KEY ENERGY SERVICES INC
Form 424B5
February 25, 2002

PROSPECTUS SUPPLEMENT DATED FEBRUARY 22, 2002 TO PROSPECTUS DATED JUNE 21, 1999

Filed Pursuant to Rule 424(b)(5)
File No. 333-67667

[KEY ENERGY SERVICES, INC. LOGO]

477,043 SHARES

KEY ENERGY SERVICES, INC.

COMMON STOCK

This prospectus relates to 477,043 shares of our common stock issued in connection with the acquisition of substantially all of the assets of Mosley Well Service, L.L.C. The terms of this acquisition were determined by direct negotiations with the owners of the business, and the shares of common stock issued are valued at prices reasonably related to current market prices. Our common stock is listed on the New York Stock Exchange under the symbol "KEG." The last reported sale price of our common stock on February 21, 2002 was $8.50 per share.

We will pay all expenses of this offering. No underwriting discounts or commissions will be paid in connection with the issuance of common stock in business combination transactions or acquisitions, although finder's fees may be paid with respect to specific acquisitions. Any person receiving a finder's fee may be deemed to be an underwriter within the meaning of Section 2(11) of the Securities Act of 1933.

INVESTING IN OUR COMMON STOCK INVOLVES RISKS. SEE "RISK FACTORS" ON PAGE S-2 OF THIS PROSPECTUS SUPPLEMENT AND PAGE 6 OF THE PROSPECTUS DATED JUNE 21, 1999.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus supplement or the prospectus. Any representation to the contrary is a criminal offense.

The date of this prospectus supplement is February 22, 2002

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You should rely only on the information contained in this prospectus and prospectus supplement. We have not authorized anyone to provide you with information that is different. This prospectus supplement and the prospectus may only be used where it is legal to sell these securities. The information in this prospectus and prospectus supplement is only accurate as of the date of this document.

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THE OFFERING

Common stock offered........................	477,043 shares
Common stock to be outstanding after the Offering (1).....................	108,587,238 shares
Use of proceeds.............................	The shares of common stock offered by this prospe issued in exchange for substantially all the asse Service, L.L.C. The Company intends to use the a operation of its business. The Company will not proceeds in exchange for issuance of the shares.
New York Stock Exchange symbol............	KEG

(1) Based on 108,110,195 shares of common stock outstanding as of February 21, 2002. Excludes shares of common stock reserved for future issuance

RISK FACTORS

YOUR INVESTMENT IN THE NOTES WILL INVOLVE RISK. YOU SHOULD CAREFULLY CONSIDER THE FOLLOWING RISK FACTORS AND THE OTHER INFORMATION SET FORTH OR INCORPORATED BY REFERENCE IN THIS PROSPECTUS BEFORE DECIDING TO PURCHASE ANY NOTES.

RISKS RELATING TO OUR BUSINESS

OUR BUSINESS IS DEPENDENT ON CONDITIONS IN THE OIL AND GAS INDUSTRY, ESPECIALLY THE CAPITAL EXPENDITURES OF OIL AND NATURAL GAS COMPANIES.

The demand for our services is primarily influenced by current and anticipated oil and natural gas prices. Prices for oil and natural gas historically have been extremely volatile and have reacted to changes in the supply of and demand for oil and natural gas (including changes resulting from the ability of the Organization of Petroleum Exporting Countries to establish and maintain production quotas for oil prices), domestic and worldwide economic conditions and political instability in oil producing countries. Weakness in oil and natural gas prices may cause lower day rates and lower utilization of available well service equipment. In addition when oil and natural gas prices are weak, fewer wells are drilled, resulting in less drilling and less maintenance work for us. Additional factors that effect demand for our services include:

- the level of development, exploration and production activity of, and corresponding spending by, oil and natural gas companies;

- oil and natural gas production costs;

- government regulation; and

- conditions in the worldwide oil and natural gas industry.

In addition, we anticipate prices for oil and natural gas will continue to be volatile and affect the demand for and pricing of our services. Reductions in oil and natural gas prices can result in a reduction in the trading prices and value of our common stock, even if the reduction in oil and natural gas prices does not affect our business generally. However, a material decline in oil or natural gas prices or activities over a sustained period of time could materially adversely affect the demand for our services and, therefore, our results of operations and financial condition.

Periods of diminished or weakened demand for our services have occurred in the past. Since the end of the first quarter of fiscal 2002 and continuing through the third quarter, we have experienced a decrease in the demand for our services. We believe this trend is due to an overall weakening of demand for onshore well services, which is attributable to lower prices for oil and natural gas and general economic uncertainty. If these conditions continue, or worsen, they could have a material adverse effect on our financial condition and results of operation. In light of these and other factors relating to the oil and natural gas industry, our historical operating results may not be indicative of future performance.

AN ECONOMIC DOWNTURN MAY ADVERSELY AFFECT OUR BUSINESS.

The United States economy is currently believed to be in a recession. An economic downturn may cause reduced demand for petroleum-based products and natural gas. In addition, many companies during these periods often reduce or delay expenditures to reduce costs. This in turn may cause a reduction in the demand for our services. Accordingly to industry data, in July 2001, there were approximately 1,293 active drilling rigs in North America. As of December 2001, the number of active drilling rigs had decreased to 928. The number of active drilling rigs may be indicative of demands for services such as those we provide. If the economic environment worsens, our business may be further adversely impacted.

WE HAVE PURSUED, AND MAY CONTINUE TO PURSUE, STRATEGIC ACQUISITIONS. OUR BUSINESS MAY BE ADVERSELY AFFECTED IF WE CANNOT EFFECTIVELY INTEGRATE ACQUIRED OPERATIONS.

A component of our strategy includes acquiring complementary businesses. Acquisitions, including recent acquisitions and any acquisitions we make in the future, involve a number of risks and challenges including:

- our ability to integrate acquired operations;
- potential loss of key employees and customers of the acquired companies; and
- an increase in our expenses and working capital requirements.

Any of these factors could adversely affect our ability to achieve anticipated levels of cash flows from our recent or future acquisitions or realize other anticipated benefits. Furthermore, competition from other potential buyers could reduce our acquisition opportunities or cause us to pay a higher price than we otherwise might pay.

OUR BUSINESS INVOLVES CERTAIN OPERATING RISKS, AND OUR INSURANCE MAY NOT BE ADEQUATE TO COVER ALL LOSSES OR LIABILITIES WE MIGHT INCUR IN OUR OPERATIONS.

Our operations are subject to many hazards and risks, including the following:

- blow-outs;
- reservoir damage;
- loss of well control;
- cratering;
- fires;
- damage to the environment; and
- liabilities from accident or damage by our fleet of trucks.

If these hazards occur they could result in suspensions of operations, damage to or destruction of our equipment and the property of others and injury or death to personnel.

We self-insure to cover a portion of these liabilities. For losses in excess of our self-insurance limits, we maintain insurance from unrelated

commercial carriers. However, our insurance may not be adequate to cover all losses or liabilities that we might incur in our operations. There can be no assurance that our insurance will adequately protect us against liability from all of the hazards of our business. Moreover, we also are subject to the risk that we may not be able to maintain or obtain insurance of the type and amount we desire at a reasonable cost. If we were to incur a significant liability for which we were not fully insured it would have a material adverse effect on our financial position and results of operations.

USE OF PROCEEDS

We will not receive any proceeds of this offering other than the value of the businesses or properties we acquire in the proposed acquisitions.

PRICE RANGE OF COMMON STOCK AND DIVIDEND POLICY

Our common stock is currently traded on the New York Stock Exchange, under the symbol "KEG." The following tables sets forth, for the periods indicated, the high and low sales prices of our common stock on the New York Stock Exchange for the first and second quarters of fiscal 2002, fiscal 2001, fiscal 2000 and fiscal 1999, as derived from published sources.

	HIGH	
Fiscal Year Ending 2002:		
Third Quarter (as of 2/21/02)	9.30	
Second Quarter	9.70	
First Quarter	11.01	
Fiscal Year Ending 2001:		
Fourth Quarter	15.33	
Third Quarter	13.52	
Second Quarter	10.50	
First Quarter	11 7/16	
Fiscal Year Ending 2000:		
Fourth Quarter	11 7/8	
Third Quarter	12 1/4	
Second Quarter	6 7/8	
First Quarter	$ 5 13/16	$
Fiscal Year Ending 1999:		
Fourth Quarter	4 1/2	
Third Quarter	5 5/8	
Second Quarter	11 3/8	
First Quarter	$ 14 15/16	

We did not pay dividends on our common stock during the fiscal years ended June 30, 2001, 2000 or 1999. We do not intend, for the foreseeable future, to pay dividends on our common stock. In addition, we are contractually restricted from paying dividends under the terms of our existing credit facilities.

On February 21, 2002 the last reported sale price for our Common Stock was $8.50 per share.

SELECTED FINANCIAL DATA

	FISCAL YEAR ENDED JUNE		
	2001	2000	1999(1)
	(IN THOUSANDS, EXCEPT PER SHA		
OPERATING DATA:			
Revenues	$ 837,262	$ 637,732	$ 491,817
Operating costs:			
Direct costs	574,938	462,386	371,428
Depreciation, depletion and amortization	75,147	70,972	62,074
General and administrative	66,071	58,772	53,108
Bad debt expense	1,263	1,648	5,928
Debt issuance costs	--	--	6,307
Restructuring charge	--	--	4,504
Interest	56,560	71,930	67,401
Income before income taxes and minority interest	99,283	(27,976)	(78,933)
Net income	62,710	(18,959)	(53,258)
INCOME PER COMMON SHARE:			
Basic	0.63	$ (0.23)	$ (1.94)
Diluted	0.61	$ (0.23)	$ (1.94)
Average common shares outstanding:			
Basic	98,195	83,815	27,501
Assuming full dilution	102,271	83,815	27,501
Common shares outstanding at period end	101,440	97,210	82,738
Market price per common share at period end	10.84	$ 9.64	$ 3.56
Cash dividends paid on common shares	--	$ --	$ --
BALANCE SHEET DATA:			
Cash	2,098	$ 109,873	$ 23,478
Current assets	206,150	253,589	132,543
Property and equipment	1,014,675	920,437	871,940
Property and equipment, net	793,716	760,561	769,562
Total assets	1,228,284	1,246,265	1,148,138
Current liabilities	115,553	92,848	73,151
Long-term debt, including current portion	493,907	666,600	699,978
Stockholders' equity	476,878	382,887	288,094
OTHER DATA:			
Adjusted EBITDA(2)	232,253	$ 116,574	$ 67,281
Net cash (used in) provided by:			
Operating activities	142,717	37,051	(13,427)
Investing activities	(83,350)	(37,766)	(294,654)
Financing Activities	(167,142)	87,110	306,294
Working capital	90,597	155,965	59,392
Book value per common share(3)	$ 4.70	$ 3.94	$ 3.47

(1) THE FINANCIAL DATA FOR THE YEAR ENDED JUNE 30, 1999 INCLUDES THE ALLOCATED PURCHASE PRICE OF DAWSON PRODUCTION SERVICES, INC. AND THE RESULTS OF THEIR OPERATIONS BEGINNING SEPTEMBER 15, 1998.

(2) ADJUSTED EBITDA IS NET INCOME BEFORE INTEREST EXPENSE, INCOME TAXES, DEPRECIATION, DEPLETION AND AMORTIZATION, BAD DEBT EXPENSE, DEBT ISSUANCE COSTS CHARGED TO EARNINGS, RESTRUCTURING CHARGE AND EXTRAORDINARY ITEMS. ADJUSTED EBITDA IS PRESENTED BECAUSE OF ITS ACCEPTANCE AS A COMPONENT OF A COMPANY'S POTENTIAL VALUATION IN COMPARISON TO COMPANIES IN THE SAME

INDUSTRY AND OF A COMPANY'S ABILITY TO SERVICE OR INCUR DEBT. MANAGEMENT INTERPRETS TRENDS INDICATED BY CHANGES IN ADJUSTED EBITDA AS AN INDICATOR OF THE EFFECTIVENESS OF ITS STRATEGIES IN ACHIEVING REVENUE GROWTH AND CONTROLLING DIRECT AND INDIRECT COSTS OF SERVICES PROVIDED. INVESTORS SHOULD CONSIDER THAT THIS MEASURE DOES NOT TAKE INTO CONSIDERATION DEBT SERVICE, INTEREST EXPENSES, COSTS OF CAPITAL, IMPAIRMENTS OF LONG LIVED ASSETS, DEPRECIATION OF PROPERTY, THE COST OF REPLACING EQUIPMENT OR INCOME TAXES. ADJUSTED EBITDA SHOULD NOT BE CONSIDERED AS AN ALTERNATIVE TO NET INCOME, INCOME BEFORE INCOME TAXES, CASH FLOWS FROM OPERATING ACTIVITIES OR ANY OTHER MEASURE OF FINANCIAL PERFORMANCE PRESENTED IN ACCORDANCE WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES. ADJUSTED EBITDA IS NOT A MEASURE OF FINANCIAL PERFORMANCE UNDER GENERALLY ACCEPTED ACCOUNTING PRINCIPLES AND IS NOT INTENDED TO REPRESENT CASH FLOW. ADJUSTED EBITDA MAY NOT BE COMPARABLE TO SIMILARLY TITLED MEASURES OF OTHER COMPANIES.

(3) BOOK VALUE PER COMMON SHARE IS STOCKHOLDERS' EQUITY AT PERIOD END DIVIDED BY THE NUMBER OF OUTSTANDING COMMON SHARES AT PERIOD END.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

The statements in this document that relate to matters that are not historical facts are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. When used in this document and the documents incorporated by reference, words such as "anticipate," "believe," "expect," "plan," "intend," "estimate," "project," "will," "could," "may," "predict" and similar expressions are intended to identify forward-looking statements. Further events and actual results may differ materially from the results set forth in or implied in the forward-looking statements. Factors that might cause such a difference include:

- fluctuations in world-wide prices and demand for oil and natural gas;

- fluctuations in the level of oil and natural gas exploration and development activities;

- fluctuations in the demand for well servicing, contract drilling and ancillary oilfield services;

- the existence of competitors, technological changes and developments in the industry;

- the existence of operating risks inherent in well servicing, contract drilling and ancillary oilfield services; and

- general economic conditions, the existence of regulatory uncertainties, the possibility of political instability in any of the countries in which we conduct business, in addition to the other matters discussed herein.

The following discussion provides information to assist in the understanding of our financial condition and results of operations. It should be read in conjunction with the consolidated financial statements and related notes appearing elsewhere in this prospectus supplement. Please note that certain reclassifications have been made to the fiscal 1999 and 1998 financial data presented below to conform to the fiscal 2000 presentation. The reclassifications consist primarily of reclassifying as drilling revenues and expenses, revenues and expenses from the limited drilling operations conducted

by certain of our well servicing divisions that were previously included in well servicing revenues and expenses in order to report the results of all drilling operations separately.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

SIX MONTHS ENDED DECEMBER 31, 2001 VERSUS SIX MONTHS ENDED DECEMBER 31, 2000

Our revenue for the six months ended December 31, 2001 increased $66,984,000, or 16.9%, to $462,574,000 from $395,590,000 for the six months ended December 31, 2000. The increase in the current period reflects higher activity levels and improved rates. Our net income for the first six months of fiscal 2002 totaled $48,635,000, or $0.46 per dilutive share, versus a net income of $19,869,000, or $0.20 per dilutive share, for the prior year period.

OPERATING REVENUES

WELL SERVICING. Well servicing revenues for the six months ended December 31, 2001 increased $53,624,000, or 15.5%, to $398,839,000 from $345,215,000 for the six months ended December 31, 2000. The increase in revenues was primarily due to higher levels of activity and higher rig and fluid hauling rates.

CONTRACT DRILLING. Contract drilling revenues for the six months ended December 31, 2001 increased $12,967,000, or 28.0%, to $59,290,000 from $46,323,000 for the six months ended December 31, 2000. The increase in revenues was primarily due to higher rig rates despite lower activity levels.

OPERATING EXPENSES

WELL SERVICING. Well servicing expenses for the six months ended December 31, 2001 increased $20,063,000, or 8.7%, to $249,872,000 from $229,809,000 for the six months ended December 31, 2000. The increase was primarily due to a higher level of activity and increased wages. Well servicing expenses, as a percentage of well servicing revenue, decreased to 62.6% for the six months ended December 31, 2001 from 66.6% for the six months ended December 31, 2000.

CONTRACT DRILLING. Contract drilling expenses for the six months ended December 31, 2001 increased $2,710,000, or 7.6%, to $38,528,000 from $35,818,000 for the six months ended December 31, 2000. The increase was primarily due to higher wages. Contract drilling expenses, as a percentage of contract drilling revenues, decreased to 65.0% for the six months ended December 31, 2001 from 77.3% for the six months ended December 31, 2000.

DEPRECIATION, DEPLETION AND AMORTIZATION EXPENSE

Our depreciation, depletion and amortization expense for the six months ended December 31, 2001 increased $1,136,000, or 3.1%, to $37,593,000 from $36,457,000 for the six months ended December 31, 2000. The increase is due to recent acquisitions and increased capital expenditures during the past twelve months as we continued major refurbishments of well servicing and contract drilling equipment partially offset by discontinued amortization of goodwill because of our adoption of SFAS 142.

GENERAL AND ADMINISTRATIVE EXPENSES

Our general and administrative expenses for the six months ended December 31, 2001 increased $5,008,000, or 16.9%, to $34,639,000 from $29,631,000 for the six months ended December 31, 2000. The increase was due to higher

administrative costs related to growth of our operations and reflects additional resources in technology and internal control functions. General and administrative expenses, as a percentage of revenues, remained constant at 7.5% for the six months ended December 31, 2001 and December 31, 2000.

INTEREST EXPENSE

Our interest expense for the six months ended December 31, 2001 decreased $7,646,000, or 24.9%, to $23,046,000, from $30,692,000 for the six months ended December 31, 2000. The decrease was primarily due to a significant reduction in our long-term debt using operating cash flow, and to a lesser extent, lower interest rates. Included in the interest expense was the amortization of debt issuance costs of $1,393,000 and $2,044,000 for the six months ended December 31, 2001 and 2000, respectively.

BAD DEBT EXPENSE

Our bad debt expense for the six months ended December 31, 2001 decreased $595,000, or 65.9%, to $308,000 from $903,000 for the six months ended December 31, 2000. We continue to carefully monitor credit risk associated with our customers.

FOREIGN CURRENCY TRANSACTION LOSS

During the six months ended December 31, 2001, we recorded an Argentine foreign currency transaction loss of approximately $1,844,000 related to dollar-denominated receivables resulting from the recent devaluation of Argentina's currency.

EXTRAORDINARY GAIN

During the six months ended December 31, 2001, we retired $114,858,000 of our long-term debt, and expensed the related unamortized debt issuance costs which resulted in a net after-tax extraordinary gain of $2,271,000. During the six months ended December 31, 2000, we retired $81,544,000 of our long-term debt, and

expensed the related unamortized debt issuance costs which resulted in a net after-tax extraordinary gain of $1,265,000.

INCOME TAXES

Our income tax expense for the six months ended December 31, 2001 increased $16,357,000 to an expense of $28,045,000 from a expense of $11,688,000 for the six months ended December 31, 2000. The increase in income tax expense is due to the increase in pretax income. Our effective tax rate for the six months ended December 31, 2001 and December 31, 2000 was 38% and 39%, respectively. The effective tax rates vary from the statutory rate of 35% because of the disallowance of certain goodwill amortization (for the six months ended December 31, 2000), and other non-deductible expenses and the effects of state and local taxes.

FISCAL YEAR ENDED JUNE 30, 2001 VERSUS FISCAL YEAR ENDED JUNE 30, 2000

Our results of operations for the year ended June 30, 2001 reflect the impact of favorable industry conditions resulting from increased commodity prices which in turn caused increased demand for our equipment and services during fiscal 2001 (see Part I--Item--Major Developments During Fiscal 2001--Favorable Industry Conditions). The positive impact of this increased

demand on our operating results was partially offset by increased operating expenses incurred as a result of the increase in our business activity.

THE COMPANY

Revenues for the year ended June 30, 2001 increased $235,530,000, or 36.9%, to $873,262,000 from $637,732,000 in fiscal 2000, while net income for fiscal 2001 increased $81,669,000 to $62,710,000 from a net loss of $18,959,000 in fiscal 2000. The increase in revenues and net income is due to improved operating conditions, higher rig hours, and increased pricing, with lower interest expense from debt reduction also contributing to net income.

OPERATING REVENUES

WELL SERVICING. Well servicing revenues for the year ended June 30, 2001 increased $198,781,000, or 35.5%, to $758,273,000 from $559,492,000 in fiscal 2000. The increase was due to increased demand for our well servicing equipment and services and higher pricing.

CONTRACT DRILLING. Contract drilling revenues for the year ended June 30, 2001 increased $39,211,000, or 57.3%, to $107,639,000 from $68,428,000 in fiscal 2000. The increase was due to increased demand for our contract drilling equipment and services and higher pricing.

OPERATING EXPENSES

WELL SERVICING. Well servicing expenses for the year ended June 30, 2001 increased $93,168,000, or 23.3%, to $493,108,000 from $339,940,000 in fiscal 2000. The increase in expenses is due to higher utilization of our well servicing equipment, higher labor costs and the overall increase in our well servicing business. Despite the increased costs, well servicing expenses as a percentage of well servicing revenues decreased from 71.5% for fiscal 2000 to 65% for fiscal 2001. The margin improvement is due to improved operating efficiencies and the effects of higher pricing.

CONTRACT DRILLING. Contract drilling expenses for the year ended June 30, 2001, increased $19,067,000, or 32.7%, to $77,366,000 from $58,299,000 in fiscal 2000. The increase is due to higher utilization of our contract drilling equipment, higher labor costs and the overall increase in our contract drilling business. Despite the increased costs, contract drilling expenses as a percentage of contract drilling revenues decreased from 85.2% in fiscal 2000 to 71.9% in fiscal 2001. The margin improvement is due to improved operating efficiencies and the effects of higher pricing.

DEPRECIATION, DEPLETION AND AMORTIZATION EXPENSE

Our depreciation, depletion and amortization expense for the year ended June 30, 2001 increased $4,175,000, or 5.9%, to $75,147,000 from $70,972,000 in fiscal 2000. The increase is due to higher capital expenditures incurred during fiscal 2001 as our refurbished equipment and increased utilization of its contract drilling equipment (which it depreciates partially based on utilization).

GENERAL AND ADMINISTRATIVE EXPENSES

Our general and administrative expenses for the year ended June 30, 2001 increased $7,299,000, or 12.4%, to $66,071,000 from $58,772,000 in fiscal 2000. The increase was due to higher administrative costs necessitated by the growth of our operations as a result of improved industry conditions. Despite the

increased costs, general and administrative expenses as a percentage of total revenues declined from 9.2% in fiscal 2000 to 7.6% in fiscal 2001.

INTEREST EXPENSE

Our interest expense for the year ended June 30, 2001 decreased $15,370,000, or 21.4%, to $56,560,000 from $71,930,000 in fiscal 2000. The decrease was primarily due to the impact of the long-term debt reduction during fiscal 2001 and, to a lesser extent, lower short-term interest rates and borrowing margins on floating rate debt.

BAD DEBT EXPENSE

Our bad debt expense for the year ended June 30, 2001 decreased $385,000, or 23.4%, to $1,263,000 from $1,648,000 in fiscal 2000. The decrease was primarily due to improved industry conditions for our customers and, to a lesser extent, the centralization of our internal credit approval process.

EXTRAORDINARY GAIN

During fiscal 2001, we repurchased $257,115,000 of our long-term debt at various discounts and premiums to par value and expensed related unamortized debt issuance costs, all of which resulted in an after-tax extraordinary gain of $429,000.

INCOME TAXES

Our income tax benefit for the year ended June 30, 2001 increased $44,408,000 to $37,002,000 from a benefit of $7,406,000 in fiscal 2000. The increase in income tax expense is due to the increased pre-tax income. Our effective tax rate for fiscal 2001 and 2000 was 37.28% and 26.5%, respectively. The effective tax rates vary from the statutory rate of 35% principally because of certain non-deductible goodwill amortization, other non-deductible expenses and state and local taxes.

