

PATTERSON UTI ENERGY INC  
Form 10-K  
February 14, 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

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)*

**75-2504748**  
*(I.R.S. Employer  
Identification No.)*

**450 Gears Road, Suite 500, Houston, Texas**  
*(Address of principal executive offices)*

**77067**  
*(Zip Code)*

**Registrant's telephone number, including area code:**

**(281) 765-7100**

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

Title of Each Class	Name of Exchange on Which Registered
Common Stock, \$0.01 Par Value	The Nasdaq Global Select Market

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

None

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

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 whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  or 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 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 definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  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 28, 2013, the last business day of the registrant's most recently completed second fiscal quarter, was approximately \$2.8 billion, calculated by reference to the closing price of \$19.36 for the common stock on the Nasdaq Global Select Market on that date.

As of February 7, 2014, the registrant had outstanding 144,233,121 shares of common stock, \$0.01 par value, its only class of common stock.

Documents incorporated by reference:

Portions of the registrant's definitive proxy statement for the 2014 Annual Meeting of Stockholders are incorporated by reference into Part III of this report.

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**DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS**

This Annual Report on Form 10-K (this Report ) and other public filings and press releases by us contain forward-looking statements within the meaning of the Securities Act of 1933, as amended (the Securities Act ), the Securities Exchange Act of 1934, as amended (the Exchange Act ), and the Private Securities Litigation Reform Act of 1995, as amended. These forward-looking statements involve risk and uncertainty. These forward-looking statements include, without limitation, statements relating to: liquidity; revenue and cost expectations and backlog; financing of operations; oil and natural gas prices; source and sufficiency of funds required for building new equipment and additional acquisitions (if further opportunities arise); impact of inflation; demand for our services; competition; equipment availability; government regulation; and other matters. Our forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts and often use words such as believes, budgeted, continue, expects, estimates, project, will, could, may, plans, intends, strategy, or anticipates, 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 orally or in writing, including, but not limited to, Management's Discussion and Analysis of Financial Condition and Results of Operations included in this Report and other sections of our filings with the United States Securities and Exchange Commission (the SEC ) under the Exchange Act and the Securities Act.

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, volatility in customer spending and in oil and natural gas prices that could adversely affect demand for our services and their associated effect on rates, utilization, margins and planned capital expenditures, global economic conditions, excess availability of land drilling rigs and pressure pumping equipment, including as a result of reactivation or construction, equipment specialization and new technologies, adverse industry conditions, adverse credit and equity market conditions, difficulty in building and deploying new equipment and integrating acquisitions, shortages, delays in delivery and interruptions in supply of equipment, supplies and materials, weather, loss of key customers, liabilities from operations for which we do not have and receive full indemnification or insurance, ability to effectively identify and enter new markets, governmental regulation, ability to realize backlog, ability to retain management and field personnel and other factors. Refer to Risk Factors contained in Item 1A of this Report for a more complete discussion of factors that might affect our performance and financial results. You are cautioned not to place undue reliance on any of our forward-looking statements. 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, changes in internal estimates or otherwise, except as required by law.

**PART I**

**Item 1. Business  
Available Information**

This Report, 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 Exchange Act, are available free of charge through our internet website ([www.patenergy.com](http://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.

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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](http://www.sec.gov)) that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC.

### **Overview**

We own and operate one of the largest fleets of land-based drilling rigs in the United States. The Company was formed in 1978 and reincorporated in 1993 as a Delaware corporation. Our contract drilling business operates in the continental United States, Alaska, and western and northern Canada.

As of December 31, 2013, we had a drilling fleet that consisted of 279 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 drill pipe and drilling rig components that support our ongoing drilling operations.

We provide pressure pumping services to oil and natural gas operators primarily in Texas and the Appalachian region. Pressure pumping services consist primarily of well stimulation and cementing for completion of new wells and remedial work on existing wells.

We also own and invest in oil and natural gas assets as a non-operating working interest owner. Our oil and natural gas working interests are located primarily in Texas and New Mexico.

On October 1, 2010, we acquired the assets and operations of a pressure pumping business and an electric wireline business. The electric wireline business that we acquired was classified as held for sale at December 31, 2010 and sold on January 27, 2011. The results of our electric wireline business are presented as discontinued operations in this Report.

### **Industry Segments**

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

contract drilling services,

pressure pumping services, and

oil and natural gas exploration and production.

