those wells has also expanded demand for our pumping services and fluid services to an even greater extent. More money is being spent on the completion of new wells than on the drilling phase. We anticipate those more complicated completions will translate to more frequent and complicated service opportunities down the road as ongoing maintenance and workover requirements drive demand for well servicing rigs, fluid services trucks, and other more specialized equipment.

OGFJ: Your company has more than 100 service locations in the US. How are you able to leverage your services to generate economies of scale and deliver value for your clients?

HUSEMAN: In the energy service business, we think scale and market coverage is important since most well-site services are sourced on a call-out basis. Our extensive geographic footprint and diversity of services allows our exploration and production customers to access their well-site solutions on a regional or even a national basis, depending on their own management structure and preference. For our part, managing a larger fleet of equipment and range of services helps spread overhead over more revenue and improves the opportunity for better margins overall. In addition, with the equipment shortage in oil markets and a weakening market in gas prone areas, we have been able to move equipment from one region to another to take advantage of those expanding markets.

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OGFJ: What percentage of your business is focused on oil and liquid-rich plays? What is your expectation of the range of the price of oil that drives activity levels of your customers?

HUSEMAN: That's a good follow-up to my previous comment. With the relocation of equipment to those oil and liquids driven markets, approximately 70% of our business is now focused in those areas compared to just a few years ago when our business was about evenly split between oil and gas. From a geographic perspective, the Permian Basin continues to be our largest market. The company was formed in the Permian Basin 20 years ago, and we currently derive about 40% of revenue from the area. In



fact, it's the only regional market where we provide the full range of services we offer. While we are most excited about the Permian Basin, we're seeing strong demand throughout all of the major oil and liquid-rich basins throughout the continental US.

Oil and gas prices drive the quantity and scope of the projects our customers pursue and the need for our services. We believe the demand for the majority of our services will remain strong as long as prices are above approximately \$70 per barrel WTI. With oil prices hovering near \$100 per barrel, operators are allocating a growing amount of capital to optimize production from existing wells as well as funding new drilling programs.

OGFJ: What are you seeing on the natural gas side of your business? How are you helping natural gas operators manage through these difficult times?

HUSEMAN: Obviously many exploration and production companies have allocated capital and transitioned their focus to oil and liquid-rich projects. With this change, Basic Energy Services has reallocated resources to these areas as well. With gas prices below \$4, we expect gas drilling activity to remain weak. However, most of our customers will keep existing wells producing as long as their realized price exceeds operating expenses. Many of our services are essential to keeping those wells in production so we won't be shutting down our operations in those gas markets.

OGFJ: What are your company's primary growth drivers? What changes in your business cycle, if any, have you noticed with the increased focus on oil and liquids-rich production?

HUSEMAN: Drilling activity in oil and liquid-rich markets have dramatically increased demand for most oilfield services in general and we have been working to take advantage of that growth. The broader application of horizontal drilling and multi-stage frac programs on oil projects has been the game changer as far as the size and scope of the fleet required to meet customer needs on those projects. We have added hundreds of frac tanks and dozens of fluid transport trucks to our fleet in the Permian Basin and South Texas to address the huge growth in completion services in those Wolfberry and Eagle Ford plays, respectively. While it's a little early to see the follow-on impact of those sorts of completions on our maintenance-related services, we anticipate a substantial increase in well servicing, water hauling, and just about every other service we offer as those wells require maintenance in the coming years.

OGFJ: Since 2003, Basic has completed around 60 acquisitions that have significantly expanded your operational footprint, as well as your service fleet capabilities. Talk with us about the benefits of these acquisitions and how you measure your M&A successes.

Basic Energy Services operates 120 service locations nationwide to meet customer needs.

Photo courtesy of Basic Energy Services.

Basic believes more complicated completions will translate to more frequent service opportunities down the road. Photo courtesy of Basic Energy Services.



HUSEMAN: As I mentioned earlier, the company began about 20 years ago in the Permian Basin. We were generally known as a well servicing company but over the last several years have added significantly to the scope of the company both in geographic coverage and the range of services.

We usually enter a new market or service by acquiring a well-positioned company as the platform to build upon. That then allows us to build on that local reputation and

“The R&D credit provides a direct reduction of tax liability for labor, supply, and contractor costs that are incurred on projects that are technological in nature, and is in place to incentivize the development of specialized solutions to engineering and construction projects. The credit is intended to reward the expansion of domestic development activities.”

organization with additional investment in new equipment. The two most recent examples of this approach are our acquisition of Platinum Pressure Services that expanded our reach into the Marcellus (Appalachia) and the more recent acquisition of the Maverick Companies, which established Basic in the Niobrara Shale in Colorado and Wyoming.

The great thing about our industry is that it’s always changing. That change provides the opportunity to grow as demand for services expands, new geographic markets open and even new services come into the market. In order for us to stay ahead of the curve and provide the essential services our customers need, we try to grow and expand our capabilities and services, and our geographic coverage. As always, we will keep our eyes open for additional M&A opportunities and weigh the benefits against organically building equipment ourselves.

OGFJ: Despite high unemployment rates throughout the US, the oil and natural gas industry continues to struggle with finding qualified oil and gas workers. How is Basic Energy Services managing this issue? What policies and practices does the company have in place to recruit and retain its workforce?

HUSEMAN: The oil and gas industry is certainly a job creator, and there are ample opportunities for employment within the industry. Over the last 13 months, Basic has hired nearly 1,500 new employees, and currently employs approximately 5,600 people. However, Basic and the industry overall needs more qualified employees in the local areas where oil and gas activity occurs. We have expanded recruiting efforts to non-oilfield areas to inform people in areas with higher unemployment of the good paying jobs we have to offer. We hope to hire an additional 300 to 400



employees over the coming year to help manage the growth we anticipate at our company.

OGFJ: What steps are you taking to increase shareholder value? Basic has approximately \$70 million in cash on its balance sheet. Revenue increased 75% from \$197 million in Q3 2010 to \$346 million in Q3 2011, while margins improved. The stock, however, currently trades at a discount compared to the industry average. What do you attribute the discount to?

HUSEMAN: I think many investors fail to realize the “life cycle” exposure we have and our ability to reposition equipment to our established business presence in the busier oil and liquids markets. Overall, demand for services is at multi-year highs even with weak gas activity. We’re well positioned to continue growing our revenue stream in those busier markets and earning some of the best margins

among our peers in the industry.

The fact that the stock is trading at a slight discount represents a strong positive for shareholders to add or build new positions in Basic Energy Services. The upside potential for BAS and its investors is as great today as it has been in years.



OGFJ: Thank you for taking the time to speak to us. Is there anything else you would like to add for our readers?

HUSEMAN: We believe we have built Basic Energy Services to weather the cyclical nature of the oil and gas business and that this strength will help us help our customers. As I mentioned before, we are involved throughout the life of many wells here in the US, and our objective is to continue to help as many customers produce as much oil and natural gas safely, responsibly, and most cost efficiently as possible. As E&P operators continue to drill new wells and keep old wells on production, we hope to remain a trusted source of well-site services. **OGFJ**

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