CASH FLOW

Our net cash provided by operating activities for the year ended June 30, 2001 increased $107,857,000 to $142,717,000 from a $34,860,000 in fiscal 2000. The increase is due to higher revenues resulting from increased demand for our equipment and services and higher pricing, partially offset by higher operating and general and administrative expenses resulting from increased business activity.

Our net cash used in investing activities for the year ended June 30, 2001 increased $45,584,000 to $83,350,000 from $37,766,000 in fiscal 2000. The increase is due primarily to higher capital expenditures.

Our net cash used by financing activities for the year ended June 30, 2001 increased $256,443,000 to a use of $167,142,000 from cash provided of $89,301,000 in fiscal 2000. The increase is primarily the result of significant debt reduction during fiscal 2001, partially offset by proceeds from the Debt Offering and the exercise of stock options and warrants.

FISCAL YEAR ENDED JUNE 30, 2000 VERSUS FISCAL YEAR ENDED JUNE 30, 1999

Our results of operations for the year ended June 30, 2000 reflect the impact of the industry recovery during such period resulting from increased commodity prices which in turn caused increased demand for our equipment and

services during fiscal 2000. The positive impact of this increased demand on our operating results was partially offset by increased operating expenses incurred as a result of the increase in our business activity.

THE COMPANY

Revenues for the year ended June 30, 2000 increased $145,915,000, or 29.7%, to $637,732,000 from $491,817,000 in fiscal 1999, while net income for fiscal 2000 increased $34,299,000 to a net loss of $18,959,000 from a net loss of $53,258,000 in fiscal 1999. The increase in revenues is due to improved operating conditions and higher rig hours, the full year effect of the acquisitions completed during the early portion of fiscal 1999 and, to a lesser extent, higher pricing. The decrease in net loss is the result of improved operating conditions, higher pricing, and cost reduction initiatives. In addition, fiscal 1999 included non-recurring charges for debt issuance costs and restructuring initiatives as well as higher bad debt expense.

OPERATING REVENUES

WELL SERVICING. Well servicing revenues for the year ended June 30, 2000 increased $125,835,000 or 29%, to $559,492,000 from $433,656,000 in fiscal 1999. The increase was due to increased demand for our well servicing equipment and services, the full year effect of the acquisitions completed during the early portion of fiscal 1999 and, to a lesser extent, higher pricing.

CONTRACT DRILLING. Contract drilling revenues for the year ended June 30, 2000 increased $17,815,000, or 35.2%, to $68,428,000 from $50,613,000 in fiscal 1999. The increase was due to increased demand for our contract drilling equipment and services, the full year effect of the acquisition completed during the early portion of fiscal 1999 and, to a lesser extent, higher pricing.

OPERATING EXPENSES

WELL SERVICING. Well servicing expenses for the year ended June 30, 2000 increased $74,975,000, or 23.1%, to $399,940,000 from $324,965,000 in fiscal 1999. The increase in expenses is due to higher utilization of our well servicing equipment, higher labor costs and the overall increase in our well servicing business. Despite the increased costs, well servicing expenses as a percent of well servicing revenues decreased from 74.9% for fiscal 1999 to 71.5% for fiscal 2000. The margin improvement is due to improved operating efficiencies and the effects of higher pricing.

CONTRACT DRILLING. Contract drilling expenses for the year ended June 30, 2000, increased $14,743,000, or 33.8%, to $58,299,000 from $43,556,000 in fiscal 1999. The increase is due to higher utilization of our contract drilling equipment, higher labor costs and the overall increase in our contract drilling business. Despite the increased costs, contract drilling expenses as a percentage of contract drilling revenues decreased from 86.1% in fiscal 1999 to 85.2% in fiscal 2000. The margin improvement is due to improved operating efficiencies and the effects of higher pricing.

DEPRECIATION, DEPLETION AND AMORTIZATION EXPENSE

Our depreciation, depletion and amortization expense for the year ended June 30, 2000 increased $8,898,000, or 14.3%, to $70,972,000 from $62,074,000 in fiscal 1999. The increase is due to higher capital expenditures incurred during fiscal 2000 as we refurbished equipment and increased utilization of its contract drilling equipment (which it depreciates partially based on utilization).

GENERAL AND ADMINISTRATIVE EXPENSES

Our general and administrative expenses for the year ended June 30, 2000 increased $5,664,000, or 10.7%, from $53,108,000 to $58,772,000 in fiscal 2000. The increase was due to higher administrative costs necessitated by the growth of our operations as a result of the fiscal 1999 acquisitions and improved industry conditions. Despite the increased costs, general and administrative expenses as a percentage of total revenues declined from 10.8% in fiscal 1999 to 9.2% in fiscal 2000.

INTEREST EXPENSE

Our interest expense for the year ended June 30, 2000 increased $4,529,000, or 6.7%, to $71,930,000 from $67,401,000 in fiscal 1999. The increase was primarily due to the full year effect of the debt incurred in connection with the acquisitions completed during the early portion of fiscal 1999, and, to a lesser extent, higher interest rates during fiscal 2000 partially offset by the impact of the long-term debt reduction during fiscal 2000.

BAD DEBT EXPENSE

Our bad debt expense for the year ended June 30, 2000 decreased $4,280,000, or 72.2%, to $1,648,000 from $5,928,000 in fiscal 1999. The decrease was primarily due to improved industry conditions for our customers and, to a lesser extent, the centralization of our internal credit approval process.

EXTRAORDINARY GAIN

During the fourth quarter of fiscal 2000, we repurchased $10,190,000 of our 5% Convertible Subordinated Notes which resulted in an after-tax gain of $1,611,000.

INCOME TAXES

Our income tax benefit for the year ended June 30, 2000 decreased $18,269,000 to $7,406,000 from $25,675,000 in fiscal 1999. The decrease in income tax benefit is due to the decrease in pretax loss. Our effective tax benefit rate for fiscal 2000 and 1999 was 26.5% and 32.5%, respectively. The fiscal 2000 effective tax benefit rate is different from the statutory rate of 35% principally because of certain non-deductible goodwill amortization, other non-deductible expenses and state and local taxes. The decrease in the fiscal 2000 effective tax benefit rate was due to an increase in the amount of non-deductible expenses, primarily as a result of the full year effect of the goodwill amortization of the acquisitions completed during the early portion of fiscal 1999.

CASH FLOW

Our net cash provided by operating activities for the year ended June 30, 2000 increased $48,287,000 to a $34,860,000 from a use of $13,427,000 in fiscal 1999. The increase is due to higher revenues resulting from increased demand for our equipment and services, the full year effect of the acquisitions completed during the early portion of fiscal 1999 and, to a lesser extent, higher pricing, partially offset by higher operating and general and administrative expenses resulting from increased business activity.

Our net cash used in investing activities for the year ended June 30, 2000 decreased $256,888,000, or 87.2%, to $37,766,000 from $294,654,000 in fiscal 1999. The decrease is due to no acquisitions having occurred during fiscal 2000 partially offset by higher capital expenditures.

Our net cash provided by financing activities for the year ended June 30, 2000 decreased $216,993,000, or 70.8%, to $89,301,000 from $306,294,000 in fiscal 1999. The decrease is primarily the result of significantly decreased borrowings during fiscal 2000 and, to a lesser extent, the repayment of long-term debt partially offset by proceeds from the equity offering and the volumetric production payment completed in fiscal 2000.

LIQUIDITY AND CAPITAL RESOURCES

We have historically funded our operations, acquisitions, capital expenditures and working capital requirements using cash flow from operations, bank borrowings and the issuance of equity and long-term debt. We believe that the current reserves of cash and cash equivalents, access to our existing credit lines, access to capital markets and internally generated cash flow from operations are and will be sufficient to finance the cash requirements of our current and future operations.

CAPITAL EXPENDITURES

Capital expenditures for fiscal 2002 have been and will be directed toward selectively refurbishing our assets as business conditions warrant. We will continue to evaluate opportunities to acquire or divest assets or businesses to enhance our primary operations. Such capital expenditures, acquisitions and divestitures are at our discretion of and will depend on management's view of market conditions as well as other factors.

LONG-TERM DEBT

SENIOR CREDIT FACILITY

As of December 31, 2001, we had a senior credit facility (the "Senior Credit Facility") with a syndicate of banks led by PNC Bank, N.A. which consisted of a $100,000,000 revolving loan facility. In addition, up to $20,000,000 of letters of credit can be issued under the Senior Credit Facility, but any outstanding letters of credit reduce the borrowing availability under the revolving loan facility. The commitment to make revolving loans will reduce to $75,000,000 on September 14, 2002. The revolving loan commitment will terminate on September 14, 2003, and all revolving loans must be paid on or before that date. As of December 31, 2001, approximately $25,000,000 was drawn under the revolving loan facility and approximately $12,000,000 of letters of credit related to workman's compensation insurance were outstanding. We drew down approximately $43 million on January 14, 2002 in order to redeem the 14% Senior Subordinated Notes.

14% SENIOR SUBORDINATED NOTES

The revolving loan bears interest based upon, at our option, the prime rate plus a variable margin of 0.75% to 2.00% or a Eurodollar rate plus a variable margin of 2.25% to 3.50%. The Senior Credit Facility has customary affirmative and negative covenants including a maximum debt to capitalization ratio, a minimum interest coverage ratio, a maximum senior leverage ratio, a minimum net worth and minimum EBITDA as well as restrictions on capital expenditures, acquisitions and dispositions.

8 3/8% SENIOR NOTES

On March 6, 2001, we completed a private placement of $175,000,000 of 8 3/8% Senior Notes due 2008 (the "8 3/8% Senior Notes"). The cash proceeds from

the private placement, net of fees and expenses, were used to repay all of the remaining balance of the Tranche B term loan under the Senior Credit Facility, and a portion of the revolving loan facility under the Senior Credit Facility. The 8 3/8% Senior Notes are subordinate to our senior indebtedness which includes borrowings under the Senior Credit Facility and the Dawson 9 3/8% Senior Notes.

14% SENIOR SUBORDINATED NOTES

On January 22, 1999, we completed the private placement of 150,000 units (the "Units") consisting of $150,000,000 of 14% Senior Subordinated Notes due 2009 (the "14% Senior Subordinated Notes") and 150,000 warrants to purchase (as subsequently adjusted) 2,173,433 shares of our common stock at an exercise price of $4.88125 per share (the "Unit Warrants"). The net cash proceeds from the private placement were used to repay substantially all of the remaining $148,600,000 principal amount (plus accrued interest) owed under our bridge loan facility arranged in connection with the acquisition of Dawson Production Services, Inc. ("Dawson"). The 14% Senior Subordinated Notes are subordinate to our senior indebtedness which includes borrowings under the Senior Credit Facility, the Dawson 9 3/8% Senior Notes and the 8 3/8% Senior Notes. The Unit Warrants have separated

from the 14% Senior Subordinated Notes and became exercisable on January 25, 2000. At December 31, 2001, $132,903,000 principal amount of the 14% Senior Subordinated Notes remained outstanding. As of December 31, 2001, 63,500 Unit Warrants had been exercised leaving 86,500 Unit Warrants outstanding.

On and after January 15, 2004, we may redeem some or all of the 14% Senior Subordinated Notes at any time at varying redemption prices in excess of par, plus accrued interest. In addition, before January 15, 2002, we may redeem up to 35% of the aggregate principal amount of the 14% Senior Subordinated Notes with the proceeds of certain sales of equity at 114% of par plus accrued interest. On January 14, 2002 we exercised our right of redemption for $35,403,000 principal amount of the 14% Senior Subordinated Notes at a price of 114% of the principal amount plus accrued interest, leaving $97,500,000 principal amount outstanding as of January 15, 2002. This transaction resulted in an extraordinary loss before taxes of approximately $8,468,000.

5% CONVERTIBLE SUBORDINATED NOTES

In late September and early October 1997, we completed a private placement of $216,000,000 of 5% Convertible Subordinated Notes due 2004 (the "5% Convertible Subordinated Notes"). The 5% Convertible Subordinated Notes are subordinate to our senior indebtedness which includes borrowings under the Senior Credit Facility, the 14% Senior Subordinated Notes, the Dawson 9 3/8% Senior Notes, and the 8 3/8% Senior Notes. The 5% Convertible Subordinated Notes are convertible, at the holder's option, into shares of our common stock at a conversion price of $38.50 per share, subject to certain adjustments. During the quarter ended December 31, 2001, we repurchased (and canceled) $61,581,000 principal amount of the 5% Convertible Subordinated Notes, leaving $50,352,000 principal amount of the 5% Convertible Subordinated Notes outstanding at December 31, 2001.

CRITICAL ACCOUNTING POLICIES

We follow certain significant accounting policies when preparing its consolidated financial statements. A complete summary of these policies is included in Note 1 to the consolidated financial statements included in the Company's Annual Report on Form 10-K.

Certain of the policies require management to make significant and subjective estimates which are sensitive to deviations of actual results from management's assumptions. In particular, management makes estimates regarding the fair value of our reporting units in assessing potential impairment of goodwill. In addition, we make estimates regarding future undiscounted cash flows from the future use of long-lived assets whenever events or changes in circumstances indicate that the carrying amount of a long-lived asset may not be recoverable.

In assessing impairment of goodwill, we have used estimates and assumptions in estimating the fair value of its reporting units. Actual future results could be different than the estimates and assumptions used. Events or circumstances which might lead to an indication of impairment of goodwill would include, but might not be limited to, prolonged decreases in expectations of long-term well servicing and/or drilling activity or rates brought about by prolonged decreases in oil or natural gas prices, changes in government regulation of the oil and natural gas industry or other events which could affect the level of activity of exploration and production companies.

In assessing impairment of long-lived assets other than goodwill where there has been a change in circumstances indicating that the carrying amount of a long-lived asset may not be recoverable, we have estimated future undiscounted net cash flows from use of the asset based on actual historical results and expectations about future economic circumstances including oil and natural gas prices and operating costs. The estimate of future net cash flows from use of the asset could change if actual prices and costs differ due to industry conditions or other factors affecting our performance.

RECENTLY ISSUED FINANCIAL ACCOUNTING STANDARDS

Recently the Financial Accounting Standards Board, ("FASB") issued Statement of Financial Accounting Standards No. 143, Accounting for Asset Retirement Obligations ("SFAS 143"), and Statement of Financial Accounting Standards No. 144, Accounting for the Impairment of Disposal of Long-Lived Assets ("SFAS 144"). SFAS 143 establishes requirements for the accounting for removal costs associated with asset retirements and SFAS

144 addresses financial accounting and reporting for the impairment of disposal of long-lived assets. SFAS 143 is effective for fiscal years beginning after June 15, 2002, with earlier adoption encouraged, and SFAS 144 is effective for fiscal years beginning after December 15, 2001 and interim periods within those fiscal years. We are currently assessing the impact of these standards on its consolidated financial statements.

INTEREST RATE RISK

At December 31, 2001, we had long-term debt and capital lease obligations outstanding of $403,711,000. Of this amount $354,634,000 or 88%, bears interest at fixed rates as follows:

	BALANCE AT DECEMBER 31, 2001
	(THOUSANDS)

8 3/8% Senior Notes Due 2008	$ 175,000
14% Senior Subordinated Notes Due 2009	128,263
5% Convertible Subordinated Notes Due 2004	50,352
Other (rates generally ranging from 8.0% to 8.5%)	1,019
	$ 354,634

The remaining $49,077,000 of long-term debt and capital lease obligations outstanding as of December 31, 2001 bears interest at floating rates which averaged approximately 5.9% at December 31, 2001. A 10% increase in short-term interest rates on the floating-rate debt outstanding at December 31, 2001 would equal approximately 59 basis points. Such an increase in interest rates would increase our fiscal 2002 interest expense by approximately $300,000 assuming borrowed amounts remain outstanding.

The above sensitivity analysis for interest rate risk excludes accounts receivable, accounts payable and accrued liabilities because of the short-term maturity of such instruments.

FOREIGN CURRENCY RISK

Recently, the Argentine government suspended the law tying the Argentine peso to the U.S. dollar at the conversion ratio of 1:1 and created a dual currency system in Argentina. Our net assets from its Argentina subsidiaries are based on the U.S. dollar equivalent of such amounts measured in Argentine pesos as of December 31, 2001. Assets and liabilities of the Argentine operations were translated to U.S. dollars at December 31, 2001, using the applicable free market conversion ratio of 1.6:1. Our net earnings and cash flows from its Argentina subsidiaries were tied to the U.S. dollar for the six months ended December 31, 2001 and will be based on the U.S. dollar equivalent of such amounts measured in Argentine pesos for periods after December 31, 2001. Revenues, expenses and cash flow will be translated using the average exchange rates during the periods after December 31, 2001. See Note 10 to the consolidated financial statements.

A 10% change in the Argentine peso to the U.S. dollar exchange rate would not be material to our net assets, net earnings or cash flows. Our net assets, net earnings and cash flows from its Canadian subsidiary are based on the U.S. dollar equivalent of such amounts measured in Canadian dollars. Assets and liabilities of the Canadian operations are translated to U.S. dollars using the applicable exchange rate as of the end of a reporting period. Revenues, expenses and cash flow are translated using the average exchange rate during the reporting period.

A 10% change in the Canadian-to-U.S. Dollar exchange rate would not be material to our net assets, net earnings or cash flows.

COMMODITY PRICE RISK

Our major market risk exposure for its oil and natural gas production operations is in the pricing applicable to its oil and natural gas sales. Realized pricing is primarily driven by the prevailing worldwide price for crude oil

and spot market for natural gas. Pricing for oil and natural gas production has been volatile and unpredictable for several years.

We periodically hedge a portion of its oil and natural gas production through collar and option agreements. The purpose of the hedges is to provide a measure of stability in the volatile environment of oil and natural gas prices and to manage exposure to commodity price risk under existing sales commitments. Our risk management objective is to lock in a range of pricing for expected production volumes. This allows us to forecast future earnings within a predictable range. We meet this objective by entering into collar and option arrangements which allow for acceptable cap and floor prices.

As of December 31, 2001, we had oil and natural gas price collars and put options in place, as detailed in the following table. The total fiscal 2002 hedged oil and natural gas volumes represent 37% and 30%, respectively, of 2001 calendar year total production. A 10% variation in the market price of oil or natural gas from their levels at December 31, 2001 would have no material impact on our net assets, net earnings or cash flows (as derived from the commodity option contracts).

The following table sets forth the future volumes hedged by year and the weighted-average strike price of the option contracts at December 31, 2001:

	MONTHLY VOLUMES			STRIKE PRI PER BBL/MMB	
	OIL (BBLS)	NATURAL GAS (MMBTUS)	TERM	FLOOR	
At December 31, 2001					
Oil Collars............	5,000	--	Mar 2001 - Feb 2002	$ 19.70	$
Oil Puts...............	5,000	--	Mar 2002 - Feb 2003	22.00	
Natural Gas Collars....	--	40,000	Mar 2001 - Feb 2002	2.40	
Natural Gas Puts.......	--	75,000	Mar 2002 - Feb 2003	3.00	

(The strike prices for oil are based on the NYMEX spot price for West Texas Intermediate; the strike prices for the natural gas collars are based on the Inside FERC-West Texas Waha spot price; the strike prices for the natural gas puts are based on the Inside FERC-El Paso Permian spot price.)

BUSINESS

THE COMPANY

We are the largest onshore, rig-based well servicing contractor in the world, with approximately 1,477 well service rigs and 1,455 oilfield service vehicles as of June 30, 2001. We provide a complete range of well services to major oil companies and independent oil and natural gas production companies, including: rig-based well maintenance, workover, completion, and recompletion services (including horizontal recompletions); oilfield trucking services; and ancillary oilfield services. We conduct well servicing operations onshore the continental United States in the following regions: Gulf Coast (including South Texas, Central Gulf Coast of Texas and South Louisiana), Permian Basin of West Texas and Eastern New Mexico, Mid-Continent (including the Anadarko, Hugoton and Arkoma Basins and the ArkLaTex region), Four Corners (including the San Juan, Piceance, Uinta, and Paradox Basins), Eastern (including the Appalachian, Michigan and Illinois Basins), Rocky Mountains (including the Denver-Julesberg, Powder River, Wind River, Green River and Williston Basins), and California (the San Joaquin Basin), and internationally in Argentina and Ontario, Canada. We are also a leading onshore drilling contractor, with 79 land drilling rigs as of

June 30, 2001. We conduct land drilling operations in a number of major domestic producing basins, as well as in Argentina and in Ontario, Canada. We also produce and develop oil and natural gas reserves in the Permian Basin region and Texas Panhandle.

Our principal executive office is located at 6 Desta Drive, Midland, Texas 79705. Our phone number is (915) 620-0300 and website address is www.keyenergy.com.

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BUSINESS STRATEGY

We have built our leadership position through the consolidation of smaller, less viable competitors. This consolidation, together with a continuing decline in the number of available domestic well service rigs due to attrition, cannibalization and transfers outside of the United States, has given us the opportunity to capitalize on improved market conditions which existed during fiscal 2001. We have focused on maximizing results by reducing debt, building strong customer alliances, refurbishing rigs and related equipment, and training personnel to maintain a qualified and safe employee base.

REDUCING DEBT. Over the past fiscal year, we have significantly reduced debt and strengthened our balance sheet. At June 30, 2001, our long-term funded debt net of cash and capitalized leases ("net funded debt") was approximately $468,845,000 and its net funded debt to capitalization ratio was approximately 50% as compared to approximately $534,816,000 and 58%, respectively, at June 30, 2000. We expect to be able to continue to reduce debt from available cash flow from operations and from anticipated interest savings resulting from prior and future debt reductions and future debt refinancings.

BUILDING STRONG CUSTOMER ALLIANCES. We seek to maximize customer satisfaction by offering a broad range of equipment and services in conjunction with highly trained and motivated employees. As a result, we are able to offer proactive solutions for most of its customer's wellsite needs. We ensure consistent high standards of quality and customer satisfaction by continually evaluating its performance. We maintain strong alliances with major oil companies as well as numerous independent oil and natural gas production companies and believes that such alliances improve the stability of demand for its oilfield services.

REFURBISHING RIGS AND RELATED EQUIPMENT. We intend to continue actively refurbishing its rigs and related equipment to maximize the utilization of its rig fleet. The increase in our cash flow, both from operations and from anticipated interest savings from reduced levels of debt, combined with our borrowing availability under its revolving credit facility, has provided ample liquidity and resources necessary to make the capital expenditures to refurbish such equipment.

TRAINING AND DEVELOPING EMPLOYEES. We have, and will continue to, devote significant resources to the training and professional development of our employees with a special emphasis on safety. We currently have two training centers in Texas and one training center in California to improve its employees' understanding of operating and safety procedures. We recognize the historically high turn-over rate in the industry and is committed to offering compensation, benefits and incentive programs for its employees that are attractive and competitive in its industry, in order to ensure a steady stream of qualified, safe personnel to provide quality service to its customers.

MAJOR DEVELOPMENTS DURING FISCAL 2001

FAVORABLE INDUSTRY CONDITIONS

Operating conditions improved significantly during fiscal 2001 as capital spending by oil and natural gas producers for well servicing and contract drilling services increased over prior year levels. The increased spending was primarily due to higher commodity prices with WTI Cushing prices for light sweet crude averaging approximately $26.97 per barrel and Nymex Henry Hub natural gas prices averaging approximately $5.09 per MMbtu during fiscal 2001, as compared to an average WTI Cushing price for light sweet crude of $25.97 per barrel and an average Nymex Henry Hub natural gas price of $3.04 per MMbtu during fiscal 2000.

This increase in commodity prices during fiscal 2001 led to a steady, sequential increase in the demand for our services and equipment during fiscal 2001 as our customers increased their exploration and development activity in our primary market areas, enabling us to increase the rates it charges for its services. This increase in demand and rates resulted in sequential increases in revenues, cash flow and net income in each quarter of fiscal 2001 over the same quarter of fiscal 2000. We expect demand for its services to remain at or above current levels as long as capital spending by our customers remains at or near their current levels.