All of our industry segments had operating profits in 2013, 2012 and 2011.

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, 2013, we had 279 marketable land-based drilling rigs based in the following regions:

70 in west Texas and southeastern New Mexico,

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25 in north central and east Texas, northern Louisiana and eastern Oklahoma,

47 in the Rocky Mountain region (Colorado, Utah, Wyoming, Montana, North Dakota and Alaska),

55 in south Texas,

32 in the Texas panhandle and western Oklahoma,

36 in the Appalachian region (Pennsylvania, Ohio and West Virginia) and

14 in western and northern Canada.

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Our marketable drilling rigs have rated maximum depth capabilities ranging from 8,000 feet to 25,000 feet. Of these drilling rigs, 180 are electric rigs and 99 are mechanical rigs. An electric rig differs from a mechanical rig in that the electric rig converts the power from its engines (the sole energy source for a mechanical rig) into electricity to power the rig. We also have a substantial inventory of drill pipe and drilling rig components, 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 over \$2.0 billion during the last three years on capital expenditures to (1) build new land drilling rigs and (2) modify, upgrade and extend the lives of components of our drilling fleet. During fiscal years 2013, 2012 and 2011, we spent approximately \$505 million, \$745 million and \$785 million, respectively, on these capital expenditures.

Depth and complexity of the well and drill site conditions are the principal factors in determining the specifications of the rig selected for a particular job.

Our contract drilling operations depend on the availability of drill pipe, drill bits, replacement parts and other related rig equipment, fuel and other materials 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 six months to three years) and provide for the use of the drilling rig to drill multiple wells. During 2013, our average number of days to drill a well (which includes moving to the drill site, rigging up and rigging down) was approximately 20 days.

Our drilling contracts obligate us to provide and operate a drilling rig and to pay certain operating expenses, including wages of our 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 an early termination payment to us in the event that the contract is terminated by the customer. We believe that our drilling contracts generally provide for indemnification rights and obligations that are customary for the markets in which we conduct those operations; however, each drilling contract contains the actual terms setting forth our rights and obligations and those of the customer, any of which rights and obligations may deviate from what is customary due to particular industry conditions, customer requirements or other factors.

Our drilling contracts provide for payment on a daywork, footage or turnkey basis, or a combination thereof. In each case, we provide the rig and crews. Our bid for each job 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.

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 the wells we drilled in 2013, 2012 and 2011 were under daywork 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-upon 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 contractor than daywork contracts. Under footage contracts, the drilling

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contractor typically assumes certain risks associated with loss of the well from fire, blowouts and other risks. Although we have entered into footage contracts in the past, we did not drill any wells under footage contracts in the past three years.

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-upon 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. Although we have entered into turnkey contracts in the past, we did not drill any wells under 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,		
	2013	2012	2011
Average rigs operating per day(1)	192	221	216
Number of rigs operated during the year	235	267	250
Number of wells drilled during the year	3,378	3,587	3,529
Number of operating days	69,918	80,833	78,758

(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 have made significant upgrades during the last several years to our drilling fleet to match the needs of our customers. While conventional wells remain an important source of natural gas and oil, our customers have expanded the development of shale and other unconventional wells to help supply the long-term demand for natural gas and oil in North America.

To address our customers' needs for drilling horizontal wells in shale and other unconventional resource plays, we have expanded our areas of operation and improved the capability of our drilling fleet. We have delivered new APEX® rigs to the market and have made performance and safety improvements to existing high capacity rigs. APEX 1500® rigs are 1,500 horsepower electric rigs with advanced electronic drilling systems, 500 ton top drives, iron roughnecks, hydraulic catwalks, and other highly automated pipe handling equipment. APEX 1000® rigs are 1,000 horsepower electric rigs with advanced technology equipment similar to the APEX 1500® rigs, but with a more compact design to fit on smaller locations. APEX WALKING® rigs are designed to efficiently drill multiple wells from a single pad, by walking between the wellbores without requiring time to lower the mast and lay down the drill pipe. Many APEX 1500® and APEX 1000® rigs have also been equipped

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with walking systems as noted below. As of December 31, 2013 our drilling fleet was comprised of the following:

Classification	Number of Rigs		Total
	U.S.	Canada	
APEX 1500 <sup>®</sup> rigs (including 19 with walking systems)	60		60
APEX 1000 <sup>®</sup> rigs (including nine with walking systems)	15		15
APEX WALKING <sup>®</sup> rigs	49		49
Other electric rigs (including two with walking systems)	48	8	56
<b>Total electric rigs</b>	<b>172</b>	<b>8</b>	<b>180</b>
Mechanical rigs	93	6	99
<b>Total</b>	<b>265</b>	<b>14</b>	<b>279</b>

We estimate the depth capacity with respect to our marketable rigs as of December 31, 2013 to be as follows:

Depth Rating (Ft.)	Number of Rigs		Total
	U.S.	Canada	
8,000 to 12,999	9	6	15
13,000 to 14,999	37	4	41
15,000 to 17,999	86	4	90
18,000 to 25,000	133		133
<b>Total</b>	<b>265</b>	<b>14</b>	<b>279</b>

At December 31, 2013, we owned and operated 298 trucks and 398 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 generally enhances the efficiency of our contract drilling operations in periods of high drilling rig utilization.

We perform repair and/or overhaul work to our drilling rig equipment at our yard facilities located in Texas, Oklahoma, Wyoming, Colorado, North Dakota, Pennsylvania and western Canada.

**Pressure Pumping Operations**

*General* We provide pressure pumping services to oil and natural gas operators primarily in Texas (Southwest Region) and the Appalachian region (Northeast Region). Pressure pumping services consist of well stimulation and cementing for the completion of new wells and remedial work on existing wells. Wells drilled in shale formations and other unconventional plays require well stimulation through fracturing to allow the flow of oil and natural gas. This is accomplished by pumping fluids under pressure into the well bore to fracture the formation. Many wells in conventional plays also receive well stimulation services. The cementing process inserts material between the wall of the well bore and the casing to support and stabilize the casing.

*Pressure Pumping Contracts* Our pressure pumping operations are conducted pursuant to a work order for a specific job or pursuant to a term contract. The term contracts are generally entered into for a specified period of time and may include minimum revenue, usage or stage requirements. We are compensated based on a combination of charges for equipment, personnel, materials, mobilization and other items. We believe that our pressure pumping contracts generally provide for indemnification rights and obligations that are customary for the markets in which we conduct those operations; however, each pressure pumping contract contains the actual terms setting forth our rights and obligations and those of the customer, any of which rights and obligations may deviate from what is customary due to particular industry conditions, customer requirements or other factors.





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*Equipment* We have pressure pumping equipment used in providing hydraulic and nitrogen fracturing services as well as nitrogen, cementing and acid pumping services, with a total of approximately 763,000 hydraulic horsepower as of December 31, 2013. Pressure pumping equipment at December 31, 2013 included:

	<b>Hydraulic Fracturing Equipment</b>	<b>Other Pumping Equipment</b>	<b>Total</b>
<b>Southwest Region:</b>			
Number of units	146	27	173
Approximate hydraulic horsepower	342,850	27,550	370,400
<b>Northeast Region:</b>			
Number of units	172	105	277
Approximate hydraulic horsepower	332,050	60,600	392,650
<b>Combined:</b>			
Number of units	318	132	450
Approximate hydraulic horsepower	674,900	88,150	763,050

Our pressure pumping operations are supported by a fleet of other equipment including blenders, tractors, manifold trailers and numerous trailers for transportation of materials to and from the worksite as well as bins for storage of materials at the worksite.

*Materials* Our pressure pumping operations require the use of acids, chemicals, proppants, fluid supplies and other materials, any of which can be in short supply, including severe shortages, from time to time. We purchase these materials from various suppliers. These purchases are made in the spot market or pursuant to other arrangements that do not cover all of our required supply and that sometimes require us to purchase the supply or pay liquidated damages if we do not purchase the material. Given the limited number of suppliers of certain of our materials, we may not always be able to make alternative arrangements if we are unable to reach an agreement with a supplier for delivery of any particular material or should one of our suppliers fail to timely deliver our materials.

**Oil and Natural Gas Interests**

We own and invest in oil and natural gas assets as a non-operating working interest owner. Our oil and natural gas working interests are located primarily in producing regions of Texas and New Mexico. Our oil and natural gas assets constituted approximately 1% of our consolidated assets as of December 31, 2013.

