

HELMERICH & PAYNE, INC.

When you think of energy companies capable of changing the world, you probably think of huge integrated firms, such as Exxon Mobile or ConocoPhillips. But a comparatively small company with just over \$2 billion in sales (in 2008) is changing the way energy is harvested. Established in 1920, rig maker and drilling contractor Helmerich & Payne, Inc. (HP) has performed well in most cycles of change and innovation in the energy drilling and exploration businesses. Recent strategic changes offer hope that it will continue to do so.

Based on its own experience as an exploration company, HP (not to be confused with Hewlett Packard, HPQ) launched an innovative program in 1998 to develop more efficient drilling technology. The result was the very successful “FlexRig” drilling rig. While many of HP’s competitors use older, less efficient rigs that possess fewer drilling angle and safety options, HP’s FlexRigs offer more energy efficient motors, newer safety features and improved reliability. In addition, they are more easily transported in the field and can drill at a variety of angles, including horizontally. This advanced technology makes unconventional drilling, in places like the Barnett Shale field in Texas or the Piceance field in the Rockies, feasible. The efficiencies of FlexRig technology also offer savings and value in more conventional drilling scenarios. As a result, HP has enjoyed significant demand for its drilling rigs and services.

The land drilling business is very competitive. So, rather than trying to focus primarily on rig prices or attempting to anticipate the highs and lows of the cyclical drilling industry, HP relies more on lowering overall total well cost for its customers and providing superior service using relatively safe, modern and innovative rigs. HP often charges its customers more per rig day and requires longer leases than its competitors, but the value proposition is clear: FlexRigs offer more efficient production. Customers have responded enthusiastically—HP now operates more than 250 rigs (67% FlexRigs) in the U.S. and Latin America, and operating results have been strong: 15.7% average net margins, 15.3% annual revenue growth, and 14.7% annual earnings-per-share growth since the first generation FlexRig was introduced in 1998. These operating metrics are much better than those of competitors who use older rig fleets and rely on traditional price competition to win business.

We like companies whose managements tend to behave like shareholders. In this case, HP’s management owns 5.4% of the company, and President and CEO Hans Helmerich’s name is on the door. His grandfather was a founder, and Hans has been with the company since 1987. We’re impressed with his leadership—he took a bold step in leaving the exploration business to focus on what he saw as the next great opportunity: creating a new generation of drilling rigs that are better able to

cope with what is actually happening in the field. In some ways, HP still has the feel of a family run business, and it is clearly taking an active role in shaping its own future.

We also like companies that stand to benefit from long-term economic trends. In this case, we believe energy use is likely to continue its long-term uptrend, despite the current global slowdown. Further, since much of the “low hanging fruit” in the world of energy development has been picked, development trends going forward will emphasize more demanding, high-density drilling operations such as fracturing and horizontal drilling. As a result, we expect the demand and pricing for HP’s FlexRigs will continue to expand.

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