During fiscal 2001, crude oil prices continued to trade at healthy levels due largely to the ability of the Organization of Petroleum Exporting Countries ("OPEC") to adhere to its production quotas designed to keep crude oil prices in the range of $22.00 to $28.00 per barrel. The adherence to the production quotas brought more stability to crude oil prices. Since June 30, 2001, however, both crude oil and natural gas prices have weakened significantly, falling below $22.00 per barrel and $2.00 per Mmbtu, respectively. While management believes that many of its customers generally base their capital spending budgets on a crude oil price of $18.00 to $22.00 per barrel and a natural gas price of $2.00 to $2.75 per MMbtu, there can be no assurances that its customers will not postpone and/or reduce their capital spending plans if crude oil prices and natural gas prices continue to remain at or below their current levels. In addition, the terrorist attacks on the World Trade Center and the Pentagon that occurred on September 11, 2001 threaten to increase the downward pressure on commodity prices as U.S. fuel consumption decreases due to significantly reduced air and other travel, the general demand for energy decreases as consumer anxiety further weakens the U.S. economy, and OPEC faces political pressure to reduce its price targets for crude oil.

The level of our revenues, cash flows, losses and earnings are substantially dependent upon, and affected by, the level of domestic and international oil and gas exploration and development activity (see Part II-Item 7-Management's Discussion and Analysis of Results of Operations and Financial Condition).

RECENT DEVELOPMENTS

Most of our foreign revenues are derived from our operations in Argentina. For fiscal 2001, revenues from operations in Argentina were $48.5 million, which accounted for 5.5% of our total revenues for such period. For fiscal 2001, net income from operations in Argentina was $4.5 million. For the six months ended December 31, 2001, revenues from operations in Argentina were $21.3 million, which accounted for 4.6% of our total revenue for such period. We incurred a net loss of $1.3 million from our operations in Argentina for the same six-month period. Recently, Argentina has been negatively affected by volatile economic and political conditions. In December 2001, the Argentine government announced that it would restrict bank account withdrawals and would

not service its public sector debt. In addition, in January 2002, the Argentine government abandoned its decade-old fixed peso-dollar exchange rate and created a dual exchange rate system. As a result of this abandonment of the fixed peso-dollar exchange rate system, at December 31, 2001 we recorded a $1.8 million foreign currency transaction loss on our dollar-denominated accounts receivable and reduced our stockholders' equity by an additional $24.2 million due to foreign currency translation related to our net investment in our Argentine subsidiary. The Argentine government has also recently announced its intent to impose a 20% tax on oil exports effective March 1, 2002 or other taxes on production that would produce comparable tax revenues.

We believe that all of these events will negatively affect oil production in Argentina, and accordingly will have a negative effect on demand for our services. The economic conditions in Argentina continue to be unstable and further devaluation of the Argentine peso may occur. We continue to evaluate the structure of our operations in Argentina, but we are currently unable to predict the effects that further instability in Argentina will have on our financial position.

DEBT REDUCTION

During fiscal 2001, we significantly reduced our long-term debt and strengthened our balance sheet. At June 30, 2001, our net funded debt was approximately $468,845,000 and its net funded debt to capitalization ratio was approximately 50% as compared to approximately $534,816,000 and 58%, respectively, at June 30, 2000. Proceeds from the Debt Offering (defined below) and from the exercise of options and warrants, as well as cash flow from operations were used to accomplish this reduction in net funded debt (see Part II-Item 7-Management's Discussion and Analysis of Results of Operations and Financial Condition-Long-Term Debt).

DEBT OFFERING

On March 6, 2001, we completed the public offering of $175,000,000 of 8 3/8% Senior Notes Due 2008 (the "Debt Offering"). Net proceeds from the Debt Offering were approximately $170.0 million, which was used to

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immediately repay the term loans in full and to repay a portion of the revolver outstanding under our senior credit facility.

DESCRIPTION OF BUSINESS SEGMENTS

We operate in two primary business segments which are well servicing and contract drilling. Our operations are conducted domestically and in Argentina and Canada. The following is a description of each of these business segments (for financial information regarding these business segments, see Note 15 to Consolidated Financial Statements-Business Segment Information).

WELL SERVICING

We provide a full range of well services, including rig-based services, oilfield trucking services and ancillary oilfield services, necessary to maintain and workover oil and natural gas producing wells. Rig-based services include: maintenance of existing wells, workovers of existing wells, completion of newly drilled wells, recompletion of existing wells (including horizontal recompletions) and plugging and abandonment of wells at the end of their useful lives.

WELL SERVICE RIGS

We use our well service rig fleet to perform four major categories of rig services for oil and natural gas producers.

MAINTENANCE SERVICES. We estimate that there are approximately 600,000 producing oil wells and approximately 300,000 producing natural gas wells in the United States. We provide the well service rigs, equipment and crews for maintenance services, which are performed on both oil and natural gas wells, but which are more commonly required on oil wells. While some oil wells in the United States flow oil to the surface without mechanical assistance, most require pumping or some other method of artificial lift. Oil wells that require pumping characteristically require more maintenance than flowing wells due to the operation of the mechanical pumping equipment installed. Few natural gas wells have mechanical pumping systems in the wellbore, and, as a result, maintenance work on natural gas wells is less frequent.

Maintenance services are required throughout the life of most producing oil and natural gas wells to ensure efficient and continuous operation. These services consist of routine mechanical repairs necessary to maintain production from the well, such as repairing inoperable pumping equipment in an oil well or replacing defective tubing in an oil or natural gas well, and removing debris such as sand and paraffin from the well. Other services include pulling the rods, tubing, pumps and other downhole equipment out of the wellbore to identify and repair a production problem.

Maintenance services are often performed on a series of wells in proximity to each other and typically require less than 48 hours per well to complete. The general demand for maintenance services is closely related to the total number of producing oil and natural gas wells in a geographic market, and maintenance services are generally the most stable type of well service activity.

WORKOVER SERVICES. In addition to periodic maintenance, producing oil and natural gas wells occasionally require major repairs or modifications, called "workovers." Workover services are performed to enhance the current production of existing wells. Such services include extensions of existing wells to drain new formations either through deepening wellbores to new zones or through drilling of horizontal lateral wellbores to improve reservoir drainage patterns. In less extensive workovers, our rigs are used to seal off depleted zones in existing wellbores and access previously bypassed productive zones. Our workover rigs are also used to convert former producing wells to injection wells through which water or carbon dioxide is then pumped into the formation for enhanced recovery operations. Other workover services include: major subsurface repairs such as casing repair or replacement, recovery of tubing and removal of foreign objects in the wellbore, repairing downhole equipment failures, plugging back the bottom of a well to reduce the amount of water being produced with the oil and natural gas, cleaning out and recompleting a well if production has declined, and repairing leaks in the tubing and casing. These extensive

workover operations are normally performed by a well service rig with a workover package, which may include rotary drilling equipment, mud pumps, mud tanks and blowout preventers depending upon the particular type of workover operation. Most of our well service rigs are designed for and can be equipped to perform complex workover operations.

Workover services are more complex and time consuming than routine maintenance operations and consequently may last from a few days to several weeks. These services are almost exclusively performed by well service rigs.

The demand for workover services is more sensitive to expectations relating to, and changes in, oil and natural gas prices than the demand for maintenance services. As oil and natural gas prices increase, the level of workover activity tends to increase as operators seek to increase production by enhancing the efficiency of their wells at higher commodity prices with correspondingly higher rates of return.

COMPLETION SERVICES. Our completion services prepare a newly drilled oil or natural gas well for production. The completion process may involve selectively perforating the well casing to access producing zones, stimulating and testing these zones and installing downhole equipment. We typically provide a well service rig and may also provide other equipment such as a workover package to assist in the completion process. Producers use well service rigs to complete their wells because the rigs have specialized equipment, properly trained employees and the experience necessary to perform these services. However, during periods of weak drilling rig demand, drilling contractors may compete with service rigs for completion work.

The completion process typically requires a few days to several weeks, depending on the nature and type of the completion, and generally requires additional auxiliary equipment that can be provided for an additional fee. The demand for well completion services is directly related to drilling activity levels, which are highly sensitive to expectations relating to, and changes in, oil and natural gas prices. As the number of newly drilled wells decreases, the number of completion jobs correspondingly decreases.

PLUGGING AND ABANDONMENT SERVICES. Well service rigs and workover equipment are also used in the process of permanently closing oil and natural gas wells at the end of their productive lives. Plugging and abandonment work can be performed with a well servicing rig along with wireline and cementing equipment. The services generally include the sale or disposal of equipment salvaged from the well as part of the compensation received and require compliance with state regulatory requirements. The demand for oil and natural gas does not significantly affect the demand for plugging and abandonment services, as well operators are required by state regulations to plug a well that it is no longer productive. The need for these services is also driven by lease and/or operator policy requirements.

OILFIELD TRUCKING

We provide liquid/vacuum truck services and fluid transportation and disposal services for operators whose wells produce saltwater and other fluids, in addition to oil and natural gas. These trucks are also utilized in connection with drilling and workover projects, which tend to produce and use large amounts of various oilfield fluids. We also own a number of salt water disposal wells. In addition, we provide haul/ equipment trucks that are used to move large pieces of equipment from one wellsite to the next. Demand and pricing for these services are generally related to demand for our well service and drilling rigs.

ANCILLARY OILFIELD SERVICES

We provide ancillary oilfield services, which include among others: hot oiling; wireline; frac tank rentals; well site construction; roustabout services; fishing and other tool rentals; blowout preventers (BOPs); and foam units and air drilling services. Demand and pricing for these services are generally related to demand for our well service and drilling rigs.

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CONTRACT DRILLING

We provide contract drilling services to major oil companies and independent oil and natural gas producers onshore the continental United States in the Permian Basin, the Four Corners region, Michigan, the Northeast, and the Rocky Mountains and internationally in Argentina and Ontario, Canada. Contract drilling services are primarily provided under standard dayrate, and, to a lesser extent, footage or turnkey contracts. Drilling rigs vary in size and capability and may include specialized equipment. The majority of our drilling rigs are equipped with mechanical power systems and have depth ratings ranging from approximately 4,500 to 12,000 feet. We have one drilling rig with a depth rating of approximately 18,000 feet. Like workover services, the demand for contract drilling is directly related to expectations relating to, and changes in, oil and natural gas prices which in turn, are driven by the supply of and demand for these commodities.

FOREIGN OPERATIONS

We also operate each of our business segments discussed above in Argentina and Ontario, Canada. Our foreign operations currently own 26 well servicing rigs, 57 oilfield trucks and eight drilling rigs in Argentina and three well servicing rigs, four oilfield trucks and three drilling rigs in Ontario, Canada.

CUSTOMERS

Our customers include major oil companies, independent oil and natural gas production companies, and foreign national oil and natural gas production companies. No single customer in fiscal 2001 accounted for 10% or more of our consolidated revenues.

COMPETITION AND OTHER EXTERNAL FACTORS

Despite the significant consolidation in the domestic well servicing industry, there are numerous smaller companies that compete in our well servicing markets. Nonetheless, we believe that our performance, equipment, safety, and availability of equipment to meet customer needs and availability of experienced, skilled personnel is superior to that of its competitors.

In the well servicing markets, an important competitive factor in establishing and maintaining long-term customer relationships is having an experienced, skilled and well-trained work force. In recent years, many of our larger customers have placed increased emphasis on the safety records and quality of the crews, equipment and services provided by their contractors. We have, and will continue to devote substantial resources toward employee safety and training programs. Management believes that many of our competitors, particularly small contractors, have not undertaken similar training programs for their employees. Management believes that our safety record and reputation for quality equipment and service are among the best in the industry.

In the contract drilling market, we compete with other regional and national oil and natural gas drilling contractors, some of which have larger rig fleets with greater average depth capabilities and a few that have better capital resources than us. Management believes that the contract drilling industry is less consolidated than the well servicing industry, resulting in a contract drilling market that is more price competitive. Nonetheless, we believe that it is competitive in terms of drilling performance, equipment, safety, pricing, availability of equipment to meet customer needs and availability of experienced, skilled personnel in those regions in which we operate.

The need for well servicing and contract drilling fluctuates, primarily, in relation to the price of oil and natural gas which, in turn, is driven by the supply of and demand for oil and natural gas. As supply of those commodities decreases and demand increases, service and maintenance requirements increase as

oil and natural gas producers attempt to maximize the producing efficiency of their wells in a higher priced environment.

EMPLOYEES

As of June 30, 2001, we employed approximately 9,300 persons (approximately 9,220 in well servicing and contract drilling and 80 in corporate). Our employees are not represented by a labor union and are not covered by

collective bargaining agreements. We have not experienced work stoppages associated with labor disputes or grievances and considers its relations with its employees to be satisfactory.

ENVIRONMENTAL REGULATIONS

Our operations are subject to various local, state and federal laws and regulations intended to protect the environment. Our operations routinely involve the handling of waste materials, some of which are classified as hazardous substances. Consequently, the regulations applicable to our operations include those with respect to containment, disposal and controlling the discharge of any hazardous oilfield waste and other non-hazardous waste material into the environment, requiring removal and cleanup under certain circumstances, or otherwise relating to the protection of the environment. Laws and regulations protecting the environment have become more stringent in recent years, and may in certain circumstances impose "strict liability," rendering a party liable for environmental damage without regard to negligence or fault on the part of such party. Such laws and regulations may expose us to liability for the conduct of, or conditions caused by, others, or for our acts, which were in compliance with all applicable laws at the times such acts were performed. Cleanup costs and other damages arising as a result of environmental laws, and costs associated with changes in environmental laws and regulations could be substantial and could have a material adverse effect on our financial condition. From time to time, claims have been made and litigation has been brought against us under such laws. However, the costs incurred in connection with such claims and other costs of environmental compliance have not had any material adverse effect on our operations or financial statements in the past, and management is not currently aware of any situation or condition that it believes is likely to have any such material adverse effect in the future. Management believes that it conducts our operations in substantial compliance with all material federal, state and local regulations as they relate to the environment. Although we have incurred certain costs in complying with environmental laws and regulations, such amounts have not been material to our financial results during the past three fiscal years.

MANAGEMENT

DIRECTORS AND EXECUTIVE OFFICERS

The following table sets forth the names and ages, as of October 25, 2001, of each of our executive officers and directors and includes their current positions.

NAME	AGE	POSITION

Francis D. John.....................	47	Chairman of the Board, President, Chief Executive O Chief Operating Officer
David J. Breazzano..................	45	Director
Kevin P. Collins....................	51	Director
William D. Fertig...................	45	Director
William D. Manly....................	78	Director
W. Phillip Marcum...................	57	Director
Morton Wolkowitz....................	73	Director
Thomas K. Grundman..................	41	Executive Vice President of International Operation Financial Officer and Chief Accounting Officer
James J. Byerlotzer.................	55	Executive Vice President of Domestic Operations

Francis D. John has been the President and Chief Executive Officer since October 1989. In addition, Mr. John has been Chairman of the Board since August 1996. Mr. John re-assumed the duties of Chief Operating Officer in April 1999. He has been a Director and President since June 1988 and served as the Chief Financial Officer from October 1989 through July 1997. Before joining the Company, he was Executive Vice President of Finance and Manufacturing of Fresenius U.S.A., Inc. Mr. John previously held operational and financial positions with Unisys, Mack Trucks and Arthur Andersen. He received a BS from Seton Hall University and an MBA from Fairleigh Dickinson University.

David J. Breazzano has been a Director since October 1997. Mr. Breazzano is one of the founding principals at DDJ Capital Management, LLC, an investment management firm established in 1996. Mr. Breazzano previously served as a Vice President and Portfolio Manager at Fidelity Investments ("Fidelity") from 1990 to 1996. Prior to joining Fidelity, Mr. Breazzano was President and Chief Investment Officer of the T. Rowe Price Recovery Fund. He is also a director of Waste Systems International, Inc. and Samuels Jewelers, Inc. He holds a BA from Union College and an MBA from Cornell University.

Kevin P. Collins has been a Director since March 1996. Mr. Collins has been a managing member of the Old Hill Company LLC since 1997. From 1992 to 1997, he served as a principal of JHP Enterprises, Ltd., and from 1985 to 1992, as Senior Vice President of DG Investment Bank, Ltd., both of which were engaged in providing corporate finance and advisory services. Mr. Collins was a director of WellTech, Inc. ("WellTech") from January 1994 until March 1996 when WellTech was merged into the Company. Mr. Collins is also a director of The Penn Traffic Company, Metretek Technologies, Inc. and London Fog Industries, Inc. He holds a BS and an MBA from the University of Minnesota.

William D. Fertig has been a Director since April 2000. Mr. Fertig has been a Principal, Manager of Sales and Training at McMahan Securities Co. L.P. since 1990. Mr. Fertig previously served as a Senior Vice President and Manager of Convertible Sales at Drexel Burnham Lambert prior to joining McMahan Securities in 1990, and from 1979 to 1989, served as Vice President and Convertible Securities Sales Manager at Credit Suisse First Boston. He holds a BS from Allegheny College and an MBA from NYU Graduate Business School.

William D. Manly has been a Director since December 1989. He retired from his position as an Executive Vice President of Cabot Corporation in 1986, a position he had held since 1978. Mr. Manly is a director of Metallamics, Inc. and CitiSteel, Inc. He holds a BS and an MS from the University of Notre Dame.

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W. Phillip Marcum has been a Director since March 1996. Mr. Marcum was a director of WellTech from January 1994 until March 1996 when WellTech was merged into the Company. From October 1995 until March 1996, Mr. Marcum was the acting

Chairman of the Board of Directors of WellTech. He has been Chairman of the Board, President and Chief Executive Officer of Metretek Technologies, Inc., formerly known as Marcum Natural Gas Services, Inc. ("Metretek Technologies"), since January 1991 and is a director of TestAmerica, Inc. He holds a BBA from Texas Tech University.

Morton Wolkowitz has been a Director since December 1989. Mr. Wolkowitz served as President and Chief Executive Officer of Wolkow Braker Roofing Corporation, a company that provided a variety of roofing services, from 1958 through 1989. Mr. Wolkowitz has been a private investor since 1989. He holds a BS from Syracuse University.

Thomas K. Grundman has been an Executive Vice President and the Chief Financial Officer since July 1999 and the Chief Accounting Officer since November 1999. Effective December 1999, Mr. Grundman became Executive Vice President of International Operations. Mr. Grundman also served as Treasurer from July 1999 through August 2000. He joined the Company in April 1999 as Sr. Vice President of Strategic and Business Development. From late 1996 through April 1999, Mr. Grundman was Senior Vice President at PNC Bank, N.A. where he ran the Oil and Gas Corporate Finance Group and was responsible for providing financing and advisory services in all sectors of the energy industry. From 1984 through 1996, Mr. Grundman held several positions at Chase Manhattan Bank and its predecessor institutions, most recently as a Managing Director in the oil and gas group. Mr. Grundman holds a BS in Finance from Syracuse University.

James J. Byerlotzer has been Executive Vice President of Domestic Well Service and Drilling Operations since July 1999. Effective December 1999, Mr. Byerlotzer's title was changed to Executive Vice President of Domestic Operations. He joined the Company in September 1998 as Vice President--Permian Basin Operations after the Company's acquisition of Dawson Production Services, Inc. ("Dawson"). From February 1997 to September 1998, he served as the Senior Vice President and Chief Operating Officer of Dawson. From 1981 to 1997, Mr. Byerlotzer was employed by Pride Petroleum Services, Inc. ("Pride"). Beginning in February 1996, Mr. Byerlotzer served as the Vice President--Domestic Operations of Pride. Prior to that time, he served as Vice President--Permian Basin of Pride and in various other operating positions in Pride's Gulf Coast and California operations. Mr. Byerlotzer holds a BA from the University of Missouri in St. Louis.

Directors are elected at the Company's annual meeting of stockholders and serve until the next annual meeting of stockholders and until their successors are elected and qualified. Each executive officer holds office until the first meeting of the Board of Directors following the annual meeting of stockholders and until his successor has been duly elected and qualified.

DIRECTOR COMPENSATION

No director who is also an employee of our or any of its subsidiaries received any fees from us for his services as a Director or as a member of any committee of the Board. During the fiscal year ended June 30, 2001 all other Directors ("Non-employee Directors") received a fee equal to $3,000 per month for each month of service and are reimbursed for travel and other expenses directly associated with Company business. Additionally, during fiscal 2001we paid the premiums with respect to life insurance for the benefit of Messrs. Collins and Marcum in the amount of $2,906 and $5,389, respectively.

EXECUTIVE COMPENSATION

SUMMARY COMPENSATION TABLE. The following table reflects the compensation for services to the Company for the years ended June 30, 2001, 2000 and 1999 for (i) the Chief Executive Officer of the Company and (ii) the other two executive officers of the Company other than the Chief Executive Officer who were serving

as executive officers at June 30, 2001 (the "Named Executive Officers").

NAME AND PRINCIPAL POSITION	FISCAL YEAR	ANNUAL COMPENSATION SALARY($)	BONUS($)	OTHER ANNUAL COMPENSATION ($)	LON COMP A SHA UNDE OPT
Francis D. John	2001	594,885	835,000	67,211(2)	1,4
President, Chief Executive Officer and	2000	589,519	307,776	--	2,0
Chief Operating Officer	1999	429,000	--	--	1,2
Thomas K. Grundman	2001	274,966	315,000	--	1
Executive Vice President of International	2000	203,845	100,000	--	5
Operations, Chief Financial Officer, and	1999	35,259(6)	--	--	3
Chief Accounting Officer					
James J. Byerlotzer	2001	249,324	275,000	--	1
Executive Vice President of Domestic	2000	185,000	89,000	--	3
Operation	1999	121,153(9)	--	--	2

(1) Represents the number of shares issuable pursuant to vested and non-vested stock options granted during the applicable fiscal year.

(2) Represents reimbursement of (i) medical expenses of $12,186, (ii) professional fees of $45,025, and (iii) other miscellaneous personal expenses of $10,000.

(3) Represents premium payments by the Company for life and health insurance.

(4) Represents (i) forgiveness of relocation loan indebtedness and interest to Mr. Grundman of $52,794, (ii) premium payments made by the Company for life insurance of $24,725 and (iii) contributions by the Company on behalf of Mr. Grundman to the Key Energy Services, Inc. 401(k) Savings & Retirement Plan of $1,000.

(5) Represents (i) premium payments by the Company for life insurance of $24,725 and (ii) contributions by the Company on behalf of Mr. Grundman to the Key Energy Services, Inc. 401(k) Savings & Retirement Plan of $250.

(6) Mr. Grundman joined the Company as an executive officer in April 1999.

(7) Represents (i) payments to Mr. Byerlotzer pursuant to a non-competition agreement entered into in connection with the Company's acquisition of Dawson Production Services, Inc. of $100,000, and (ii) contributions by the Company on behalf of Mr. Byerlotzer to the Key Energy Services, Inc. 401(k) Savings & Retirement Plan of $1,000.

(8) Represents (i) payments to Mr. Byerlotzer pursuant to a non-competition agreement entered into in connection with the Company's acquisition of Dawson Production Services, Inc. of $100,000, and (ii) contributions by the Company on behalf of Mr. Byerlotzer to the Key Energy Services, Inc. 401(k)

Savings & Retirement Plan of $250.

(9) Mr. Byerlotzer joined the Company as an executive officer in September 1998.

(10) Represents payments to Mr. Byerlotzer pursuant to a non-competition agreement entered into in connection with the Company's acquisition of Dawson Production Services, Inc.

OPTION GRANTS IN LAST FISCAL YEAR

The following table sets forth certain information relating to options granted under the Key Energy Group, Inc. 1997 Incentive Plan (the "Plan") and outside the Plan to the Named Executive Officers during fiscal 2001. The Company did not grant any stock appreciation rights during fiscal 2001.

	INDIVIDUAL GRANTS			
NAME	NUMBER OF SECURITIES OF UNDERLYING OPTIONS GRANTED	% OF TOTAL OPTIONS GRANTED TO EMPLOYEES IN FISCAL YEAR (1)	EXERCISE PRICE PER SHARE	EXPIRA DAT
Francis D. John.................	960,000(3)	37.9%	$ 8.25	08/07
	500,000(4)	19.7%	$ 8.25	12/11
Thomas K. Grundman.............	135,000(5)	5.3%	$ 8.25	12/11
James J. Byerlotzer............	115,000(6)	4.5%	$ 8.25	12/11

(1) Based on options to purchase a total of 2,533,000 of Common Stock granted during fiscal 2001.

(2) The grant date value of stock options was estimated using the Black-Scholes option pricing model with the following assumptions: expected volatility--59%; risk-free interest rate--4.3%; time of exercise--5 years; and no dividend yield.