**Customers**

The customers of each of our contract drilling and pressure pumping business segments are oil and natural gas operators. Our customer base includes both major and independent oil and natural gas operators. During 2013, one customer accounted for approximately \$286 million or 10.5% of our consolidated operating revenues. These revenues were earned in both our contract drilling and pressure pumping businesses.

**Competition**

Our contract drilling and pressure pumping businesses are highly competitive. Historically, available equipment used in these businesses has frequently exceeded demand. The price for our services is a key competitive factor, in part because equipment used in our businesses can be moved from one area to another in response to market conditions. In addition to price, we believe availability, condition and technical specifications of equipment, quality of personnel, service quality and safety record are key factors in determining which contractor is awarded a job. We expect that the market for land drilling and pressure pumping services will continue to be highly competitive.

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### **Government and Environmental Regulation**

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

drilling of oil and natural gas wells,

hydraulic fracturing, cementing, nitrogen and acidizing and related well servicing activities,

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

use of underground storage tanks and injection wells, and

our employees.

To date, applicable environmental laws and regulations in the places in which we operate have not required the expenditure of significant resources outside the ordinary course of business. 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, 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, regional and local laws, rules and regulations that relate to the oil and natural gas industry. The adoption of laws, rules and regulations affecting the oil and natural gas industry for economic, environmental and other policy reasons could increase costs relating to drilling, completion and production, and otherwise have an adverse effect on our operations. Federal, state, foreign, regional and local environmental laws, rules and regulations currently apply to our operations and may become more stringent in the future. Any suspension or moratorium of the services we or others provide, whether or not short-term in nature, by a federal, state, foreign, regional or local governmental authority, could have a material adverse effect on our business, financial condition and results of operation.

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, which may have resulted, or may result, in soil and groundwater contamination in certain locations. Any contamination found on, under or originating from the properties may be subject to remediation requirements under federal, state, foreign, regional and local laws, rules and regulations. 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. We could be required to remove or remediate wastes disposed of or released by prior owners or operators. In addition, it is possible we could be held responsible for oil and natural gas properties in which we own an interest but are not the operator.

Some of the environmental laws and regulations that are applicable to our business operations are discussed in the following paragraphs, but the discussion does not cover all environmental laws and regulations that govern our operations.

In the United States, 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, including prior owners and operators who are no longer active at a site; and

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

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The Federal Resource Conservation and Recovery Act ( RCRA ), as amended, and comparable state statutes and implementing regulations 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

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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, into jurisdictional waters; and

liability for drainage into such waters.

The Oil Pollution Act imposes strict liability for a comprehensive and expansive list of damages from an oil spill into jurisdictional 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. 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 activities include the performance of hydraulic fracturing services to enhance the production of oil and natural gas from formations with low permeability, such as shale and other unconventional formations. Due to concerns raised relating to potential impacts of hydraulic fracturing on groundwater quality, legislative and regulatory efforts at the federal level and in some states have been initiated to render permitting and compliance requirements more stringent for hydraulic fracturing or prohibit the activity altogether. Such efforts could have an adverse effect on oil and natural gas production activities, which in turn could have an adverse effect on the hydraulic fracturing services that we render for our exploration and production customers. See Item 1A. Risk Factors Potential Legislation and Regulation Covering Hydraulic Fracturing Could Increase Our Costs and Limit or Delay Our Operations.

In Canada, a variety of Canadian federal, provincial and municipal laws, rules and regulations impose, among other things, restrictions, liabilities and obligations in connection with the generation, handling, use, storage, transportation, treatment and disposal of hazardous substances and wastes and in connection with spills, releases and emissions of various substances to the environment. These laws, rules and regulations also require that facility sites and other properties associated with our operations be operated, maintained, abandoned and reclaimed to the satisfaction of applicable regulatory authorities. In addition, new projects or changes to existing projects may require the submission and approval of environmental assessments or permit applications. These laws, rules and regulations are subject to frequent change, and the clear trend is to place increasingly stringent limitations on activities that may affect the environment.

Our operations are also subject to federal, state, foreign, regional and local laws, rules and regulations for the control of air emissions, including those associated with the Federal Clean Air Act and the Canadian Environmental Protection Act. We and our customers may be required to make capital expenditures in the future for air pollution control equipment in connection with obtaining and maintaining operating permits and approvals for air emissions. For more information, please refer to our discussion under Item 1A. Risk Factors Environmental and Occupational Health and Safety Laws and Regulations, Including Violations Thereof, Could Materially Adversely Affect Our Operating Results.