(3) These options were granted on August 7, 2000, and vested immediately on the date of grant.

(4) These options were granted on December 11, 2000 and vested immediately on the date of grant.

(5) These options were granted on December 11, 2000 and vest in three equal annual installments commencing on July 1, 2001 as follows: 45,000 on July 1, 2001; 45,000 on July 1, 2002; and 45,000 on July 1, 2003.

(6) These options were granted on December 11, 2000 and vest in three equal annual installments commencing on July 1, 2001 as follows: 38,333 on July 1, 2001; 38,333 on July 1, 2002; and 38,334 on July 1, 2003.

AGGREGATED OPTION EXERCISES AND VALUES AS OF FISCAL YEAR END

The following table sets forth certain information as of June 30, 2001 relating to the number and value of (i) options exercised by the Named Executive Officers and (ii) unexercised options held by the Named Executive Officers.

	SHARES ACQUIRED ON EXERCISE(#)	VALUE REALIZED ($) (1)	NUMBER OF UNEXERCISED OPTIONS AT JUNE 30, 2001		VAL
			EXERCISABLE	UNEXERCISABLE	
Francis D. John............	1,825,000	12,850,875	2,418,333	791,667	$
Thomas K. Grundman.........	200,000	1,934,000	250,000	485,000	$
James J. Byerlotzer........	165,000	1,595,550	159,167	350,833	$

(1) The dollar values in this column are calculated by determining the difference between the fair market value of the Company's common stock on the date of exercise of the relevant options and the exercise price of such options. The fair market value on the date of exercise is based on the last sale price of the Company's common stock on the NYSE on such date.

(2) The dollar values in this column are calculated by determining the difference between the fair market value of the Common Stock for which the relevant options are exercisable as of the end of the fiscal year and the exercise price of the options. The fair market value is based on the last sale price of the Common Stock on the NYSE on June 29, 2001 which was $10.84.

EMPLOYMENT AGREEMENTS WITH EXECUTIVE OFFICERS

Effective as of October 16, 2001, we entered into second amended and restated employment agreement with Mr. John, which provides that Mr. John will serve as our Chairman of the Board, President and Chief Executive Officer for a five-year term commencing July 1, 2001 and continuing until June 30, 2006, with an automatic one-year renewal on each June 30, commencing on June 30, 2006, unless terminated by us or by Mr. John with proper notice. Under this employment agreement, Mr. John's annual base salary is $595,000 per year until December 31, 2002 and $695,000 per year thereafter, in each case subject to increase after annual reviews by the Board of

Directors. This employment agreement also provides that Mr. John will be entitled to (i) participate in our Performance Compensation Plan, with performance criteria to be approved by the Compensation Committee, (ii) receive additional bonuses at the discretion of the Compensation Committee, and (iii) participate in stock option grants made to our executives. In addition to salary and bonus, Mr. John is entitled to medical, dental, accident and life insurance, reimbursement of expenses and various other benefits. To the extent Mr. John is taxed on any such reimbursement or benefit, we will pay Mr. John an amount which, on an after-tax basis, equals the amount of these taxes.

In the event that we terminate Mr. John's employment voluntarily or by nonrenewal, or by Mr. John for "Good Reason," or if Mr. John's employment is terminated by us or by Mr. John following a "Change in Control" (in each case as defined in the employment agreement), Mr. John will be entitled to receive: (i) his accrued but unpaid salary and bonuses to the date of termination, and a PRO RATA bonus for the year in which termination occurs; (ii) a severance payment in

an amount equal to five times his average total annual compensation (i.e., salary plus bonus) for the preceding three years; (iii) immediate vesting and exercisability of all stock options held by him (to the extent not already vested and exercisable) for the remainder of the original terms of the options; (iv) any other amounts or benefits earned, accruing or owing to him, but not yet paid; and (v) continued participation in medical, dental and life insurance coverage, as well as the receipt of other benefits to which he was entitled, until the first to occur of the third year anniversary of the date his employment was terminated or the date on which he receives equivalent coverage and benefits under the plans and programs of a subsequent employer (or, in the event of a "Change in Control," an amount in cash equal to the reasonable expenses that we would incur if it were to provide these benefits for three years). In the event that Mr. John's employment is terminated as a result of Mr. John's disability, Mr. John will be entitled to receive (i) through (v) above, except that his severance compensation will be an amount equal to three times his average total annual compensation for the preceding three years, reduced by the amount of any company-paid disability insurance proceeds paid to Mr. John. In the event that we terminate Mr. John's employment for "Cause," as defined in the employment agreement, or by Mr. John voluntarily or by nonrenewal, he will be entitled to receive only (i) and (v) above and will forfeit any restricted stock or options not previously vested. In the event Mr. John's employment is terminated by reason of his death, he will be entitled to receive (i), (iii), (iv) and (v) above, except that his family will be entitled to receive the medical and dental insurance coverage provided in (v) above until the death of Mr. John's spouse. In addition, if any of the above benefits are subject to the tax imposed by Section 4999 of the Internal Revenue Code, we will reimburse Mr. John for such tax on an after-tax basis.

The employment agreement specifies that Mr. John may not engage in any activities that are competitive with ours for a period of three years after the termination of his employment.

Pursuant to the employment agreement, we will pay to Mr. John, on or prior to December 31, 2001, a one-time retention incentive bonus equal to the aggregate amount of all principal and interest on loans we previously made to Mr. John that were to be forgiven over a ten year period beginning July 1, 2001, as well as the amount, on an after-tax basis, required to pay the taxes incurred Mr. John in connection with such payment. The after-tax proceeds of the bonus will be used to repay such loans. The employment agreement goes on to provide that if, prior to June 30, 2011, we terminate Mr. John for Cause, or by Mr. John voluntarily or by nonrenewal, Mr. John will repay us a percentage of the retention incentive bonus beginning at 100% during the first year and declining at the rate of 10% each year to 0% on and after June 30, 2011.

Mr. Grundman entered into an employment agreement with us effective as of July 1, 1999, which was amended effective July 1, 2000. This agreement is for a three-year term and thereafter for successive one-year terms unless terminated 60 days prior to the commencement of an extension term. Under this agreement, Mr. Grundman initially receives an annual base compensation of $200,000, which can be increased but not decreased, and is eligible for additional annual incentive bonuses. If, during the term of his employment agreement, we terminate Mr. Grundman for any reason other than for cause, or if he terminates his employment because of a material breach by the company or following a change of control of the company, he will be entitled to severance compensation equal to his base compensation in effect at the time of termination payable in equal installments over a 36-month period following termination; PROVIDED, HOWEVER, that if termination results from a change of control of the company, severance compensation will be payable in a lump sum on the date of termination. Also, if Mr. Grundman

is subject to the tax imposed by Section 4999 of the Internal Revenue code, we have agreed to reimburse him for such tax on an after-tax basis.

Effective as of December 31, 2001, we entered into an employment agreement with Royce Mitchell, which provides that Mr. Mitchell will serve as our Executive Vice President and Chief Financial Officer for a three-year term commencing January 1, 2002 and continuing until December 31, 2004, with an automatic twelve-month renewal on each December 31, commencing on December 31, 2004, unless terminated by us or by Mr. Mitchell with proper notice. Under this employment agreement, Mr. Mitchell's annual base salary is $295,000 per year and subject to increase after annual reviews by the Board of Directors. This employment agreement also provides that Mr. Mitchell will be entitled to (i) participate in the our Performance Compensation Plan, with performance criteria to be approved by the Compensation Committee, (ii) receive additional bonuses at the discretion of the Compensation Committee which it, after consultation with the Chief Executive Officer, deems appropriate; and (iii) participate in stock option grants made to our executives. In addition to salary and bonus, Mr. Mitchell is entitled to medical, dental, accident and life insurance, reimbursement of expenses and various other benefits.

In the event that Mr. Mitchell's employment is terminated by Mr. Mitchell for "Good Reason" or by us for reasons other than "Cause" (as defined in the employment agreement) or "Disability" (as defined in the employment agreement), or if Mr. Mitchell's employment is terminated by either party following a Change in Control (as defined in the employment agreement), Mr. Mitchell will be entitled to receive: (i) severance compensation in the aggregate amount of three times his base salary at the rate in effect on the termination date, payable in thirty six equal installments, provided, however, that if Mr. Mitchell's employment is terminated within one year following a Change in Control or if we terminate Mr. Mitchell for other than Cause or Disability in anticipation of a Change in Control, the severance payment shall be increased by an amount equal to three times the average annual total bonuses we paid to Mr. Mitchell during the three year period (or shorter period as Mr. Mitchell may have been employed) preceding the date on which the notice of termination is given and shall be payable in one lump sum on the effective date of the termination; (ii) immediate vesting and exercisability of all stock options held by him (to the extent not already vested and exercisable); (iii) continued participation in medical, dental and life insurance coverage, as well as the receipt of other benefits to which he was entitled, until the first to occur of the third anniversary of the date his employment was terminated or the date on which he received equivalent coverage and benefits under the plans and programs of a subsequent employer. In the event Mr. Mitchell's employment is terminated by reason of disability, in addition to the other severance and benefits to which he is entitled, he shall also be entitled to three times his base salary at the rate in effect at the time of termination and payable in 36 equal monthly installments reduced by the amount of any disability proceeds paid to Mr. Mitchell. In the event there is a Change of Control following Mr. Mitchell's termination and while Mr. Mitchell is entitled to severance payments, any severance payments which remain unpaid as of the Change of Control shall be paid in one lump sum as of the Change in Control. Notwithstanding the above, in the event of the termination of Mr. Mitchell's employment for any reason, Mr. Mitchell (or his estate) is entitled to receive: (i) any unpaid portion of his base salary through the effective date of termination; (ii) accrued but unused vacation (payable in an amount equal to the base salary divided by 255 and multiplied by the number of accrued but unused vacation days; (iii) any prior fiscal year bonus earned but not paid; (iv) provided that Mr. Mitchell's employment was not terminated for Cause, a pro-rata portion of any bonus for the current fiscal year (so long as certain performance objectives have been met or it is reasonably likely such performance goals would have been met had Mr. Mitchell remained employed by us); and (v) any amounts for expense reimbursement and similar items which have been properly incurred prior to termination and have not yet been paid. Also, if Mr. Mitchell is subject to

the tax imposed by Section 4999 of the Internal Revenue Code, we have agreed to pay him an amount equal to the tax , plus any amounts necessary to "gross up" Mr. Mitchell for additional taxes resulting from the payments to him.

The employment agreement specifies that Mr. Mitchell may not engage in any activities that are competitive with ours so long as Mr. Mitchell is employed by us and for a period thereafter (a) as Mr. Mitchell is entitled to receive severance payments under the employment agreement; or (b) for a period of 3 years if Mr. Mitchell's severance payment is accelerated due to a Change in Control; or (c) for a period of 12 months if we terminate Mr. Mitchell's employment for Cause or if Mr. Mitchell terminates his employment for any reason, other than Good Reason

Pursuant to the employment agreement, we will pay to Mr. Mitchell, on or prior to December 31, 2001, a one-time bonus of $100,000. The employment agreement goes on to provide that if, prior to December 31, 2004, we terminate Mr. Mitchell for Cause, or by Mr. Mitchell for Good Reason, Mr. Mitchell will repay us a percentage of the bonus beginning at 100% during the first year and declining at the rate of 33 1/3% each year to 0% on and after December 31, 2004.

Effective as of December 31, 2001, we entered into an employment agreement with Jim Byerlotzer, which provides that Mr. Byerlotzer will serve as our Executive Vice President and Chief Operating Officer for a term commencing January 1, 2002 and continuing until June 30, 2004, with an automatic twelve-month renewal on each June 30, commencing on June 30, 2004, unless terminated by us or by Mr. Byerlotzer with proper notice. Under this employment agreement, Mr. Byerlotzer's annual base salary is $275,000 until July 1,2002 and $340,000 per year thereafter, in each case subject to increase after annual reviews by the Board of Directors. This employment agreement also provides that Mr. Byerlotzer will be entitled to (i) participate in the our Performance Compensation Plan, with performance criteria to be approved by the Compensation Committee, (ii) receive additional bonuses at the discretion of the Compensation Committee which it, after consultation with the Chief Executive Officer, deems appropriate; and (iii) participate in stock option grants made to our executives. In addition to salary and bonus, Mr. Byerlotzer is entitled to medical, dental, accident and life insurance, reimbursement of expenses and various other benefits.

In the event that Mr. Byerlotzer's employment is terminated by Mr. Byerlotzer for "Good Reason" or by us for reasons other than "Cause" (as defined in the employment agreement) or "Disability" (as defined in the employment agreement), or if Mr. Byerlotzer's employment is terminated by either party following a Change in Control (as defined in the employment agreement), Mr. Byerlotzer will be entitled to receive: (i) severance compensation in the aggregate amount of three times his base salary at the rate in effect on the termination date, payable in thirty six equal installments, provided, however, that if Mr. Byerlotzer's employment is terminated within one year following a Change in Control or if we terminate Mr. Byerlotzer for reasons other than Cause or Disability in anticipation of a Change in Control, the severance payment shall be increased by an amount equal to three times the average annual total bonuses we paid to Mr. Byerlotzer during the three year period (or shorter period as Mr. Byerlotzer may have been employed) preceding the date on which the notice of termination is given and shall be payable in one lump sum on the effective date of the termination; (ii) immediate vesting and exercisability of all stock options held by him (to the extent not already vested and exercisable); (iii) continued participation in medical, dental and life insurance coverage, as well as the receipt of other benefits to which he was entitled, until the first to occur of the third anniversary of the date his

employment was terminated or the date on which he received equivalent coverage and benefits under the plans and programs of a subsequent employer. In the event Mr. Byerlotzer's employment is terminated by reason of disability, in addition to the other severance and benefits to which he is entitled, he shall also be entitled to three times his base salary at the rate in effect at the time of termination and payable in thirty six equal monthly installments reduced by the amount of any disability proceeds paid to Mr. Byerlotzer. In the event there is a Change of Control following Mr. Byerlotzer's termination and while Mr. Byerlotzer is entitled to severance payments, any severance payments which remain unpaid as of the Change of Control shall be paid in one lump sum as of the Change in Control. Notwithstanding the above, in the event of the termination of Mr. Byerlotzer's employment for any reason, Mr. Byerlotzer (or his estate) is entitled to receive: (i) any unpaid portion of his base salary through the effective date of termination; (ii) accrued but unused vacation (payable in an amount equal to the base salary divided by 255 and multiplied by the number of accrued but unused vacation days; (iii) any prior fiscal year bonus earned but not paid; (iv) provided that Mr. Byerlotzer's employment was not terminated for Cause, a pro-rata portion of any bonus for the current fiscal year (so long as certain performance objectives have been met or it is reasonably likely such performance goals would have been met had Mr. Byerlotzer remained employed by us); and (v) any amounts for expense reimbursement and similar items which have been properly incurred prior to termination and have not yet been paid. Also, if Mr. Byerlotzer is subject to the tax imposed by Section 4999 of the Internal Revenue Code, we have agreed to pay him an amount equal to the tax, plus any amounts necessary to "gross up" Mr. Byerlotzer for additional taxes resulting from the payments to him.

The employment agreement specifies that Mr. Byerlotzer may not engage in any activities that are competitive with ours so long as Mr. Byerlotzer is employed by us and for a period thereafter (a) as Mr. Byerlotzer is entitled to receive severance payments under the employment agreement; or (b) for a period of 3 years if Mr. Byerlotzer's severance payment is accelerated due to a Change in Control; or (c) for a period of 12 months if we

terminate Mr. Byerlotzer's employment for Cause or if Mr. Byerlotzer terminates his employment for any reason, other than Good Reason.

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

In connection with the negotiation of the terms of a five-year employment agreement with Mr. Francis D. John, our Chairman of the Board, President and Chief Executive Officer, and as an inducement to Mr. John to enter into such employment agreement, we entered into a separate agreement with Mr. John dated as of August 2, 1999, which as amended through June 30, 2001, provides that $6.5 million in loans we previously made to Mr. John, together with the accrued interest payable thereon (accruing at a rate equal to 125 basis points above LIBOR, adjusted monthly) will be forgiven ratably during the ten year period commencing on July 1, 2001 and ending on June 30, 2011. The agreement provides that the foregoing forgiveness of indebtedness is predicated and conditioned upon Mr. John remaining employed by us during such period. In addition, in the event that Mr. John is terminated by us for "Cause" (as defined in the agreement), or in the event that Mr. John voluntarily terminates his employment with us, the agreement further provides that the entire remaining principal balance of these loans, together with accrued interest payable thereon, will become immediately due and payable by Mr. John. However, in the event that Mr. John's employment is terminated for "Good Reason", or as a result of Mr. John's death or "Disability", or as a result of a "Change in Control" (all as defined in that agreement), the agreement stipulates that the remaining principal balance outstanding on the loans, together with accrued interest thereon will be

forgiven. This agreement further provides that with respect to any forgiveness of the payment of principal and interest on the loans, Mr. John will be entitled to receive a "gross-up" payment in an amount sufficient for him to pay any federal, state, or local income taxes that may be due and payable by him with respect to the forgiveness of such indebtedness (principal and interest). The agreement has been effectively superseded by Mr. John's new employment agreement that provides for a one-time retention incentive bonus used to repay all amounts owed under the agreement (see Item 11--Executive Compensation--Employment Agreements with Executive Officers).

In connection with the negotiation of an employment agreement with Thomas K. Grundman, our Executive Vice President of International Operations, Chief Financial Officer and Chief Accounting Officer, we made a $240,000 short-term loan and a $150,000 relocation loan to assist Mr. Grundman's relocation to our executive offices. Interest on these loans accrues at a rate of 6.125% per annum. The short-term loan has been repaid. The relocation loan together with accrued interest will be forgiven in three installments of $50,000 each on July 1, 2000, 2001 and 2002; PROVIDED, HOWEVER, that if Mr. Grundman's employment is terminated during such period in a way that (i) triggers severance obligations, all amounts owed shall be immediately forgiven or (ii) does not trigger severance obligations, all amounts owed shall be immediately due and payable. This agreement further provides that with respect to any forgiveness of the payment of principal and interest on the loans, Mr. Grundman will be entitled to receive a "gross-up" payment in an amount sufficient for him to pay any federal, state, or local income taxes that may be due and payable by him with respect to the forgiveness of such indebtedness (principal and interest).

OWNERSHIP OF CAPITAL STOCK

MANAGEMENT

The following table sets forth as of October 25, 2001, the number of shares of Common Stock beneficially owned by each (i) each Director, (ii) each Named Executive Officer, and (iii) all Directors and executive officers of the Company as a group. Except as noted below, each holder has sole voting and investment power with respect to all shares of Common Stock listed as owned by such person.

NAME OF BENEFICIAL OWNER	NUMBER OF SHARES(1)	PERCENTAGE OF OUTSTANDING SHARES(2)
Francis D. John (3)	2,613,833	2.5%
Kevin P. Collins (4)	223,405	*
William D. Fertig (5)	30,000	*
William D. Manly (6)	221,042	*
W. Philip Marcum (7)	223,405	*

NAME OF BENEFICIAL OWNER	NUMBER OF SHARES(1)	PERCENTAGE OF OUTSTANDING SHARES(2)

David J. Breazzano (8)	208,333	*
Morton Wolkowitz (9)	608,302	*
Thomas K. Grundman (10)	355,000	*
James J. Byerlotzer (11)	263,667	*
Directors and Executive Officers as a group (9 persons)	4,716,987	4.4%

* Less than 1%

(1) Includes all shares with respect to which each Director or executive officer directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, has or shares the power to vote or to direct voting of such shares and/or to dispose or to direct the disposition of such shares. Includes shares that may be purchased under currently exercisable stock options and warrants.

(2) Based on 102,357,547 shares of Common stock outstanding at October 25, 2001, plus, for each beneficial owner, those number of shares underlying currently exercisable options held by each executive officer or Director.

(3) Includes 2,543,333 shares issuable upon exercise of vested options. Does not include 666,667 shares issuable pursuant to options that have not vested.

(4) Includes 218,333 shares issuable upon the exercise of vested options. Does not include 51,667 shares issuable pursuant to options that have not vested.

(5) Includes 25,000 shares issuable upon the exercise of vested options. Does not include 25,000 shares issuable pursuant to options that have not vested.

(6) Includes 218,333 shares issuable upon the exercise of vested options. Does not include 51,667 shares issuable pursuant to options that have not vested.

(7) Includes 218,333 shares issuable upon the exercise of vested options. Does not include 51,667 shares issuable pursuant to options that have not vested.

(8) Includes 148,333 shares issuable upon the exercise of vested options. Does not include 51,667 shares issuable pursuant to options that have not vested.

(9) Includes 118,000 shares issuable upon the exercise of vested options. Does not include 57,000 shares issuable pursuant to options that have not vested.

(10) Includes 345,000 shares issuable upon the exercise of vested options. Does not include 390,000 shares issuable pursuant to options that have not vested.

(11) Includes 241,667 shares issuable upon the exercise of vested options. Does not include 268,333 shares issuable pursuant to options that have not vested.

CERTAIN BENEFICIAL OWNERS

The following table sets forth, as of October 25, 2001, certain information regarding the beneficial ownership of Common Stock by each person, other than the Company's directors or executive officers, who is known by the

Company to own beneficially more than 5% of the outstanding shares of Common Stock.

NAME AND ADDRESS OF BENEFICIAL OWNER, IDENTITY OF GROUP	SHARES BENEFICIALLY O OCTOBER 19, 200	
	NUMBER	PE
Perkins, Wolf, McDonnell and Company (1).......................... 53 W. Jackson Blvd., Suite 722 Chicago, III 60604	11,036,014(2)	
Berger, L.L.C. (3)... 210 University Boulevard Suite 900 Denver, CO 80206	9,810,240(2)	

NAME AND ADDRESS OF BENEFICIAL OWNER, IDENTITY OF GROUP	SHARES BENEFICIALLY O OCTOBER 19, 200	
	NUMBER	PE
Mellon Financial Corporation (4)................................. One Mellon Center Pittsburgh, PA 15258	6,183,414	
T. Rowe Price Associates, Inc. (5)............................... 100 E. Pratt Street Baltimore, MD 21202	6,735,600	

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(1) As reported on Schedule 13G filed with the Commission on October 11, 2001.

(2) The Company believes that Perkins, Wolf, McDonell & Co. shares voting power with respect to 9,810,240 of its shares with Berger, LLC and that, therefore, the 9,810,240 shares shown as being beneficially owned by Berger, LLC are the same securities shown as being beneficially owned by Perkins, Wolf, McDonnell & Co.

(3) As reported on Schedule 13F filed with the Commission on August 14, 2001.

(4) As reported on Schedule 13G filed with the Commission on January 26, 2001.

(5) As reported on Schedule 13G (Amendment No. 1) filed with the Commission on February 8, 2001.

PLAN OF DISTRIBUTION

Well will issue common stock from time to time in connection with acquisitions by us or our subsidiaries of other businesses, assets or securities. We expect that the terms of the acquisitions involving the issuance of securities covered by this prospectus will be determined by direct negotiations with the owners or controlling persons of the businesses, assets or securities to be acquired by us or our subsidiaries. No underwriting discounts or commissions will be paid in connection with the issuance of our common stock, although finders' fees may be paid from time to time with respect to specific mergers or acquisitions. Any person receiving such fees may be deemed to be an underwriter within the meaning of the Securities Act.

LEGAL MATTERS

Certain legal matters in connection with this offering will be passed upon for us by Porter & Hedges, L.L.P.

EXPERTS

Our consolidated financial statements as of December 31, 2001 and 2000, and for each of the years in the three-year period ended December 31, 2001, have been included or incorporated by reference herein in reliance upon the report of KPMG LLP, independent certified public accountants, incorporated by reference herein, and upon the authority of such firm as experts in accounting and auditing.

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31, 2001 and 2000...

Notes to Consolidated Financial Statements..

KEY ENERGY SERVICES, INC.
CONSOLIDATED BALANCE SHEETS

	JUNE 30,
	(THOUSAND
ASSETS	
Current Assets:	
Cash and cash equivalents..	$ 2,
Accounts receivable, net of allowance for doubtful accounts ($4,082--2001, $3,189--2000)..	177,
Inventories..	16,
Income taxes receivable...	
Prepaid expenses and other current assets...	10,
Total current assets..	206,
Property and equipment:	
Well servicing equipment..	723,
Contract drilling equipment...	119,
Motor vehicles..	64,
Oil and gas properties and other related equipment, successful efforts method.....	44,
Furniture and equipment...	24,
Buildings and land..	37,
Total property and equipment..	1,014,
Accumulated depreciation & depletion..	(220,
Net property and equipment..	793,
Goodwill, net of accumulated amortization ($28,168--2001, $18,849--2000)..........	189,
Deferred costs, net...	17,
Notes receivable -- related parties...	6,
Other assets..	14,
Total assets..	$ 1,228,
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current liabilities:	
Accounts payable..	$ 42,
Other accrued liabilities...	48,
Accrued interest..	16,
Current portion of long-term debt...	7,
Total current liabilities...	115,
Long-term debt, less current portion..	485,
Deferred revenue..	14,
Non-current accrued expenses..	8,
Deferred tax liability..	127,
Commitments and contingencies...	

Stockholders' equity:	
Common stock, $0.10 par value; 200,000,000 shares authorized, 101,440,166 and 97,209,504 shares issued, respectively at June 30, 2001 and June 30, 2000, respectively	10,
Additional paid-in capital	444,
Treasury stock, at cost; 416,666 shares at June 30, 2001 and June 30, 2000	(9,
Accumulated other comprehensive income	
Retained earnings (deficit)	31,
Total stockholders' equity	476,
Total liabilities and stockholders' equity	$ 1,228,

SEE THE ACCOMPANYING NOTES WHICH ARE AN INTEGRAL PART OF
THESE CONSOLIDATED FINANCIAL STATEMENTS.

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KEY ENERGY SERVICES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

	YEAR ENDED JUNE 30,		
	2001	2000	
	(THOUSANDS, EXCEPT PER SHARE		
REVENUES:			
Well servicing	$ 758,273	$ 559,492	$
Contract drilling	107,639	68,428	
Other, net	7,350	9,812	
Total revenues	873,262	637,732	
COSTS AND EXPENSES:			
Well servicing	493,108	399,940	
Contract drilling	77,366	58,299	
Depreciation, depletion and amortization	75,147	70,972	
General and administrative	66,071	58,772	
Bad debt expense	1,263	1,648	
Debt issuance costs	--	--	
Interest	56,560	71,930	
Other expenses	4,464	4,147	
Corporate restructuring	--	--	
Total costs and expenses	773,979	665,708	
Income (loss) before income taxes	99,283	(27,976)	
Income tax benefit (expense)	(37,002)	7,406	
INCOME (LOSS) BEFORE EXTRAORDINARY GAIN (LOSS)	$ 62,281	$ (20,570)	$
Extraordinary gain (loss) on retirement of debt, less applicable income taxes of $255--23001 and $580--2000	429	1,611	
NET INCOME (LOSS)	$ 62,710	$ (18,959)	$

EARNINGS (LOSS) PER SHARE:			
Basic - before extraordinary gain (loss)..............	$ 0.63	$ (0.25)	
Extraordinary gain (loss) on retirement of debt, net of tax..	--	0.02	
Basic - after extraordinary gain.....................	$ 0.63	$ (0.23)	$
Diluted--before extraordinary gain...................	$ 0.61	$ (0.25)	$
Extraordinary gain on retirement of debt, net of tax..	--	0.02	
Diluted - after extraordinary gain...................	$ 0.61	$ (0.23)	$
WEIGHTED AVERAGE SHARES OUTSTANDING:			
Basic...	98,195	83,815	
Diluted...	102,271	83,815	

SEE THE ACCOMPANYING NOTES WHICH ARE AN INTEGRAL PART OF
THESE CONSOLIDATED FINANCIAL STATEMENTS.

KEY ENERGY SERVICES, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	YEAR ENDED JUNE	
	2001	2000
		(THOUSANDS)
NET INCOME (LOSS)...	$ 62,710	$ (18,959)
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX:		
Derivative transition adjustment (See Note 8).................	(778)	--
Oil and natural gas derivatives adjustment (See Note 8)........	306	--
Amortization of oil and natural gas derivatives (See Note 8)...	558	--
Reversal of unrealized gains on available-for-sale securities	--	--
Currency translation gain (loss)..............................	(32)	(1)
COMPREHENSIVE INCOME (LOSS), NET OF TAX.........................	$ 62,764	$ (18,960)

SEE THE ACCOMPANYING NOTES WHICH ARE AN INTEGRAL PART OF
THESE CONSOLIDATED FINANCIAL STATEMENTS.

KEY ENERGY SERVICES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

YEAR ENDED JUNE	
2001	2000

	(THOUSANDS)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income/(loss)	$ 62,710	$ (18,959)
ADJUSTMENTS TO RECONCILE INCOME FROM OPERATIONS TO NET CASH PROVIDED BY (USED IN) OPERATIONS:		
Depreciation, depletion and amortization	75,147	70,972
Bad debt expense	1,263	1,648
Amortization of deferred debt issuance costs	4,317	5,919
Restructuring charge	--	--
Deferred income taxes	34,698	(1,818)
(Gain) loss on sale of assets	173	25
Extraordinary (gain) loss, net of tax	(429)	(1,611)
Other non-cash items	--	--
CHANGE IN ASSETS AND LIABILITIES NET OF EFFECTS FROM THE ACQUISITIONS:		
(Increase) decrease in accounts receivable	(55,076)	(32,853)
(Increase) decrease in other current assets	(4,485)	(5,483)
Increase (decrease) in accounts payable, accrued interest and accrued expenses	29,414	18,875
Other assets and liabilities	(5,015)	(1,855)
Net cash provided by (used in) operating activities	142,717	34,860
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures--well servicing	(50,799)	(26,469)
Capital expenditures--contract drilling	(15,884)	(8,282)
Capital expenditures--other	(15,437)	(3,422)
Proceeds from sale of fixed assets	3,415	2,722
Notes receivable from related parties	(1,500)	(2,315)
Cash received in acquisitions	--	--
Acquisitions--well servicing	(2,345)	--
Acquisitions--contract drilling	(800)	--
Other assets and liabilities	--	--
Net cash provided by (used in) investing activities	(83,350)	(37,766)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayment of long-term debt and capital lease obligations	(382,540)	(51,077)
Borrowings under line-of-credit	30,000	12,000
Proceeds from equity offerings, net of expenses	--	100,571
Proceeds from long-term debt	175,210	--
Proceeds paid for debt issuance costs	(4,958)	--
Proceeds from other long-term debt	--	--
Proceeds from forward sale, net of expenses	--	18,236
Proceeds from issuance of warrants	--	--
Proceeds from exercise of warrants	847	8,473
Proceeds from exercise of stock options	14,617	1,098
Other	(318)	--
Net cash provided by (used in) financing activities	(167,142)	89,301
Net increase (decrease) in cash	(107,775)	86,395
Cash and cash equivalents at beginning of period	109,873	23,478
Cash and cash equivalents at end of period	$ 2,098	$ 109,873

SEE THE ACCOMPANYING NOTES WHICH ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS.

KEY ENERGY SERVICES, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(THOUSANDS)

	COMMON STOCK		ADDITIONAL		
	NUMBER OF SHARES	AMOUNT AT PAR	PAID-IN CAPITAL	TREASURY STOCK	RET EAR
BALANCE AT JUNE 30, 1998.............	18,685	$ 1,868	$ 119,303	$ (9,682)	$
Reversal of unrealized gain on available for sale securities.......	--	--	--	--	
Foreign currency translation adjustment, net of tax.............	--	--	--	--	
Issuance of warrants with 14% Notes.............................	--	--	7,434	--	
Issuance of common stock in equity offering, net of offering costs.....................	64,245	6,425	174,016	--	
Issued to lender in lieu of fee.......	200	20	980	--	
Exercise of options..................	15	2	92	--	
Other	10	2	(210)	--	
Net income (loss)....................	--	--	--	--	(
BALANCE AT JUNE 30, 1999.............	83,155	$ 8,317	$ 301,615	$ (9,682)	$ (
Foreign currency translation adjustment, net of tax.............	--	--	--	--	
Exercise of warrants.................	2,431	243	8,230	--	
Exercise of options..................	241	24	1,074	--	
Conversion of 7% Debentures..........	380	38	3,568	--	
Issuance of common stock in equity offering, net of offering costs...	11,000	1,100	99,471	--	
Other	3	1	4	--	
Net income (loss)....................	--	--	--	--	(
BALANCE AT JUNE 30, 2000.............	97,210	$ 9,723	$ 413,962	$ (9,682)	$ (
Derivative transition adjustment (see Note 8).......................	--	--	--	--	
Oil and natural gas derivatives Adjustment, net of tax (See Note 8).	--	--	--	--	
Amortization of oil and natural gas Derivatives (see Note 8)...........	--	--	--	--	
Foreign currency translation adjustment, Net of tax.............	--	--	--	--	
Exercise of warrants.................	185	19	828	--	
Exercise of options..................	3,106	308	14,309	--	
Conversion of 7% Debentures..........	101	10	947	--	
Issuance of common stock for acquisitions.......................	838	84	8,036	--	
Deferred tax benefit--compensation Expense...........................	--	--	7,004	--	
Other	--	--	(318)	--	
Net income (loss)....................	--	--	--	--	

BALANCE AT JUNE 30, 2001.............	101,440	$ 10,144	$444,768	$ (9,682)	$
	==========	==========	===========	==========	===

SEE THE ACCOMPANYING NOTES WHICH ARE AN INTEGRAL PART OF
THESE CONSOLIDATED FINANCIAL STATEMENTS.

KEY ENERGY SERVICES INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2001, 2000 AND 1999

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

THE COMPANY

Key Energy Services, Inc. (the "Company" or "Key"), is the largest onshore, rig-based well servicing contractor in the world, with approximately 1,477 well service rigs and 1,455 oilfield service vehicles as of June 30, 2001. The Company provides a complete range of well services to major oil companies and independent oil and natural gas production companies, including: rig-based well maintenance, workover, completion, and recompletion services (including horizontal recompletions); oilfield trucking services; and ancillary oilfield services. Key conducts well servicing operations onshore the continental United States in the following regions: Gulf Coast (including South Texas, Central Gulf Coast of Texas, and South Louisiana), Permian Basin of West Texas and Eastern New Mexico, Mid-Continent (including the Anadarko, Hugoton and Arkoma Basins, and the ArkLaTex region), Four Corners (including the San Juan, Piceance, Uinta, and Paradox Basins), Eastern (including the Appalachian, Michigan and Illinois Basins), Rocky Mountains (including the Denver-Julesberg, Powder River, Wind River, Green River and Williston Basins), and California (the San Joaquin Basin), and internationally in Argentina and Ontario, Canada. The Company is also a leading onshore drilling contractor, with 79 land drilling rigs as of June 30, 2001. Key conducts land drilling operations in a number of major domestic producing basins, as well as in Argentina and in Ontario, Canada. Key also produces and develops oil and natural gas reserves in the Permian Basin region and Texas Panhandle.

BASIS OF PRESENTATION

The Company's consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant inter-company transactions and balances have been eliminated. The accounting policies presented below have been followed in preparing the accompanying consolidated financial statements.

ESTIMATES AND UNCERTAINTIES

Preparation of the accompanying consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

INVENTORIES

Inventories, which consist primarily of oilfield service parts and

supplies held for consumption and parts and supplies held for sale at the Company's various retail supply stores, are valued at the lower of average cost or market.

PROPERTY AND EQUIPMENT

The Company provides for depreciation and amortization of oilfield service and related equipment using the straight-line method, excluding its drilling rigs, over the following estimated useful lives of the assets:

DESCRIPTION	YEARS
Well service rigs..................................	25
Motor vehicles.....................................	5
Furniture and equipment............................	3-7
Buildings and improvements.........................	10-40
Gas processing facilities..........................	10
Disposal wells.....................................	15-30
Trucks, trailers and related equipment..............	7-15

The components of a well service rig that generally require replacement during the rig's life are depreciated over their estimated useful lives, which range from three to 15 years. The basic rigs, excluding components, have estimated useful lives from date of original manufacture ranging from 25 to 35 years. Salvage values are assigned to the rigs based on an estimate of 10%.

Effective July 1, 1998, the Company made certain changes in the estimated useful lives of its well service rigs, increasing the lives from 17 years to 25 years. This change decreased the net loss for the twelve months ended June 30, 1999 by approximately $3,100,000 ($0.11 per share-basic). This change was made to better reflect the expected utilization of these assets over time, to better provide matching of revenues and expenses and to better reflect the industry standard in regards to estimated useful lives of workover rigs.

The Company uses the units-of-production method to depreciate its drilling rigs. This method takes into consideration the number of days the rigs are actually in service each month and depreciation is recorded for at least 15 days each month for each rig that is available for service. The Company believes that this method appropriately reflects its financial results by matching revenues with expenses and appropriately reflects how the assets are to be used over time.

The Company uses the successful efforts method of accounting for its oil and gas properties. Under this method, all costs associated with productive wells and nonproductive development wells are capitalized, while nonproductive exploration costs and geological and geophysical costs (if any), are expensed. Capitalized costs relating to proved properties are depleted using the units-of-production method.

The Company follows the provisions of FASB Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed

Of. This statement requires that long-lived assets including certain identifiable intangibles, held and used by the Company, be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. For purposes of applying this statement, the Company groups its long-lived assets, including goodwill, on a yard-by-yard basis and compares the estimated future cash flows of each yard to the yard's net carrying value including allocable goodwill. The Company would record an impairment charge, reducing the yard's net carrying value to an estimated fair value, if the estimated future cash flows were less than the yard's net carrying value. Since adoption of this statement no impairment charges have been required.

HEDGING AND DERIVATIVE FINANCIAL INSTRUMENTS

The Company uses derivative financial instruments, primarily commodity option contracts to reduce the exposure of its oil and gas producing operations to changes in the market price of natural gas and crude oil and to fix the price for natural gas and crude oil independently of the physical sale.

The financial instruments that the Company accounts for as hedging contracts must meet the following criteria: the underlying asset or liability must expose the Company to price risk that is not offset in another asset or liability, the hedging contract must reduce that price risk, and the instrument must be designated as a hedge at the inception of the contract and throughout the contract period. In order to qualify as a hedge, there must be clear correlation between changes in the fair value of the financial instrument and the fair value of the underlying asset or liability such that changes in the market value of the financial instrument will be offset by the effect of price rate changes on the exposed items.

Prior to the adoption of SFAS 133, premiums paid for commodity option contracts, which qualify as hedges, are amortized to oil and natural gas sales over the terms of the contracts. Unamortized premiums are included in other assets in the consolidated balance sheet. Amounts receivable under the commodity option contracts are accrued as an increase in oil and natural gas sales for the applicable periods.

Effective July 1, 2000, the Company adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133") as amended by SFAS No. 137 and No. 138 ("SFAS 138"). SFAS 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and hedging activities. It requires the recognition of all derivative instruments as assets and liabilities in the Company's balance sheet and measurement of those instruments at fair value. The accounting treatment of changes in fair value is dependent upon whether or not a derivative instrument is designated as a hedge and if so, the type of hedge. For derivatives designated as cash flow hedges, changes in fair value are recognized in other comprehensive income until the hedged item is recognized in earnings. See Note 8.

COMPREHENSIVE INCOME

The Company follows the provisions of Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income" ("SFAS 130"). SFAS 130

establishes standards for reporting and presentation of comprehensive income and its components. SFAS 130 requires that all items that are required to be recognized under accounting standards as components of comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. In accordance with the provisions of SFAS 130, the Company has presented the components of comprehensive income in its Consolidated Statements of Comprehensive Income.

ENVIRONMENTAL

The Company is subject to extensive federal, state and local environmental laws and regulations. These laws, which are constantly changing, regulate the discharge of materials into the environment and may require the Company to remove or mitigate the adverse environmental effects of the disposal or release of petroleum or chemical substances at various sites. Environmental expenditures are expensed or capitalized depending on their future economic benefit. Expenditures that relate to an existing condition caused by past operations and that have no future economic benefits are expensed. Liabilities for expenditures of a non-capital nature are recorded when environmental assessment and/or remediation is probable, and the costs can be reasonably estimated.

GOODWILL

Net goodwill, totaling $189.9 million and $198.6 million at June 30, 2001 and 2000, respectively, represents the cost in excess of fair value of the net tangible and identifiable intangible assets acquired and liabilities assumed in purchase transactions. Goodwill is being amortized on a straight-line basis over periods ranging from ten to 25 years. Amortization of goodwill for fiscal 2001, 2000 and 1999 was approximately $9,322,000, $9,840,000 and $9,202,000, respectively. The carrying amount of unamortized goodwill is reviewed for potential

impairment loss whenever events or changes in circumstances indicate that the carrying amount of goodwill may not be recoverable (see Property and Equipment above, for further discussion).

DEFERRED COSTS

Deferred costs totaling $31,052,000 and $30,998,000 at June 30, 2001 and 2000, respectively, represent debt issuance costs and are recorded net of accumulated amortization of $13,428,000 and $12,143,000 at June 30, 2001 and 2000, respectively. Deferred costs are amortized to interest expense using the straight-line method over the life of each applicable debt instrument or to extraordinary loss as related debt is retired early. This method approximates the amortization which would be recorded using the effective interest method. Amortization of deferred costs totaled approximately $3,578,000, $5,176,000 and $4,664,000 for fiscal 2001, 2000 and 1999, respectively. Unamortized debt issuance costs included in the determination of the extraordinary gain (loss) on retirement of debt, net of tax, totaled approximately $1,620,000 for fiscal 2001.

INCOME TAXES

The Company accounts for income taxes based upon Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("SFAS 109"). Under SFAS 109, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using statutory tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rate is recognized in income in the period that includes the statutory enactment date. A valuation allowance for deferred tax assets is recognized when it is more likely than not that the benefit of deferred tax assets will not be realized.

The Company and its eligible subsidiaries file a consolidated U.S. federal income tax return. Certain subsidiaries that are consolidated for financial reporting purposes are not eligible to be included in the consolidated U. S. federal income tax return and separate provisions for income taxes have been determined for these entities or groups of entities.

EARNINGS PER SHARE

The Company presents earnings per share information in accordance with the provisions of Statement of Financial Accounting Standards No. 128, "Earnings per Share" ("SFAS 128"). Under SFAS 128, basic earnings per common share are determined by dividing net earnings applicable to common stock by the weighted average number of common shares actually outstanding during the year. Diluted earnings per common share is based on the increased number of shares that would be outstanding assuming conversion of dilutive outstanding convertible securities using the "as if converted" method.

	YEAR ENDED JU	
	2001	2000
	(THOUSANDS, EXCEPT P	
BASIC EPS COMPUTATION:		
NUMERATOR		
Net Income (loss) before extraordinary gain (loss)...........	$ 62,281	$ (20,570
Extraordinary gain (loss), net of tax.......................	429	1,611
Net income (loss)...	$ 62,710	$ (18,959
DENOMINATOR		
Weighted average common shares outstanding..................	98,195	83,815
BASIC EPS:		
Before extraordinary gain (loss)............................	$ 0.63	$ (0.25
Extraordinary gain (loss), net of tax.......................	--	(0.02

Net income (loss)	$ 0.63	$ (0.23
DILUTED EPS COMPUTATION:		
NUMERATOR		
Net income (loss) before extraordinary gain (loss) and effect of dilutive securities, tax effected	$ 62,281	$ (20,570
Convertible securities	5	--
Net income (loss) before extraordinary gain (loss)	$ 62,286	$ (20,570
Extraordinary gain (loss), net of tax	429	1,611
Net income (loss)	$ 62,715	$ (18,959
DENOMINATOR		
Weighted average common shares outstanding	98,195	83,815
Warrants	205	--
Stock options	3,853	--
7% Convertible Debentures	18	--
	102,271	83,815

KEY ENERGY SERVICES INC.
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	YEAR ENDED JUN	
	2001	2000
	(THOUSANDS, EXCEPT PE	
DILUTED EPS:		
Before extraordinary gain (loss)	$ 0.61	$ (0.25
Extraordinary gain (loss), net of tax	--	0.02
Net income (loss)	$ 0.61	$ (0.23

The diluted earnings per share calculation for the year ended June 30, 2001 excludes the effect of the exercise of 360,000 stock options and the conversion of the Company's 5% Convertible Subordinated Notes because the effects of such instruments on earnings per share would be anti-dilutive.

The diluted earnings per share calculation for the years ended June 30, 2000 and 1999 excludes the effect of the conversion of all of the Company's then outstanding convertible debt and the exercise of all of the Company's then outstanding warrants and stock options because the effects of such instruments on loss per share would be anti-dilutive.

CONCENTRATION OF CREDIT RISK

Financial instruments, which potentially subject the Company to

concentrations of credit risk, consist primarily of temporary cash investments and trade receivables. The Company restricts investment of temporary cash investments to financial institutions with high credit standing and, by policy, limits the amount of credit exposure to any one financial institution. The Company's customer base consists primarily of multi-national and independent oil and natural gas producers. This may affect the Company's overall exposure to credit risk either positively or negatively in as much as its customers are affected by economic conditions in the oil and gas industry, which have historically been cyclical. However, account receivables are well diversified among many customers and a significant portion of the receivables are from major oil companies, which management believes minimizes potential credit risk. Historically, credit losses have been insignificant. Receivables are generally not collateralized, although the Company may generally secure a receivable at any time by filing a mechanic's or material-man's lien on the well serviced. The Company maintains reserves for potential credit losses, and such losses have been within management's expectations.

The Company did not have any one customer who represented 10% or more of consolidated revenues for the fiscal year ended June 30, 2001, 2000 or 1999.

STOCK-BASED COMPENSATION

The Company accounts for stock option grants to employees using the intrinsic value method of accounting prescribed by APB Opinion No. 25, Accounting for Stock Issued to Employees ("APB 25"). Under the Company's stock incentive plans, the price of the stock on the grant date is the same as the amount an employee must pay to exercise the option to acquire the stock; accordingly, the options have no intrinsic value at grant date, and in accordance with the provisions of APB 25, no compensation cost is recognized.

Statement of Financial Accounting Standards No. 123 ("SFAS 123"), "Accounting for Stock-Based Compensation," sets forth alternative accounting and disclosure requirements for stock-based compensation arrangements. Companies may continue to follow the provisions of APB 25 to measure and recognize employee

stock-based compensation; however, SFAS 123 requires disclosure of pro forma net income and earnings per share that would have been reported under the fair value based recognition provisions of SFAS 123. The Company has disclosed in Note 10 the pro forma information required under SFAS 123.

FOREIGN CURRENCY GAINS AND LOSSES

The local currency is the functional currency for all of the Company's foreign operations (Argentina and Canada). The cumulative translation gains and losses, resulting from translating each foreign subsidiary's financial statements from the functional currency to U.S. dollars, is included in other comprehensive income and accumulated in stockholders' equity until a partial or complete sale or liquidation of the Company's net investment in the foreign entity.

CASH AND CASH EQUIVALENTS

The Company considers all unrestricted highly liquid investments with less than a three-month maturity when purchased, as cash equivalents.

RECLASSIFICATIONS

Certain reclassifications have been made to the fiscal 2000 and 1999 consolidated financial statements to conform to the fiscal 2001 presentation. The reclassifications consist primarily of reclassifying oil and natural gas productions revenues and expenses. Oil and natural gas production revenues and related expenses have been reclassified to other revenues and other expenses because the Company does not believe this business segment is material to the Company's consolidated financial statements.

2. RESTRUCTURING CHARGE

In response to an industry downturn caused by historically low oil and gas prices and the resulting slowdown in business, on December 7, 1998, the Company announced a company-wide restructuring plan to reduce operating costs beyond those achieved through the Company's consolidation efforts. The plan involved a reduction in the size of management and on-site work force, salary reductions averaging 21% for senior management, the combination of previously separate operating divisions and the elimination of redundant overhead and facilities. The restructuring plan resulted in pretax charges to earnings of approximately $6.7 million in the second quarter ending December 31, 1998 and $1.5 million in the third quarter ending March 31, 1999. However, due to an increase in oil and gas prices beginning during the quarter ended March 31,1999, the Company amended its restructuring plan to decrease the number of planned employee terminations.