We are aware of the increasing focus of local, state, national and international regulatory bodies on greenhouse gas ( GHG ) emissions and climate change issues. We are also aware of legislation proposed by United States lawmakers and the Canadian legislature to reduce GHG emissions, as well as GHG emissions regulations enacted by the EPA and the Canadian provinces of Alberta and British Columbia. We will continue to monitor and assess any new policies, legislation or regulations in the areas where we operate to determine the impact of GHG emissions and climate change on our operations and take appropriate actions, where necessary.

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Any direct and indirect costs of meeting these requirements may adversely affect our business, results of operations and financial condition. See Item 1A. Risk Factors – Legislation and Regulation of Greenhouse Gases Could Adversely Affect Our Business.

**Risks and Insurance**

Our operations are subject to many hazards inherent in the contract drilling and pressure pumping businesses, including inclement weather, blowouts, well fires, loss of well control, pollution and reservoir damage. These hazards could cause personal injury or death, work stoppage, and serious damage to equipment and other property, as well as significant environmental and reservoir damages. These risks could expose us to substantial liability for personal injury, wrongful death, property damage, loss of oil and natural gas production, pollution and other environmental damages.

We have indemnification agreements with many of our customers, and we also maintain liability and other forms of insurance. In general, our drilling and pressure pumping contracts typically contain provisions requiring our customer to indemnify us for, among other things, reservoir and certain pollution damage. Our right to indemnification may, however, be unenforceable or limited due to negligent or willful acts or omissions by us, our subcontractors and/or suppliers. Our customers may dispute, or be unable to meet, their indemnification obligations to us due to financial, legal or other reasons. Accordingly, we may be unable to transfer these risks to our customers by contract or indemnification agreements. Incurring a liability for which we are not fully indemnified or insured could have a material adverse effect on our business, financial condition, cash flows and results of operations.

We maintain insurance coverage of types and amounts that we believe to be customary in the industry, but we are not fully insured against all risks, either because insurance is not available or because of the high premium costs. The insurance coverage that we maintain includes insurance for fire, windstorm and other risks of physical loss to our rigs and certain other assets, employer's liability, automobile liability, commercial general liability, workers' compensation and insurance for other specific risks. We cannot assure, however, that any insurance obtained by us will be adequate to cover any losses or liabilities, or that this insurance will continue to be available or available on terms that are acceptable to us. While we carry insurance to cover physical damage to, or loss of, our drilling rigs and certain other assets, such insurance does not cover the full replacement cost of the rigs or other assets. We have also elected in some cases to accept a greater amount of risk through increased deductibles on certain insurance policies. For example, we generally maintain a \$1.0 million per occurrence deductible on our workers' compensation and equipment insurance coverage and a \$2.0 million per occurrence self-insured retention on our general liability and automobile liability insurance coverage. We self-insure a number of other risks, including loss of earnings and business interruption, and do not carry a significant amount of insurance to cover risks of underground reservoir damage.

Our insurance will not in all situations provide sufficient funds to protect us from all liabilities that could result from our operations. Our coverage includes aggregate policy limits and exclusions. As a result, we retain the risk for any loss in excess of these limits or that is otherwise excluded from our coverage. There can be no assurance that insurance will be available to cover any or all of our operational risks, or, even if available, that insurance premiums or other costs will not rise significantly in the future, so as to make the cost of such insurance prohibitive or that our coverage will cover a specific loss. Further, we may experience difficulties in collecting from insurers or such insurers may deny all or a portion of our claims for insurance coverage.

If a significant accident or other event occurs and is not fully covered by insurance or an enforceable or recoverable indemnity from a third party, it could have a material adverse effect on our business, financial condition, cash flows and results of operations. See Item 1A. Risk Factors – Our Operations Are Subject to a Number of Operational Risks, Including Environmental and Weather Risks, Which Could Expose Us to Significant Losses and Damage Claims. We Are Not Fully Insured Against All of These Risks and Our Contractual Indemnity Provisions May Not Fully Protect Us.

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### **Employees**

We had approximately 7,800 full-time employees at December 31, 2013. 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 has not significantly affected our overall operations. However, our drilling operations in Canada are subject to slow periods of activity during the annual spring thaw. Additionally, toward the end of some years, we experience slower activity in our pressure pumping operations in connection with the holidays and as customers' capital expenditure budgets are depleted.