Increased demand for the Company's services made such terminations unnecessary and would have, in management's opinion, restricted the Company's ability to provide services to its customers. Consequently, the Company did not utilize approximately $3.7 million of the pretax charges. Essentially all of the unutilized portion of the restructuring charge was reversed in the fourth quarter ending June 30, 1999 resulting in a total pretax charge for the fiscal year ended June 30, 1999 of approximately $4.5 million. The charges included severance payments and other termination benefits for approximately 97 employees, lease commitments related to closed facilities and environmental studies performed on closed leased yard locations.

The Company completed the plan at June 30, 2000. There remained approximately $180,000 for COBRA benefits to terminated employees and $53,000 for contractual payments to an employee at June 30, 1999. The major components of the restructuring charge and costs incurred through June 30, 1999 were as follows:

DESCRIPTION	RESTRUCTURING CHARGE	COST INCURRED THROUGH JUNE 30, 1999
		(IN THOUSANDS)
Severance/Employee costs............................	$ 4,457	$ (4,224)

Lease commitments..................................	27	(27)
Environmental clean-up.............................	20	(20)
Total..	$ 4,504	$ (4,271)

3. BUSINESS AND PROPERTY ACQUISITIONS

ACQUISITIONS COMPLETED IN FISCAL 2001 AND 2000

There were no acquisitions completed by the Company during fiscal 2000. During fiscal 2001, the Company completed several small acquisitions for a total consideration of $11,965,000, which was paid using a combination of cash, notes and shares of the Company's common stock. Through these acquisitions, the Company acquired 34 well service rigs, 8 trucking vehicles, ancillary equipment and five salt water disposal facilities. Each of the acquisitions was accounted for using the purchase method and the results of the operations generated from the acquired assets are included in the Company's results of operations as of the completion date of each acquisition.

DAWSON PRODUCTION SERVICES, INC.

In September 1998, the Company completed the acquisition of all of the capital stock of Dawson Production Services, Inc. (Dawson) for an aggregate consideration of approximately $382.6 million, including approximately $207.1 million of cash paid for the Dawson stock and for transactional fees and approximately $175.5 million of net liabilities assumed.

Expenditures for the Dawson acquisition, including acquisition costs, less cash acquired were as follows (in thousands):

Fair value of assets acquired, including goodwill..
Liabilities assumed..
Liabilities for employee termination costs and lease termination costs.......................

Cash paid, including acquisition related expenditures and the cost of Dawson common stock previously held...
Less: Cash acquired..

Net cash used for the acquisition..

At the time of the closing, Dawson owned approximately 527 well service rigs, 200 oilfield trucks, and 21 production testing units in South Texas and the Gulf Coast, East Texas and Louisiana, the Permian Basin of West

Texas and New Mexico, the Anadarko Basin of Texas and Oklahoma, California, and in the inland waters of the Gulf of Mexico.

In connection with the Dawson acquisition, the Company recognized liabilities for the estimated costs to involuntarily terminate employees of Dawson and to exit certain activities of Dawson, primarily Dawson's lease liability for its corporate offices. As of June 30, 1999, the Company had completed its severance plan, terminating 44 former Dawson employees. At June 30, 1999, the Company had $592,000 accrued, representing the estimated lease termination costs of Dawson's former corporate offices.

OTHER FISCAL 1999 ACQUISITIONS

In addition to its acquisition of Dawson, the Company acquired the assets and/or capital stock of six well servicing and contract drilling businesses during fiscal 1999, increasing its rig and truck fleet by a total of approximately 93 well service rigs, 4 drilling rigs and 185 oilfield trucks (and related equipment) for an aggregate purchase price of approximately $93.7 million in cash. Each of the acquisitions was accounted for using the purchase method and the results of the operations, generated from the acquired assets, are included in the Company's results of operations as of the completion date of each acquisition.

PRO FORMA RESULTS OF OPERATIONS--(UNAUDITED)

The following unaudited pro forma results of operations have been prepared as though the Dawson acquisition had been acquired on July 1, 1998 with adjustments to record specifically identifiable decreases in direct costs and general and administrative expenses related to the termination of individual employees. Pro forma amounts are not necessarily indicative of the results that may be reported in the future.

	YEAR ENDED JUNE 30, 1999 (IN THOUSANDS, EXCEPT PER
Revenue	$ 524,924
Net income (loss)	(58,211)
Basic earnings (loss) per share	(2.12)

4. COMMITMENTS AND CONTINGENCIES

Various suits and claims arising in the ordinary course of business are pending against the Company. Management does not believe that the disposition of any of these items will result in a material adverse impact to the consolidated financial position, results of operations or cash flows of the Company.

In order to retain qualified senior management, the Company enters into employment agreements with its executive officers. These employment agreements run for periods ranging from three to five years, but can be automatically extended on a yearly basis unless terminated by the Company or the executive officer. In addition to providing a base salary for each executive officer, the employment agreements provide for severance payments for each executive officer varying from 1 to 3 years of the executive officer's base salary. At June 30, 2001 the annual base salaries for the executive officers covered under such employment agreements totaled $1,125,000. The Company also enters into employment agreements with other key employees as it deems necessary in order to retain qualified personnel.

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The components of long-term debt are as follows:

	JUNE 3
	2001
	(THOUSAN
Senior Credit Facility(i)	
Revolving Loans	$ 2,000
Tranche A Term Loan	--
Tranche B Term Loan	--
8 3/8% Senior Subordinated Notes Due 2009(iii)	134,466
5% Convertible Subordinated Notes Due 2004(iv)	158,426
7% Convertible Subordinated Debentures Due 2003(v)	--
Capital Leases	22,964
Other notes payable	805
	493,907
Less current portion	7,946
Total long-term debt	$ 485,961

(I) SENIOR CREDIT FACILITY

At June 30, 2001, the Company's senior credit facility (the "Senior Credit Facility") consisted of a $125 million revolving credit facility. In addition, up to $20 million of letters of credit can be issued under the Senior Credit Facility, but any outstanding letters of credit reduces borrowing availability under the revolver. The commitment to make revolving loans reduced to $100 million, on September 14, 2001 and will reduce to $75 million on September 14, 2002. The revolving commitment will terminate on September 14, 2003, and all the revolving loans must be paid on or before that date.

The revolving loans bear interest at rates based upon, at the Company's option, either the prime rate plus a margin ranging from 0.75% to 2.00% or a Eurodollar rate plus a margin ranging from 2.25% to 3.50%, in each case depending upon the ratio of the Company's total debt (less cash on hand over $5 million) to the Company's trailing 12-month EBITDA, as adjusted. The Company pays commitment fees on the unused portion of the revolving loan at a varying rate (depending upon the pricing ratio) of between 0.25% and 0.50%.

The Senior Credit Facility contains various financial covenants, including: (i) consolidated debt-to-capitalization ratio at generally decreasing levels varying between 79% and 65%, (ii) consolidated interest coverage ratio at generally increasing levels varying between 2.00-to-1.00 and 3.50-to-1.00, (iii) consolidated senior leverage ratio at generally decreasing levels varying between 2.50-to-1.00 and 2.00-to-1.00, and (iv) trailing 12-month EBITDA, as adjusted, at generally increasing levels varying between $50 million and $150 million. In addition, the Company must maintain a consolidated fixed charge coverage ratio at generally decreasing levels varying between 1.25-to-1.00 and 1.00 to 1.00. The covenants for consolidated senior leverage ratio and

consolidated interest coverage ratio are not imposed until the quarter ending March 31, 2001, and the covenant levels for consolidated debt-to-capitalization and trailing 12-month EBITDA, as adjusted, will remain fixed at 79% and $50 million, respectively, for the same period. The Company is also required to maintain a consolidated liquidity level of at least $30 million.

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The Senior Credit Facility subjects the Company to other restrictions, including restrictions upon the Company's ability to incur additional debt, liens and guarantee obligations, to merge or consolidate with other persons, to sell assets, to make dividends, purchases of our stock or subordinated debt, to make capital expenditures in excess of levels ranging from $37.5 million in fiscal 1999 to $65 million in fiscal 2004, or to make investments, loans and advances or changes to debt instruments and organizational documents. The Company will not be permitted to make acquisitions unless (i) its consolidated debt to capitalization ratio is not more than 60% or (ii) its consolidated debt to capitalization ratio is not increased and the acquisition is funded solely with capital stock. The Company must also maintain consolidated net worth not less than, $195 million plus (i) 75% of consolidated net income for each fiscal quarter beginning with the period ending December 31, 1998, (ii) 75% of the net cash proceeds from issuance of capital stock after September 14, 1998 and (iii) 75% of the increase in consolidated net worth resulting from the conversion of the 5% Convertible Subordinated Notes or other convertible debt issued after September 14, 1998. All obligations under the Senior Credit Facility are guaranteed by most of the Company's subsidiaries and are secured by substantially all the Company's assets, including the Company's accounts receivable, inventory and equipment.

During fiscal 2001, a portion of the net proceeds from the Equity Offering (see Note 10) was used to repay the entire outstanding balance of the Tranche A term loan then outstanding under the Senior Credit Facility and $2.3 million of the Tranche B term loan then outstanding under the Senior Credit Facility. In addition, $65 million of the net proceeds from the Equity Offering were used to reduce the principal amount outstanding under the revolver. The remainder of the net proceeds of the Equity Offering was used to retire other long-term debt. A portion of the proceeds from the Company's 8 3/8% Senior Note offering in fiscal 2001 was used to repay the entire outstanding balance of the Tranche B term loan then outstanding under the Senior Credit Facility and approximately $59.1 million under the revolver.

At June 30, 2001, there was approximately $2,000,000 outstanding under the revolving loans. Additionally, the Company had outstanding letters of credit of $11,995,000 and $15,132,000 as of June 30, 2001 and 2000, respectively, related to its workers compensation insurance.

(II) 8 3/8% SENIOR NOTES

On March 6, 2001 the Company completed a private placement of $175,000,000 of 8 3/8% Senior Notes due 2008 (the "8 3/8% Senior Notes"). The net cash proceeds from the private placement were used to repay all of the remaining balance of the original term loans under the Senior Credit Facility and a portion of the revolving loan facility under the Senior Credit Facility. The 8 3/8% Senior Notes are senior unsecured obligations, ranking equally with the Company's senior unsecured indebtedness. The 8 3/8% Senior Notes are effectively subordinated to Key's secured indebtedness which includes borrowings

under the Senior Credit Facility and the Dawson 9 3/8% Senior Notes.

On and after March 1, 2005, the Company may redeem some or all of the 8 3/8% Senior Notes at any time at varying redemption prices in excess of par, plus accrued interest. In addition, before March 1, 2004, the Company may redeem up to 35% of the aggregate principal amount of the 8 3/8% Senior Notes with the proceeds of certain sales of equity at 108.375% of par plus accrued interest.

At June 30, 2001, $175,000,000 principal amount of the 8 3/8% Senior Notes remained outstanding. The 8 3/8% Senior Notes pay interest semi-annually on March 1 and September 1 of each year.

(III) 14% SENIOR SUBORDINATED NOTES

On January 22, 1999, the Company completed the private placement of 150,000 units ("the Units") consisting of $150,000,000 of 14% Senior Subordinated Notes due 2009 (the "14% Senior Subordinated Notes") and 150,000 warrants to purchase 2,173,433 shares of common stock at an exercise price of $4.88125 per share (the "Unit Warrants"). The net cash proceeds from the private placement were used to repay substantially all of the remaining $148.6 million principal amount (plus accrued interest) owed under the Company's bridge loan facility arranged in connection with the acquisition of Dawson Production Services, Inc. ("Dawson").

On and after January 15, 2004, the Company may redeem some or all of the 14% Senior Subordinated Notes at any time at varying redemption prices in excess of par, plus accrued interest. In addition, before January 15, 2002, the Company may redeem up to 35% of the aggregate principal amount of the 14% Senior Subordinated Notes with the proceeds of certain sales of equity at 114% of par, plus accrued interest. On June 11, 2001, the Company exercised its right of redemption for $10,313,000 principal amount of the 14% Senior Subordinated Notes at a price of 114% of the principal amount plus accrued interest, leaving $139,687,000 principal amount outstanding as of June 30, 2001.

The Unit Warrants have separated from the 14% Senior Subordinated Notes and became exercisable on January 25, 2000. On the date of issuance, the value of the Unit Warrants was estimated at $7,434,000 and is classified as a discount to the 14% Senior Subordinated Notes on the Company's consolidated balance sheet. The discount is being amortized to interest expense over the term of the 14% Senior Subordinated Notes. The 14% Senior Subordinated Notes mature and the Unit Warrants expire on January 15, 2009. The 14% Senior Subordinated Notes are subordinate to the Company's senior indebtedness, which includes borrowings under the Current Senior Credit Facility, the Dawson 9 3/8% Senior Notes and the 8 3/8% Senior Notes.

In the event of a change in control of the Company, as defined in the indenture under which the 14% Senior Subordinated Notes were issued, each holder of 14% Senior Subordinated Notes will have the right, at the holder's option, to require the Company to repurchase all or any part of the holder's 14% Senior Subordinated Notes, within 60 days of such event, at a price equal to 100% of the principal amount thereof, together with accrued and unpaid interest thereon.

During fiscal 2001, the Company repurchased (and cancelled) $10,313,000 principal amount of the 14% Senior Subordinated Notes and paid a premium of

approximately $1,444,000. At June 30, 2001, $139,687,000 principal amount of the 14% Senior Subordinated Notes remained outstanding. The 14% Senior Subordinated Notes pay interest semi-annually on January 15 and July 15 of each year, beginning July 15, 1999. Interest of approximately $10,500,000 was paid on July 15, 2000 and January 15, 2001. As of June 30, 2001, 62,500 Unit Warrants had been exercised, producing approximately $4,173,000 of proceeds to the Company and leaving 87,500 Unit Warrants outstanding.

(IV) 5% CONVERTIBLE SUBORDINATED NOTES

In late September and early October 1997, the Company completed a private placement of $216 million of 5% Convertible Subordinated Notes due 2004 (the "5% Convertible Subordinated Notes"). The 5% Convertible Subordinated Notes are subordinate to the Company's senior indebtedness, which includes borrowings under the Senior Credit Facility, the 14% Senior Subordinated Notes, the Dawson 9 3/8% Senior Notes and the 8 3/8% Senior Notes. The 5% Convertible Subordinated Notes are convertible, at the holder's option, into shares of the Company's common stock at a conversion price of $38.50 per share, subject to certain adjustments.

The 5% Convertible Subordinated Notes are redeemable, at the Company's option, on and after September 15, 2000, in whole or part, together with accrued and unpaid interest. The initial redemption price is 102.86% for the year beginning September 15, 2000 and declines ratably thereafter on an annual basis.

During fiscal 2001, the Company repurchased (and cancelled) $47,384,000 principal amount of the 5% Convertible Subordinated Notes, leaving $158,426,000 principal amount of the 5% Convertible Subordinated Notes outstanding at June 30, 2001. These repurchases resulted in an after tax gain of approximately $3.2 million. Interest on the 5% Convertible Subordinated Notes is payable on March 15 and September 15. Interest of approximately $4,890,000 was paid on September 15, 2000 and $4,815,000 was paid on March 15, 2001, respectively.

(V) DAWSON 9 3/8% SENIOR NOTES

As a result of the Dawson acquisition (see Note 3), the Company, its subsidiaries and U.S. Trust Company of Texas, N.A., as trustee ("U.S. Trust"), entered into a Supplemental Indenture dated September 21, 1998 (the "Supplemental Indenture"), pursuant to which the Company assumed the obligations of Dawson under the Indenture dated February 20, 1997 (the "Dawson Indenture") between Dawson and U.S. Trust. The senior notes due 2007 (the "Dawson 9 3/8% Senior Notes") issued pursuant to the Dawson Indenture were equally and ratably secured with the obligations under the Senior Credit Facility. As a result of a mandatory tender offer made in connection with the Dawson acquisition and subsequent repurchases, only $1,106,000 principal amount of Dawson 9 3/8% Senior Notes remained outstanding at June 30, 2000.

During fiscal 2001, the Company repurchased $860,000 principal amount of the Dawson 9 3/8% Senior Notes, leaving $246,000 principal amount outstanding as of June 30, 2001. Interest on the Dawson 9 3/8% Senior Notes is payable on February 1 and August 1 of each year. Interest of approximately $52,000 and approximately $14,000 was paid on August 1, 2000 and February 1, 2001, respectively.

(VI) 7% CONVERTIBLE SUBORDINATE DEBENTURES

In July 1996, the Company completed a private placement of $52,000,000 principal amount of 7% Convertible Subordinated Debentures due 2003 (the "7% Convertible Subordinated Debentures"). During the quarter ended September 30, 2000, $985,000 principal amount of the 7% Convertible Subordinated Debentures were surrendered for conversion by the holders thereof and 101,025 shares of common stock were issued on September 1, 2000 in connection with the conversion. On September 1, 2000, the remaining $15,000 principal amount of the outstanding 7% Convertible Subordinated Debentures was redeemed at 103% of the principal amount plus accrued interest, leaving none outstanding. Interest on the 7% Convertible Subordinated Debentures was payable on January 1 and July 1 of each year. Interest of approximately $35,000 was paid on July 1, 2000.

CAPITALIZED DEBT ISSUANCE COSTS, REPAYMENT SCHEDULE AND INTEREST EXPENSE

The Company capitalized a total of approximately $4,958,000 and $16,370,000 in fees and costs in connection with its various financings during fiscal 2001 and 1999 respectively. The Company did not incur any fees or costs in connection with financing activities in fiscal 2000.

Presented below is a schedule of the repayment requirements of long-term debt for each of the next five years and thereafter as of June 30, 2001:

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FISCAL YEAR ENDED JUNE 30,	PRI A (IN T
2002	$
2003	
2004	
2005	
2006	
Thereafter	
	$

The Company's interest expense for the years ended June 30, 2001, 2000, and 1999 consisted of the following:

	2001	2000	
	(IN THOUSANDS)		
Cash payments for interest	$ 51,524	$ 61,956	$
Commitment and agency fees paid	1,203	1,139	

Accretion of discount on notes.....................	739	743	
Amortization of debt issuance costs................	3,578	5,176	
Net change in accrued interest.....................	146	2,916	
Other..	(630)	--	
	$ 56,560	$ 71,930	$

6. DEBT ISSUANCE COSTS

During fiscal 1999, the Company recorded an expense item of $6,307,000 which represented the write-off of debt issuance costs. The debt issuance costs were associated with a bridge loan incurred in connection with the Dawson acquisition, which was subsequently paid primarily with the proceeds from the Company's private placement of 14% Senior Subordinated Notes (see Note 5). During fiscal 2000, the Company expensed $338,000 of debt issuance costs related to the conversion of 7% Convertible Subordinated Debentures and other prepayments of debt.

7. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following table presents the carrying amounts and estimated fair values of the Company's financial instruments at June 30, 2001 and 2000. FASB Statement No. 107, "Disclosures about Fair Value of Financial Instruments", defines the fair value of a financial instrument as the amount at which the instrument could be exchanged in a current transaction between willing parties.

	2001		
	CARRYING VALUE	FAIR VALUE	CARRYING VALUE
Financial Assets:			
Cash and cash equivalents.................	$ 2,098	$ 2,098	$ 109,873
Accounts receivable, net..................	177,016	177,016	123,203
Notes receivable--related parties.........	6,050	6,600	5,150
Commodity option contracts................	1,035	1,035	--
Financial Liabilities:			
Accounts payable..........................	42,544	42,544	34,091
Commodity option contracts................	344	344	--
Long-term debt			
Senior Credit Facility..................	2,000	2,000	291,948
8 3/8% Senior Notes.....................	175,000	176,094	--
5% Convertible Subordinated Notes.......	158,426	141,989	205,810
7% Convertible Subordinated Debentures..	--	--	1,000
14% Senior Subordinated Notes...........	134,466	153,498	143,650
Dawson 9 3/8% Senior Notes..............	246	246	1,106
Capital lease liabilities...............	22,964	22,964	21,911

Other debt............................	805	805	1,175

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

Cash, trade receivables and trade payables: The carrying amounts approximate fair value because of the short maturity of those instruments.

Commodity option contracts: For fiscal 2001, under SFAS 133, the carrying amount of the commodity option contracts approximate fair value. For fiscal 2000, the carrying value is comprised of the unamortized premiums paid for the option contracts. The fair value of the commodity option contracts is estimated using the discounted forward prices of each options index price, for the term of each option contract.

Notes receivable-related parties: The amounts reported relate to notes receivable from officers of the Company.

Long-term debt: The fair value of the Company's long-term debt is based upon the quoted market prices for the various notes and debentures at June 30, 2001 and 2000, and the carrying amounts outstanding under the Company's senior credit facility.

8. DERIVATIVE FINANCIAL INSTRUMENTS

The Company utilizes derivative financial instruments to manage well defined commodity price risks. The Company is exposed to credit losses in the event of nonperformance by the counter-parties to its commodity hedges. The Company only deals with reputable financial institutions as counter-parties and anticipates that such counter-parties will be able to fully satisfy their obligations under the contracts. The Company does not obtain collateral or other security to support financial instruments subject to credit risk but monitors the credit standing of the counter-parties.

The Company periodically hedges a portion of its oil and natural gas production through collar and option agreements. The purpose of the hedges is to provide a measure of stability in the volatile environment of oil and natural gas prices and to manage exposure to commodity price risk under existing sales commitments. The Company's risk management objective is to lock in a range of pricing for expected production volumes. This allows the Company to forecast future earnings within a predictable range. The Company meets this objective by entering into collar and option arrangements which allow for acceptable cap and floor prices.

The Company does not enter into derivative instruments for any purpose other than for economic hedging. The Company does not speculate using derivative instruments. The Company has identified the following derivative instruments:

FREESTANDING DERIVATIVES. On March 30, 2000 the Company entered into a collar arrangement for a 22-month period whereby the Company will pay if the specified price is above the cap index and the counter-party will pay if the price should fall below the floor index. The hedge defines a range of cash flows bounded by the cap and floor prices. On May 25, 2001 the Company entered into an

option arrangement for a 12-month period beginning March 2002. whereby the counter-party will pay if the price should fall below the floor index. The Company desires a measure of stability to ensure that cash flows do not fall below a certain level.

Prior to the adoption of SFAS 133 as discussed in Note 1, these collars and options were accounted for as cash flow type hedges. Accordingly, the transition adjustment resulted in recording a $778,000 liability for the fair value of the collars to accumulated other comprehensive income, of which $520,000 was recognized in earnings during fiscal 2001. It is estimated that the remaining $258,000 of this transition adjustment will be recognized in earnings over the next fiscal year. While this arrangement was intended to be an economic hedge, as of July 1, 2000, the Company had not documented the March 30, 2000 oil and natural gas collars as cash flow hedges and therefore reported a charge to operations of $565,000 for the increase in fair value of the liability as of September 30, 2000 in other income. As of October 1, 2000, the Company documented these collars as cash flow hedges. As of May 25, 2001, the Company had not documented the May 25, 2001 oil and natural gas options as cash flow hedges and therefore has included income of $768,000 for the increase in fair value of the asset as of June 30, 2001 in other income. As of July 1, 2001, the Company documented these options as cash flow hedges. During fiscal 2001, the Company recorded a net increase of $999,000 in derivative assets, net of derivative liabilities, of which $132,000 represented ineffectiveness and was credited to earnings.

EMBEDDED DERIVATIVES. The Company is party to a volumetric production payment that meets the definition of an embedded derivative under SFAS 133. Effective July 1, 2000, the Company determined and documented that the volumetric production payment is excluded from the scope of SFAS 133 under the normal purchases/sales exclusion as set forth in SFAS 138.

For fiscal 2000 and 1999, gains and amortization of premiums paid on option contracts are recognized as an adjustment to sales revenue when the related transactions being hedged are finalized.

The net effect of the Company's commodity hedging activities decreased oil and natural gas revenues for the year ended June 30, 2000 by $822,270 and increased oil and natural gas revenues for the year ended June 30, 1999 by $158,500.

The following table sets forth the future volumes hedged by year and the weighted-average strike price of the option contracts at June 30, 2001 and 2000:

	MONTHLY INCOME			STRIKE P PER BBL/M
	OIL (BBLS)	NATURAL GAS (MMBTU)	TERM	FLOOR
At June 30, 2001				

Oil Collars..........	5,000	--	Mar 2001 - Feb. 2002	$ 19.70	-
Oil Put..............	5,000	--	Mar 2002 - Feb. 2003	22.00	-
Natural Gas Collars...	--	40,000	Mar 2001 - Feb. 2002	2.40	-
Natural Gas Put.......	--	75,000	Mar 2002 - Feb. 2003	3.00	-
At June 30, 2000					
Oil Collars..........	4,000	--	May 2000 - Feb. 2001	$ 22.20	-
	5,000	--	Mar 2001 - Feb. 2002	$ 19.70	-
Gas Collars..........		30,000	May 2000 - Feb. 2001	$ 2.60	-
		40,000	Mar 2001 - Feb. 2002	$ 2.40	-

(The strike prices for the oil options are based on the NYMEX spot price for West Texas Intermediate; the strike prices for the natural gas collars are based on the Inside FERC-West Texas Waha spot price; the strike price for the natural gas put is based on the Inside FERC-El Paso Permian spot price.)

9. OTHER ACCRUED LIABILITIES

Other accrued liabilities consist of the following:

	JUNE 30, 2001	JUNE 30, 2000
	(IN THOUSANDS)	
Accrued payroll, taxes and employee benefits............	$ 31,242	$ 15,261
State sales, use and other taxes........................	5,825	2,465
Oil and gas revenue distribution........................	1,606	1,714
Other...	10,250	6,958
Total...	$ 48,923	$ 26,398

10. STOCKHOLDERS' EQUITY

EQUITY OFFERINGS

On June 30, 2000, the Company closed the public offering of 11,000,000 shares of common stock at $9.625 per share, or approximately $106 million (the "Equity Offering"). Net proceeds from the Equity Offering of approximately $101 million were used to repay a portion of the Company's term loan borrowings and revolving line of credit under its senior credit facility and retire other long-term debt.

On May 7, 1999, the Company closed the public offering of 55,300,000 shares of common stock (300,000 shares of which were sold pursuant to the underwriters' over-allotment option discussed below) at $3.00 per share, or $166 million (the "Prior Public Offering"). Concurrently therewith, the Company closed the offering of 3,508,772 shares of common stock at $2.85 per share, or $10 million (the "Prior Concurrent Offering" and together with the Prior Public Offering, the "Prior Equity Offerings"). In addition, on

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June 7, 1999, the underwriters of the Prior Public Offering exercised an over-allotment option to purchase an additional 5,436,000 million shares to cover overallotments. Net proceeds from the Prior Equity Offerings of approximately $180.4 million were used to repay a portion of the Company's term loan borrowings under its senior credit facility.

STOCK INCENTIVE PLANS

On January 13, 1998 the Company's shareholders approved the Key Energy Group, Inc. 1997 Incentive Plan, as amended (the "1997 Incentive Plan"). The 1997 Incentive Plan is an amendment and restatement of the plans formerly known as the "Key Energy Group, Inc. 1995 Stock Option Plan" (the "1995 Option Plan") and the "Key Energy Group, Inc. 1995 Outside Directors Stock Option Plan" (the "1995 Directors Plan") (collectively, the "Prior Plans").

All options previously granted under the Prior Plans and outstanding as of November 17, 1997 (the date on which the Company's board of directors adopted the plan) were assumed and continued, without modification, under the 1997 Incentive Plan.

Under the 1997 Incentive Plan, the Company may grant the following awards to key employees, directors who are not employees ("Outside Directors") and consultants of the Company, its controlled subsidiaries, and its parent corporation, if any: (i) incentive stock options ("ISOs") as defined in Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"), (ii) "nonstatutory" stock options ("NSOs"), (iii) stock appreciation rights ("SARs"), (iv) shares of the restricted stock, (v) performance shares and performance units, (vi) other stock-based awards and (vii) supplemental tax bonuses (collectively, "Incentive Awards"). ISOs and NSOs are sometimes referred to collectively herein as "Options".

The Company may grant Incentive Awards covering an aggregate of the greater of (i) 3,000,000 shares of the Company's common stock and (ii) 10% of the shares of the Company's common stock issued and outstanding on the last day of each calendar quarter, provided, however, that a decrease in the number of issued and outstanding shares of the Company's common stock from the previous calendar quarter shall not result in a decrease in the number of shares available for issuance under the 1997 Incentive Plan. As a result of the Company's equity offering discussed above, as of June 30, 2001, the number of shares of the Company's common stock that may be covered by Incentive Awards has increased to approximately 10.1 million.

Any shares of the Company's common stock that are issued and are forfeited or are subject to Incentive Awards under the 1997 Incentive Plan that expire or terminate for any reason will remain available for issuance with respect to the granting of Incentive Awards during the term of the 1997 Incentive Plan, except as may otherwise be provided by applicable law. Shares of the Company's common stock issued under the 1997 Incentive Plan may be either newly issued or treasury shares, including shares of the Company's common stock that the Company receives in connection with the exercise of an Incentive Award. The number and kind of securities that may be issued under the 1997 Incentive Plan and pursuant to then outstanding Incentive Awards are subject to adjustments to prevent enlargement or dilution of rights resulting from stock dividends, stock splits, recapitalizations, reorganization or similar transactions.

The maximum number of shares of the Company's common stock subject to Incentive Awards that may be granted or that may vest, as applicable, to any one

Covered Employee (defined below) during any calendar year shall be 500,000 shares, subject to adjustment under the provisions of the 1997 Incentive Plan.

The maximum aggregate cash payout subject to Incentive Awards (including SARs, performance units and performance shares payable in cash, or other stock-based awards payable in cash) that may be granted to any one Covered Employee during any calendar year is $2,500,000. For purposes of the 1997 Incentive Plan, "Covered Employees" means a named executive officer who is one of the group covered employees as defined in Section 162(m) of the Code and the regulation promulgated thereunder (i.e., generally the chief executive officer and the other four most highly compensated executive officers for a given year.)

The 1997 Incentive Plan is administrated by the Compensation Committee appointed by the Board of Directors (the "Committee") consisting of not less than two directors each of whom is (i) an "outside director" under Section 162(m) of the Code and (ii) a "non-employee director" under Rule 16b-3 of the Securities Exchange Act of 1934. In addition, subject to applicable shareholder approval requirements, the Company may issue NSOs outside the 1997 Incentive Plan.

The exercise price of options granted under the 1997 Incentive Plan and outside the 1997 Incentive Plan is at or above the fair market value per share on the date the options are granted. The exercise of NSOs results in a U.S. tax deduction to the Company equal to the income tax effect of the difference between the exercise price and the market price at the exercise date. The following table summarizes the stock option activity related to the Company's plans (shares in thousands):

	FISCAL YEAR ENDING JUNE 30,			
	2001		2000	
	SHARES	WEIGHTED-AVERAGE EXERCISE PRICE	SHARES	WEIGHTED-AVERAGE EXERCISE PRICE
Outstanding-beginning of fiscal year.....	$ 9,470	$ 6.37	6,920	$ 5.55
Granted..............................	2,533	8.08	3,688	8.61
Exercised............................	(3,107)	4.70	(241)	4.56
Forfeited............................	(193)	4.92	(897)	9.80
Outstanding--end of fiscal year..........	8,703	7.49	9,470	6.37
Exercisable--end of fiscal year..........	5,820		4,370	

STOCK INCENTIVE PLANS

The foregoing stock option activity summary reflects that effective as of September 4, 1998, the Committee authorized the cancellation and reissue of stock options for employees that were not executive officers for the purpose of changing the exercise price and vesting schedule of such options. A total of 473,556 stock options were cancelled, with a weighted average price of approximately $13.09 per share, and reissued with an exercise price of $7.125 per share. The vesting of the new options is ratable over a three-year period from the date of grant.

The following table summarizes information about the stock options outstanding at June 30, 2001 (shares in thousands):

	OPTIONS OUTSTANDING			OPTI
RANGE OF EXERCISE PRICES	NUMBER OF SHARES OUTSTANDING AT JUNE 30, 2001	WEIGHTED-AVERAGE REMAINING CONTRACTUAL LIFE	WEIGHTED-AVERAGE EXERCISE PRICE	NUMBER SHAR EXERCISA JUNE 30,
$ 3.00 - $ 6.8125	1,921	6.49	$ 3.65	1,8
$ 6.00 - $ 7.4375	1,252	7.82	7.25	4
$ 8.125 - $ 8.3125	2,135	8.67	8.25	1,6
$ 8.50 - $ 13.50	3,395	7.69	9.27	1,9

The Company applies the intrinsic value method of APB 25 in accounting for its employee stock incentive plans. Accordingly, no compensation expense has been recognized for any stock options issued under the employee plans. Had compensation expense for stock options granted to employees been recognized based on the fair value at the grant dates, using the methodology prescribed by SFAS 123, the Company's net income (loss) and earnings per share would have been reduced to pro forma amounts indicated below:

	2001	2000	
	(IN THOUSANDS, EXCEPT PER SHARE A		
Net income (loss):			
As reported	$ 62,710	$ (18,959)	$
Pro forma	52,338	(25,684)	
Basic earnings per share of common stock:			
As reported	$ 0.63	$ (0.23)	$
Pro forma	0.53	(0.31)	
Diluted earnings per share of common stock:			
As reported	$ 0.61	$ (0.23)	$
Pro forma	0.51	(0.31)	

SFAS 123 does not apply to options granted prior to January 1, 1995; therefore, the pro forma effect disclosed above may not be representative of pro forma amounts in future years.

The total fair value of stock options granted during fiscal 2001, 2000 and 1999 was approximately $11,217,000, $19,541,000 and $15,695,000, respectively. The fair value of each stock option grant was estimated on the date of grant using the Black-Sholes option-pricing model, based on the following weighted-average assumptions.

	FISCAL YEAR OF GRANT	
	2001	2000
Risk-free interest rate............................	4.30%	6.40%
Expected life of options...........................	5 years	5 years
Expected volatility of the Company's stock price..	59%	67%
Expected dividends.................................	none	none

11. INCOME TAXES

Components of income tax expense (benefit) are as follows:

	FISCAL YEAR ENDED JUNE 30,		
	2001	2000	199
		(IN THOUSANDS)	
Federal and State:			
Current.............................	$ 2,304	$ (5,588)	$
Deferred			
U.S.............................	34,698	(1,818)	(2
Foreign.........................	--	--	
	$ 37,002	$ (7,406)	$ (2

No income tax payments were made for fiscal 2001, 2000 or 1999. Additionally a deferred tax benefit of $7,004,000 has been allocated to stockholders' equity in fiscal 2001 for compensation expense for income tax purposes in excess of amounts recognized for financial reporting purposes.

Income tax expense (benefit) differs from amounts computed by applying

the statutory federal rate as follows:

	FISCAL YEAR ENDED JUNE 30,	
	2001	2000
Income tax computed at statutory rate.....	35.0%	(35.0)%
Amortization of goodwill disallowance.....	2.2	7.0
State taxes..............................	1.4	--
Change in valuation allowance and other...	(1.4)	1.5
	37.2%	(26.5)%

Deferred tax assets (liabilities) are comprised of the following:

	FISCAL YEAR ENDED JUNE
	2001
	(IN THOUSANDS)
Net operating loss and tax credit carry forwards...........	$ 69,376
Property and equipment....................................	(182,442)
Self insurance reserves...................................	405
Allowance for bad debts...................................	1,542
Acquisition expenses, expensed for tax....................	(626)
Other...	148
Net deferred tax liability................................	(111,597)
Valuation allowance of deferred tax assets................	(15,803)
Net deferred tax liability, net of valuation allowance.....	$ (127,400)

A valuation allowance is provided when it is more likely than not that some portion of the deferred tax assets will not be realized. As described below, due to annual limitations on certain net operating loss carryforwards, it does not appear more likely than not that the Company will be able to utilize all available carryforwards prior to their ultimate expiration.

The Company estimates that as of June 30, 2001, the Company will have available approximately $185,474,305 of net operating loss carryforwards (which will continue to expire in fiscal 2002). Approximately $53,570,522 of the net operating loss carryforwards are subject to an annual limitation of approximately $1,012,000, under Sections 382 and 383 of the Internal Revenue Code.

12. LEASING ARRANGEMENTS

The Company leases certain property and equipment under non-cancelable operating leases that generally expire at various dates through fiscal 2006. The term of the operating leases generally run from 24 to 60 months with varying payment dates throughout each month.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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As of June 30, 2001, the future minimum lease payments under non-cancelable operating leases are as follows (in thousands):

FISCAL YEAR ENDING JUNE 30,	LEASE PAYMENTS
2002	$ 4,689
2003	4,587
2004	4,493
2005	4,426
2006	2,626
	$ 20,821

Operating lease expense was approximately $6,072,000, $6,460,000 and $7,313,000 for the fiscal years ended June 30, 2001, 2000 and 1999, respectively.

13. EMPLOYEE BENEFIT PLANS

In order to retain quality personnel, the Company maintains 401(k) plans as part of its employee benefits package. From July 1, 1998 through December 31, 1998, the Company matched 100% of employee contributions into its 401(k) plan up to a maximum of $1,000 per participant per year. From January 1, 1999 through March 31, 2000, the Company elected not to match employee contributions. Commencing April 1, 2000, the Company matches, 100% of employee contributions into its 401(k) plan up to a maximum of $250 per participant per year. The maximum limit was increased to $500 effective October 1, 2000, $750 effective January 1, 2001 and $1,000 effective July 1, 2001. The Company's matching contributions for fiscal 2001, 2000 and 1999 were approximately $1,857,000, $77,000 and $908,000, respectively.

14. TRANSACTIONS WITH RELATED PARTIES

In connection with the negotiation of the terms of a five-year employment agreement with Mr. Francis D. John, Chairman of the Board, President and Chief Executive Officer of the Company, and as an inducement to Mr. John to enter into such employment agreement, the Company entered into a separate agreement with Mr. John, dated as of August 2, 1999, which as amended through June 30, 2001, provides that $6.5 million in loans previously made by the Company to Mr. John, together with the accrued interest payable thereon, will be forgiven, ratably during the ten year period commencing on July 1, 2001 and ending on June 30, 2010. The agreement provides that the foregoing forgiveness of indebtedness is predicated and conditioned upon Mr. John remaining employed by the Company during such period. In addition, in the event that Mr. John is terminated by the Company for Cause (as defined in the agreement), or in the event that Mr. John voluntarily terminates his employment with the Company, the agreement further

provides that the entire remaining principal balance of these loans, together with accrued interest payable thereon, will become immediately due and payable by Mr. John. However, in the event that Mr. John's employment is terminated for "Good Reason", or as a result of Mr. John's death or "Disability", or as a result of a "Change in Control" (all as defined in that agreement), the agreement stipulates that the remaining principal balance outstanding on the loans, together with accrued interest thereon will be forgiven.

In connection with the negotiation of an employment agreement with Thomas K. Grundman, the Company's Executive Vice President, Chief Financial Officer and Chief Accounting Officer, the Company made a $240,000 short-term loan and a $150,000 relocation loan to assist Mr. Grundman's relocation to the Company's executive offices. Interest on these loans accrues at a rate of 6.125% per annum. The short-term loan has been repaid. The relocation loan together with accrued interest will be forgiven in three installments of $50,000 each on July 1, 2000, 2001 and 2002; provided, however, that if Mr. Grundman's employment is terminated during such period in a way that (i) triggers severance obligations, all amounts owed shall be immediately forgiven or (ii) does not trigger severance obligations, all amounts owed shall be immediately due and payable.

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JUNE 30, 2001, 2000 AND 1999

15. BUSINESS SEGMENT INFORMATION

The Company's reportable business segments are well servicing and contract drilling. Oil and natural gas production operations previously were presented separately as a reportable business segment and are now included in "corporate/other."

WELL SERVICING: the Company's operations provide well servicing (ongoing maintenance of existing oil and natural gas wells), workover (major repairs or modifications necessary to optimize the level of production from existing oil and natural gas wells) and production services (fluid hauling and fluid storage tank rental).

CONTRACT DRILLING: the Company provides contract drilling services for major and independent oil companies onshore the continental United States, Argentina and Ontario, Canada.

The Company's management evaluates the performance of its operating segments based on net income and operating profits (revenues less direct operating expenses). Corporate expenses include general corporate expenses associated with managing all reportable operating segments. Corporate assets consist principally of cash and cash equivalents, deferred debt financing costs and deferred income tax assets.

	WELL SERVICING	CONTRACT DRILLING	CORPORA /OTHER
TWELVE MONTHS ENDED JUNE 30, 2001			
Operating revenues..................................	$ 758,273	$ 107,639	$ 7,3
Operating profit	265,165	30,273	2,8

Depreciation, depletion and amortization.............	63,578	7,947	3,6
Interest expense....................................	1,831	--	54,7
Net income (loss) before extraordinary gain (loss)*...	109,159	9,466	(56,3
Identifiable assets.................................	664,611	95,473	278,3
Capital expenditures (excluding acquisitions).........	50,799	15,884	15,4
TWELVE MONTHS ENDED JUNE 30, 2000			
Operating revenues..................................	$ 559,492	68,428	$ 9,8
Operating profit....................................	159,552	10,129	5,6
Depreciation, depletion and amortization.............	62,680	6,105	2,1
Interest expense....................................	2,300	--	69,6
Net income (loss) before extraordinary gain (loss)*...	48,062	(1,664)	(56,9
Identifiable assets.................................	635,304	89,574	322,7
Capital expenditures (excluding acquisitions).........	30,098	8,282	3,4
TWELVE MONTHS ENDED JUNE 30, 1999			
Operating revenues..................................	$ 433,657	$ 50,613	$ 7,5
Operating profit....................................	108,692	7,057	4,6
Depreciation, depletion and amortization.............	52,638	6,586	2,8
Interest expense....................................	1,659	18	65,7
Net income (loss) before extraordinary gain (loss)*...	15,447	(4,093)	(64,6
Identifiable assets.................................	651,781	81,074	209,8
Capital expenditures (excluding acquisitions).........	26,776	1,063	3,4

* Net income (loss) before extraordinary gain (loss) for the contract drilling segment includes a portion of well servicing general and administrative expenses allocated on a percentage of revenue basis.

Operating revenues and operating profit for the Company's foreign operations, which includes Argentina and Canada, were $54.5 million and $13.4 million, respectively, for the year ended June 30, 2001. Operating revenues and operating profit for the Company's foreign operations, which includes Argentina and Canada, were $37.7 million and $7.3 million, respectively, for the year

ended June 30, 2000. Operating revenues and operating profit for the Company's foreign operations, which includes Argentina and Canada, were $26.9 million and $5.4 million, respectively, for the year ended June 30, 1999.

The Company had $84.1 million and $66.9 million of identifiable assets as of June 30, 2001 and 2000, respectively, related to its foreign operations.

16. SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES

	FISCAL YEAR ENDED JUN	
	2001	2000
Fair value of common stock issued in purchase transactions..................................	$8,120	$ --
Fair value of common stock issued to lender in		

lieu of fees..................................	--	--
Fair value of common stock issued upon conversion of long-term debt...................	957	3,606
Capital lease obligations...........................	9,595	10,758

17. UNAUDITED SUPPLEMENTARY INFORMATION--QUARTERLY RESULTS OF OPERATIONS

Summarized quarterly financial data for fiscal 2001, 2000 and 1999 are as follows:

	FIRST QUARTER	SECOND QUARTER	THIRD QUARTER
	(IN THOUSANDS, EXCEPT PER SHARE AMO		
2001			
Revenues	$ 191,679	$ 203,911	$ 227,370
Income (loss) from operations................	12,229	18,063	27,912
Net income (loss) before extraordinary gain (loss)..................................	7,510	11,094	17,587
Extraordinary gain (loss), net of tax.........	1,197	68	(167)
Net income (loss)...........................	8,707	11,162	17,420
Earnings (loss) per share:			
Basic--before extraordinary gain (loss)....	0.08	0.11	0.18
Extraordinary gain (loss), net of tax......	0.01	--	--
Basic--after extraordinary gain (loss).....	0.09	0.11	0.18
Diluted--before extraordinary gain (loss)..	0.08	0.11	0.17
Extraordinary gain (loss),................	0.01	--	--
Diluted--after extraordinary gain (loss)...	0.09	0.11	0.17
Weighted average shares outstanding:			
Basic....................................	96,880	97,534	98,211
Diluted..................................	100,472	100,534	103,524
2000			
Revenues...................................	$149,892	$159,389	$158,551
Income (loss) from operations................	(13,191)	(7,953)	(5,730)

	FIRST QUARTER	SECOND QUARTER	THIRD QUARTER

		(IN THOUSANDS, EXCEPT PER SHARE AMO	
Net income (loss) before extraordinary gain (loss)..................................	(9,451)	(5,693)	(4,150)
Extraordinary gain (loss), net of tax........	--	--	--
Net income (loss)...........................	(9,451)	(5,693)	(4,150)

	FIRST QUARTER	SECOND QUARTER	THIRD QUARTER
		(IN THOUSANDS, EXCEPT PER SHARE AMO	
Earnings (loss) per share:			
Basic--before extraordinary gain (loss)....	(0.11)	(0.07)	(0.05)
Extraordinary gain (loss), net of tax......	--	--	--
Basic--after extraordinary gain (loss).....	(0.11)	(0.07)	(0.05)
Diluted--before extraordinary gain (loss)..	(0.11)	(0.07)	(0.05)
Extraordinary gain (loss), net of tax......	--	--	--
Diluted--after extraordinary gain (loss)...	(0.11)	(0.07)	(0.05)
Weighted average shares outstanding:			
Basic......................................	82,738	82,738	84,633
Diluted....................................	82,738	82,738	84,633

18. VOLUMETRIC PRODUCTION PAYMENT

In March 2000, Key sold a portion of its future oil and natural gas production from Odessa Exploration Incorporated, its wholly owned subsidiary, for gross proceeds of $20 million pursuant to an agreement under which the purchaser is entitled to receive a share of the production from certain oil and natural gas properties in amounts ranging from 3,500 to 10,000 barrels of oil and 58,800 to 122,100 Mmbtus of natural gas per month over a six year period ending February 2006. The total volume of the forward sale is approximately 486,000 barrels of oil and 6.135 million Mmbtus of natural gas.

19. CONDENSED CONSOLIDATING FINANCIAL INFORMATION

The Company's senior notes are guaranteed by all of the Company's subsidiaries (except for the foreign subsidiaries), all of which are wholly-owned. The guarantees are joint and several, full, complete and unconditional. There are currently no restrictions on the ability of the subsidiary guarantors to tranfer funds to the parent company.

The accompanying condensed consolidating financial information has been prepared and presented pursuant to SEC Regulation S-X Rule 3-10 "Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered." The information is not intended to present the financial position, results of operations and cash flows of the individual companies or

groups of companies in accordance with generally accepted accounting principles.