### **Raw Materials and Subcontractors**

We use many suppliers of raw materials and services. Although these materials and services have historically been available, 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, financial condition, cash flows and results of operations could be harmed. You should also refer to the other information set forth in this Report, including our consolidated financial statements and the related notes.

#### ***We Are Dependent on the Oil and Natural Gas Industry and Market Prices for Oil and Natural Gas. Declines in Customers' Operating and Capital Expenditures and in Oil and Natural Gas Prices May Adversely Affect Our Operating Results.***

We depend on our customers' willingness to make operating and capital expenditures to explore for, develop and produce oil and natural gas in North America. If these expenditures decline, our business may suffer. Our customers' willingness to explore, develop and produce depends largely upon prevailing industry conditions that are influenced by numerous factors over which we have no control, such as:

the supply of and demand for oil and natural gas, including current natural gas storage capacity and usage,

the prices, and expectations about future prices, of oil and natural gas,

the supply of and demand for drilling and pressure pumping equipment,

the cost of exploring for, developing, producing and delivering oil and natural gas,

the environmental and other laws and governmental regulations regarding the exploration, development, production and delivery of oil and natural gas, and in particular, public pressure on, and legislative and regulatory interest within, federal, state, foreign, regional and local governments to stop, significantly limit or regulate drilling and pressure pumping activities, including hydraulic fracturing, and

merger and divestiture activity among oil and natural gas producers.

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In particular, our revenue, profitability and cash flows are highly dependent upon prevailing prices for oil and natural gas and expectations about future prices. For many years, oil and natural gas prices and markets have been extremely volatile. Prices are affected by factors such as:

market supply and demand,

domestic and international military, political, economic and weather conditions,



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

technical advances affecting energy consumption and production, and

the price and availability of alternative fuels.

All of these factors are beyond our control. Declines in the market prices of natural gas and oil caused our customers to significantly reduce their drilling activities beginning in the fourth quarter of 2008, and drilling activities remained low throughout 2009. Drilling activities increased in 2010 as did the prices for oil and natural gas. The increased drilling activity was largely attributable to increased development of unconventional oil and natural gas reservoirs and an improvement in the price of oil. Drilling for oil and liquids rich targets continued to increase in 2011 as oil averaged \$94.86 per barrel for the year (WTI spot price as reported by the United States Energy Information Administration). Natural gas prices decreased in 2011 to an average of \$4.00 per Mcf (Henry Hub spot price as reported by the United States Energy Information Administration). This decrease continued into 2012 where natural gas prices fell below \$2.00 per Mcf in April and averaged \$2.75 per Mcf for the year, resulting in continued low levels of drilling activity for natural gas in 2012. The increase in drilling activity in oil rich basins absorbed some of the decrease in demand for natural gas drilling activities in 2012. During 2013, natural gas prices averaged \$3.73 per Mcf, and oil prices averaged \$97.91 per barrel, and demand for natural gas drilling activities continued to decline. Our average number of rigs operating remains well below the number of our available rigs. Construction of new land drilling rigs in the United States during the last decade has significantly contributed to excess capacity in total available drilling rigs. As a result of decreased drilling activity and excess capacity, our average number of rigs operating has declined from historic highs. 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. Low market prices for oil and natural gas would likely result in lower demand for our drilling rigs and pressure pumping services and could adversely affect our operating results, financial condition and cash flows. Even during periods of high prices for oil and natural gas, companies exploring for oil and natural gas may cancel or curtail programs, or reduce their levels of capital expenditures for exploration and production for a variety of reasons, which could reduce demand for our drilling rigs and pressure pumping services.

### ***Global Economic Conditions May Adversely Affect Our Operating Results.***

Global economic conditions and volatility in commodity prices may cause our customers to reduce or curtail their drilling and well completion programs, which could result in a decrease in demand for our services. In addition, uncertainty in the capital markets may result in reduced access to financing by our customers and reduced demand for our services. Furthermore, these factors may result in certain of our customers experiencing an inability to pay suppliers, including us. The global economic environment in the past has experienced significant deterioration in a relatively short period, and there is no assurance that the global economic environment will not quickly deteriorate again due to one or more factors. A deterioration in the global economic environment could have a material adverse effect on our business, financial condition, cash flows and results of operations.