KEY ENERGY SERVICES INC.
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CONDENSED CONSOLIDATING BALANCE SHEETS

	JUNE 30, 2001		
	PARENT COMPANY	GUARANTOR SUBSIDIARIES	NON-GUARANTOR SUBSIDIARIES
	(IN THOUSANDS)		
Assets:			
Current assets..............	$ 10,680	$ 165,653	$ 29,817
Net property and equipment..	21,418	717,989	54,309
Goodwill, net	3,374	184,379	2,122
Deferred costs, net.........	17,624	--	--
Intercompany receivables	664,592	--	--
Other assets................	15,303	5,616	--
Total assets....................	$ 732,991	1,073,637	$ 86,248
Liabilities and equity:			
Current liabilities.........	$ 35,671	$ 64,679	$ 15,203
Long-term debt..............	470,668	15,331	(38)
Intercompany payables.......	--	608,764	55,828
Deferred tax liability......	127,400	--	--
Other long-term liabilities..............	8,240	14,252	--
Stockholders' equity........	91,012	370,611	15,255
Total liabilities and stockholders' equity............	$ 732,991	$1,073,637	$ 86,248

	JUNE 30,2000		
	PARENT COMPANY	GUARANTOR SUBSIDIARIES	NON-GUARANTOR SUBSIDIARIES
	(IN THOUSANDS)		
Assets:			
Current assets..............	$ 120,216	$ 115,178	$ 18,195
Net property and equipment..	7,308	704,531	48,722
Goodwill, net	3,606	192,641	2,386
Deferred costs, net.........	18,855	--	--
Intercompany receivables....	788,166	--	--

Other assets...............	9,062	5,565	--
Total assets...................	$ 947,213	$1,017,915	$ 69,303
Liabilities and equity:			
Current liabilities.........	$ 33,637	$ 47,736	$ 11,475
Long-term debt.............	637,438	14,486	21
Intercompany payables.......	--	740,268	47,898
Deferred tax liability......	99,707	--	--
Other long-term liabilities............	1,751	17,127	--
Stockholders' equity........	174,680	198,298	9,909
Total liabilities and stockholders' equity........	$ 947,213	$1,017,915	$ 69,303

KEY ENERGY SERVICES INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2001, 2000 AND 1999

CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS

	JUNE 30, 2001		
	PARENT COMPANY	GUARANTOR SUBSIDIARIES	NON-GUARANTOR SUBSIDIARIES
			(IN THOUSANDS)
Revenues.......................	$ 2,018	$816,724	$ 54,520
Costs and expenses.............			
Direct expenses............	--	533,807	41,131
Depreciation, depletion and amortization expense	1,353	69,714	4,080
General and administrative expense.................	18,991	43,644	3,436
Interest...................	54,464	1,275	821
Other......................	318	943	2
Total costs and expenses........	75,126	649,383	49,470
Income (loss) before income taxes......................	(73,108)	167,341	5,050
Income tax (expense) benefit....	27,247	(62,367)	(1,882)
Net income (loss) before extraordinary items	(45,861)	104,974	3,168
Extraordinary items, net of tax.......................	429	--	--

Net income (loss)	$ (45,432)	$104,974	$ 3,168

	JUNE 30, 2000		
	PARENT COMPANY	GUARANTOR SUBSIDIARIES	NON-GUARANTOR SUBSIDIARIES
			(IN THOUSANDS)
Revenues	$ 790	$ 599,225	$ 37,717
Costs and expenses:			
Direct expenses	--	431,997	30,389
Depreciation, depletion and amortization expense	1,162	66,453	3,357
General and administrative expense	11,101	44,473	3,198
Interest	69,802	1,527	601
Other	--	1,648	--
Total costs and expenses	82,065	546,098	37,545
Income (loss) before income taxes	(81,275)	53,127	172
Income tax (expense) benefit	21,516	(14,064)	(46)
Net income (loss) before extraordinary items	(59,759)	39,063	126
Extraordinary items, net of tax	1,611	--	--
Net income (loss)	$ (58,148)	$ 39,063	$ 126

KEY ENERGY SERVICES INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2001, 2000 AND 1999

CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS (CONT'D)

	JUNE 30, 1999		
	PARENT COMPANY	GUARANTOR SUBSIDIARIES	NON-GUARANTOR SUBSIDIARIES
			(IN THOUSANDS)
Revenues	$ 1,086	$463,813	$ 26,918
Costs and expenses:			
Direct expenses	--	349,936	21,492

Depreciation, depletion and amortization expense..	428	58,403	3,243
General and administrative expense...................	14,962	34,490	3,656
Interest....................	65,724	1,559	118
Other.......................	10,811	5,928	--
Total costs and expenses........	91,925	450,316	28,509
Income (loss) before income taxes.......................	(90,839)	13,497	(1,591)
Income tax (expense) benefit....	29,547	(4,390)	518
Net income (loss) before extraordinary items.........	(61,292)	9,107	(1,073)
Extraordinary items, net of tax.........................	--	--	--
Net income (loss)..............	$ (61,292)	$ 9,107	$ (1,073)

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KEY ENERGY SERVICES INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2001, 2000 AND 1999

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS

	FISCAL YEAR ENDED JUNE 30, 2		
	PARENT COMPANY	GUARANTOR SUBSIDIARIES	NON-GUARANTOR SUBSIDIARIES
			(IN THOUSANDS)
Net cash provided by (used in) operating activities...	$ 68,567	$ 64,408	$ 9,742
Net cash provided by (used in) investing activities...	(19,459)	(56,711)	(7,180)
Net cash provided by (used in) financing activities...	(158,627)	(8,456)	(59)
Net increase (decrease) in cash......................	(109,519)	(759)	2,503
Cash and cash equivalents at beginning of period........	111,166	(1,246)	(47)
Cash and cash equivalents at end of period.............	$ 1,647	$ (2,005)	$ 2,456

FISCAL YEAR ENDED JUNE 30, 2

	PARENT COMPANY	GUARANTOR SUBSIDIARIES	NON-GUARANTOR SUBSIDIARIES
			(IN THOUSANDS)
Net cash provided by (used in) operating activities...	$ 18,962	$ 10,434	$ 5,464
Net cash provided by (used in) investing activities...	(4,468)	(26,671)	(6,627)
Net cash provided by (used in) financing activities...	80,070	9,287	(56)
Net increase (decrease) in cash.......................	94,564	(6,950)	(1,219)
Cash and cash equivalents at beginning of period........	16,602	5,704	1,172
Cash and cash equivalents at end of period.............	$ 111,166	$ (1,246)	$ (47)

KEY ENERGY SERVICES INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2001, 2000 AND 1999

	FISCAL YEAR ENDED JUNE 30, 1		
	PARENT COMPANY	GUARANTOR SUBSIDIARIES	NON-GUARANTOR SUBSIDIARIES
			(IN THOUSANDS)
Net cash provided by (used in) operating activities...	$ (49,167)	$ 26,508	$ 9,232
Net cash provided by (used in) investing activities...	(272,620)	(13,986)	(8,048)
Net cash provided by (used in) financing activities...	313,526	(7,196)	(36)
Net increase (decrease) in cash.......................	(8,261)	5,326	1,148
Cash and cash equivalents at beginning of period........	24,863	378	24
Cash and cash equivalents at end of period.............	$ 16,602	$ 5,704	$ 1,172

INDEPENDENT AUDITORS' REPORT

To The Board of Directors
Key Energy Services, Inc. :

We have audited the accompanying consolidated balance sheets of Key Energy Services, Inc., and subsidiaries as of June 30, 2001 and 2000, and the related consolidated statements of operations, comprehensive income, cash flows and stockholders' equity for each of the years in the three-year period ended June 30, 2001. In connection with our audits of the consolidated financial statements, we also have audited the financial statement schedule listed in the Index at Item 14. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Key Energy Services, Inc. and subsidiaries as of June 30, 2001 and 2000, and the results of their operations and their cash flows for each of the years in the three-year period ended June 30, 2001, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 8 to the consolidated financial statements, the Company changed its method of accounting for derivative instruments and hedging activities in 2001.

KPMG LLP

Midland, Texas
August 31, 2000

KEY ENERGY SERVICES, INC.
CONSOLIDATED BALANCE SHEETS

	DECEMBER 31, 2001
	(Unau
ASSETS	(IN THOUSANDS, E
Current assets:	
Cash and cash equivalents.......................................	$ 7,966
Accounts receivable, net of allowance for doubtful accounts of $4,590 and $4,082, at December 31, 2001 and June 30, 2001, respectively............................	149,312
Inventories..	12,249
Prepaid expenses and other current assets......................	10,141

Total current assets	179,668
Property and Equipment:	
Well servicing equipment	747,848
Contract drilling equipment	123,022
Motor vehicles	68,554
Oil and natural gas properties and other related equipment, successful efforts method	44,502
Furniture and equipment	29,396
Building and land	37,970
Total property and equipment	1,051,292
Accumulated depreciation and depletion	(250,790)
Net property and equipment	800,502
Goodwill, net of accumulated amortization at $27,970 at December 31, 2001 and $28,168 at June 30, 2001	193,217
Deferred costs, net	14,257
Notes and accounts receivable - related parties	456
Other assets	28,253
Total assets	$ 1,216,353

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:	
Accounts payable	$ 28,675
Other accrued liabilities	40,786
Accrued interest	14,434
Current portion of long-term debt and capital lease obligations	8,215
Total current liabilities	92,110
Long-term debt, less current portion	379,269
Capital lease obligations, less current portion	16,227
Deferred revenue	11,541
Non-current accrued expenses	9,816
Deferred tax liability	151,305
Commitments and contingencies	---
Stockholders' equity:	
Common stock, $.10 par value: 200,000,000 shares authorized, 108,371,945 and 101,440, 166 shares issued, at December 31, 2001 and June 30, 2001, respectively	10,837
Additional paid-in capital	498,702
Treasury stock, at cost; 416,666 shares at December 31, 2001 and June 30, 2001	(9,682)

Accumulated other comprehensive income (loss)	(23,993)
Retained earnings (deficit)	80,221
Total stockholders' equity	556,085
Total liabilities and stockholders' equity	$ 1,216,353

SEE THE ACCOMPANYING NOTES WHICH ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS

KEY ENERGY SERVICES, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

	THREE MONTHS ENDED DECEMBER 31,	
	2001	2000
	(IN THOUSANDS, EXCEPT PE	
REVENUES		
Well servicing	$ 186,338	$ 178,650
Contract drilling	25,654	24,178
Other	1,345	1,083
	213,337	203,911
COSTS AND EXPENSES:		
Well servicing	117,092	118,123
Contract drilling	17,340	18,360
Depreciation, depletion and amortization	19,724	18,146
General and administrative	16,755	15,264
Bad debt expense	64	709
Interest	11,097	14,581
Other expenses	1,150	665
Foreign currency transaction loss, Argentina (see Note 10)	1,844	---
	185,066	185,848
Income (loss) before income taxes	28,271	18,063
Income tax (expense) benefit	(10,903)	(6,969)
Income (loss) before extraordinary gain (loss)	17,368	11,094
Extraordinary gain (loss) on retirement of debt, less applicable income taxes of $1,267 and $1,374 for the three and six months ended December 31, 2001, respectively, and income taxes of $41 and $793, for		

the three and six months ended December 31, 2000, respectively	2,091	68	
NET INCOME (LOSS)	$ 19,459	$ 11,162	$
EARNINGS (LOSS) PER SHARE:			
Basic - before extraordinary gain (loss)	$ 0.17	$ 0.11	$
Extraordinary gain (loss), net of tax	0.02	---	
Basic - after extraordinary gain (loss)	$ 0.19	$ 0.11	$
Diluted - before extraordinary gain (loss)	$ 0.17	$ 0.11	
Extraordinary gain (loss), net of tax	0.02	$ ---	
Diluted - after extraordinary gain (loss)	$ 0.19	$ 0.11	$
WEIGHTED AVERAGE SHARES OUTSTANDING:			
Basic	103,115	97,534	
Diluted	104,811	100,496	

SEE THE ACCOMPANYING NOTES WHICH ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS

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KEY ENERGY SERVICES, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

	THREE MONTHS ENDED DECEMBER 31,		
	2001	2000	
		(IN THOUSAND	
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income (loss)	$ 19,459	$ 11,162	$
ADJUSTMENTS TO RECONCILE INCOME FROM OPERATIONS TO NET CASH PROVIDED BY (USED IN) OPERATIONS:	19,724	18,146	
Depreciation, depletion and amortization	64	709	
Amortization of deferred debt issuance costs and other deferred costs	398	1,008	
Deferred income taxes	7,731	6,969	
(Gain) loss on sale of assets	232	(41)	
Foreign currency transaction loss, Argentina	1,844	--	
Extraordinary (gain) loss, net of tax	(2,091)	(68)	
CHANGE IN ASSETS AND LIABILITIES:			
(Increase) decrease in accounts receivable	31,047	(7,062)	
(Increase) decrease in other current assets	(2,327)	(2,548)	
Increase (decrease) in accounts payable, accrued accrued expenses	(17,478)	4,870	

Other assets and liabilities	(1,017)	(38)	
Net cash provided by (used in) operating activities	57,586	33,107	
CASH FLOWS FROM INVESTING ACTIVITIES			
Capital expenditures - well servicing	(16,418)	(9,093)	
Capital expenditures - contract drilling	(2,923)	(4,041)	
Capital expenditures - other	(2,412)	(3,942)	
Proceeds from sale of fixed assets	239	850	
Acquisitions - well servicing	(6,002)	(1,700)	
Acquisitions - contract drilling	--	(800)	
Net cash provided by (used in) investing activities	(27,516)	(18,726)	
CASH FLOWS FROM FINANCING ACTIVITIES			
Repayment of long-term debt	(118,441)	(13,812)	(
Repayment of capital lease obligations	(2,544)	(2,559)	
Borrowings under line-of-credit	53,000	--	
Proceeds from equity offering, net of expense	42,590	--	
Proceeds from exercise of warrants	--	265	
Proceeds from exercise of stock options	1,079	1,024	
Other	(89)	(15)	
Net cash provided by (used in) financing activities	(24,405)	(15,097)	(
Effect of exchange rate changes on cash	(192)	--	
Net increase (decrease) in cash and cash equivalents	5,473	(716)	
Cash and cash equivalents at beginning of period	2,493	2,635	
Cash and cash equivalents at end of period	$ 7,966	$ 1,919	$

SEE THE ACCOMPANYING NOTES WHICH ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS.

KEY ENERGY SERVICES, INC.

UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	THREE MONTHS ENDED DECEMBER 31,		THRE S
	2001	2000	2001
		(IN THOUSANDS)	
NET INCOME (LOSS)	$ 19,459	$ 11,162	$ 48,63
OTHER COMPREHENSIVE INCOME (LOSS):			

Derivative transition adjustment (see Note 7).....	--	--	-
Oil and natural gas derivatives adjustment, net of tax (see Note 7).......................	180	(52)	35
Amortization of oil and natural gas derivative, net of tax (see Note 7).......................	(154)	146	(18
Foreign currency translation gain (loss), net of tax Note 10)................................	(24,202)	--	(24,22
COMPREHENSIVE INCOME (LOSS)........................	$ (4,717)	$ 11,256	$ 24,58

SEE THE ACCOMPANYING NOTES WHICH ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS.

KEY ENERGY SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2001 AND 2000

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

The consolidated financial statements of Key Energy Services, Inc. (the "Company" or "Key") and its wholly-owned subsidiaries as of December 31, 2001 and for the three and six month periods ended December 31, 2001 and 2000 are unaudited. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted in this Form 10-Q pursuant to the rules and regulations of the Securities and Exchange Commission. However, in the opinion of management, these interim financial statements include all the necessary adjustments to fairly present the results of the interim periods presented. These unaudited interim consolidated financial statements should be read in conjunction with the audited financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2001. The results of operations for the three and six month periods ended December 31, 2001 are not necessarily indicative of the results of operations for the full fiscal year ending June 30, 2002.

RECLASSIFICATIONS

Certain reclassifications have been made to the consolidated financial statements for the three and six month periods ended December 31, 2000 to conform to the presentation for the three and six month periods ended December 31, 2001. The reclassifications consist primarily of reclassifying oil and natural gas production revenues and expenses. Oil and natural gas production revenues and related expenses have been reclassified to other revenues and other expenses because the Company does not believe this business segment is material to the Company's consolidated financial statements.

2. EARNINGS PER SHARE

The Company accounts for earnings per share based upon Statement of Financial Accounting Standards No. 128, "Earnings per Share" ("SFAS 128"). Under SFAS 128, basic earnings per common share are determined by dividing net earnings applicable to common stock by the weighted average number of common shares actually outstanding during the period. Diluted earnings per common share is based on the increased number of shares that would be outstanding assuming

exercise of dilutive stock options and warrants and conversion of dilutive outstanding convertible securities using the "as if converted" method.

	THREE MONTHS ENDED DECEMBER 31,		SIX D
	2001	2000	2001
	(IN THOUSANDS, EXCEPT PER SHARE DATA)		(IN T PE
BASIC EPS COMPUTATION:			
NUMERATOR			
Net income (loss) before extraordinary gain (loss)............................	$ 17,368	$ 11,094	$ 46,3
Extraordinary gain (loss), net of tax.......	2,091	68	2,2
Net income (loss)..........................	$ 19,459	$ 11,162	$ 48,6
DENOMINATOR			
Weighted average common shares outstanding..	103,115	97,534	102,4
BASIC EPS:			
Before extraordinary gain (loss)...........	$ 0.17	$ 0.11	$ 0.
Extraordinary gain (loss), net of tax.......	0.02	-	0.
After extraordinary gain (loss)............	$ 0.19	$ 0.11	$ 0.
DILUTED EPS COMPUTATION:			
NUMERATOR			
Net income (loss) before extraordinary gain (loss)............................	$ 17,368	$ 11,094	$ 46,3
Effect of dilutive convertible securities, tax effected............................	-	4	
Extraordinary gain (loss), net of tax.......	2,091	68	2,2
Net income (loss)..........................	$ 19,459	$ 11,166	$ 48,6
DENOMINATOR			
Weighted average common shares outstanding..	103,115	97,534	102,4
Warrants..................................	526	80	5
Stock options.............................	1,170	2,882	1,3
7% Convertible Debentures..................	-	-	
	104,811	100,496	104,3
DILUTED EPS:			
Before extraordinary gain (loss)...........	$ 0.17	$ 0.11	$ 0.
Extraordinary gain (loss), net of tax.......	0.02	-	0.
After extraordinary gain (loss)............	$ 0.19	$ 0.11	$ 0.

The diluted earnings per share calculation (i) for the three month period ended December 31, 2001 excludes the effects of 3,588,000 stock options and (ii) for the six month period ended December 31, 2000 excludes the effects of 1,463,000 stock options. Both calculations exclude the effects of the conversion of the Company's 5% Convertible Subordinated Notes. The effects of such options and convertible notes on earnings per share would be anti-dilutive.

The diluted earnings per share calculation for the three and six month periods ended December 31, 2000 excludes the effects of 1,175,000 stock options and the effects of the conversion of the Company's 5% Convertible Subordinated Notes because the effects of such options and convertible notes on earnings per share would be anti-dilutive.

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3. STOCKHOLDERS' EQUITY

EQUITY OFFERING

On December 19, 2001, the Company closed an "at-the-market" public offering of 5,400,000 shares of common stock, yielding net proceeds to the Company of approximately $43.2 million or $8.00 per share (the "Equity Offering"). Net proceeds from the Equity Offering of approximately $42.6 million were used to temporarily reduce amounts outstanding under the Company's revolving line of credit. The net proceeds of the Equity Offering were ultimiately used in January, 2002 to redeem a portion of the Company's 14% Senior Subordinated Notes fully utilizing the Company's equity "claw-back" rights for up to 35% of the original $150 million in issue.

4. COMMITMENTS AND CONTINGENCIES

Various suits and claims arising in the ordinary course of business are pending against the Company. Management does not believe that the disposition of any of these items will result in a material adverse impact to the consolidated financial position, results of operations or cash flows of the Company.

5. INDUSTRY SEGMENT INFORMATION

The Company's reportable business segments are well servicing and contract drilling. Oil and natural gas production operations were previously separately presented as a reportable business segment and are now included in "corporate/other".

WELL SERVICING: The Company's operations provide well servicing (ongoing maintenance of existing oil and natural gas wells), completions, workover (major repairs or modifications necessary to optimize the level of production from existing oil and natural gas wells) and production services (fluid hauling and fluid storage tank rental).

CONTRACT DRILLING: The Company provides contract drilling services for major and independent oil companies onshore the continental United States, Argentina and Ontario, Canada.

	WELL SERVICING	CONTRACT DRILLING	CORPORA /OTHER
		(IN THOUSANDS)	

THREE MONTHS ENDED DECEMBER 31, 2001			
Operating revenues..................................	$186,338	$25,654	$ 1,3
Operating profit	69,246	8,314	1
Depreciation, depletion and amortization.............	16,470	2,204	1,0
Interest expense....................................	405	-	10,6
Net income (loss) before extraordinary gain (loss)*...	26,546	2,555	(11,7
Identifiable assets.................................	673,162	94,693	255,2
Capital expenditures	16,418	2,923	2,4
THREE MONTHS ENDED DECEMBER 31, 2000			
Operating revenues..................................	$178,650	$24,178	$ 1,0
Operating profit....................................	60,527	5,818	4
Depreciation, depletion and amortization.............	15,261	1,890	9
Interest expense....................................	446	-	14,1
Net income (loss) before extraordinary gain (loss)*...	24,720	1,208	(14,8
Identifiable assets.................................	639,979	91,066	233,0
Capital expenditures (excluding acquisitions).........	9,093	4,041	3,9

* Net income (loss) includes general and administrative expenses allocated on a percentage of revenue basis.

Operating revenues for the Company's foreign operations for the three months ended December 31, 2001 and 2000 were $11.9 million and $13.3 million, respectively. Operating profits for the Company's foreign operations for the three months ended December 31, 2001 and 2000 were $2.1 million and $3.2 million, respectively. The

Company had $56.1 million and $75.3 million of identifiable assets as of December 31, 2001 and 2000, respectively, related to foreign operations.

	WELL SERVICING	CONTRACT DRILLING	CORPORA /OTHER
		(IN THOUSANDS)	
SIX MONTHS ENDED DECEMBER 31, 2001			
Operating revenues..................................	$398,839	$59,290	$ 4,4
Operating profit	148,967	20,762	2,1
Depreciation, depletion and amortization.............	31,027	4,584	1,9
Interest expense....................................	953	-	22,0
Net income (loss) before extraordinary gain (loss)*...	61,091	7,863	(22,5
Identifiable assets.................................	673,162	94,693	255,2
Capital expenditures (excluding acquisitions).........	28,312	11,077	5,5
SIX MONTHS ENDED DECEMBER 31, 2000			
Operating revenues..................................	345,215	$46,323	$ 4,0
Operating profit....................................	115,406	10,505	2,0
Depreciation, depletion and amortization.............	30,950	3,696	1,8
Interest expense....................................	1,103	-	29,5
Net income (loss) before extraordinary gain (loss)*...	46,499	1,861	(29,7
Identifiable assets.................................	639,979	91,066	233,0
Capital expenditures (excluding acquisitions).........	17,095	7,174	6,0

* Net income (loss) includes general and administrative expenses allocated on a

percentage of revenue basis.

Operating revenues for the Company's foreign operations for the six months ended December 31, 2001 and 2000 were $23.9 million and $26.5 million, respectively. Operating profits for the Company's foreign operations for the six months ended December 31, 2001 and 2000 were $4.7 million and $6.2 million, respectively. The Company had $56.1 million and $75.3 million of identifiable assets as of December 31, 2001 and 2000, respectively, related to foreign operations.

6. VOLUMETRIC PRODUCTION PAYMENT

In March 2000, Key sold a portion of its future oil and natural gas production from Odessa Exploration Incorporated, its wholly owned subsidiary, for gross proceeds of $20 million pursuant to an agreement under which the purchaser is entitled to receive a portion of the production from certain oil and natural gas properties over the six year period ending February 28, 2006 in amounts starting at 10,000 barrels of oil per month and declining to 3,500 barrels of oil per month and starting at 122,100 Mmbtu of natural gas per month and declining to 58,800 Mmbtu of natural gas per month. The total volume of the forward sale is approximately 486,000 barrels of oil and 6,135,000 Mmbtu of natural gas.

7. DERIVATIVE INSTRUMENTS

The Company utilizes derivative financial instruments to manage well-defined commodity price risks. The Company is exposed to credit losses in the event of nonperformance by the counter-parties to its commodity hedges. The Company only deals with reputable financial institutions as counter-parties and anticipates that such counter-parties will be able to fully satisfy their obligations under the contracts. The Company does not obtain collateral or other security to support financial instruments subject to credit risk but monitors the credit standing of the counter-parties.

The Company periodically hedges a portion of its oil and natural gas production through collar and option agreements. The purpose of the hedges is to provide a measure of stability in the volatile environment of oil and natural gas prices and to manage exposure to commodity price risk under existing sales commitments. The Company's risk management objective is to lock in a range of pricing for expected production volumes. This allows the Company to forecast future earnings within a predictable range. The Company meets this objective by entering into collar and option arrangements which allow for acceptable cap and floor prices.

The Company does not enter into derivative instruments for any purpose other than for economic hedging. The Company does not speculate using derivative instruments. The Company has identified the following derivative instruments:

FREESTANDING DERIVATIVES: On March 30, 2000 the Company entered into a collar arrangement for a 22-month period whereby the Company will pay if the specified price is above the cap index and the counter-party will pay if the price should fall below the floor index. The hedge defines a range of cash flows bounded by the cap and floor prices. On May 25, 2001 the Company entered into an option arrangement for a 12-month period beginning March 2002 whereby the counter-party will pay should the price fall below the floor index. The Company desires a measure of stability to ensure that cash flows do not fall below a certain level.

Prior to the adoption of Statement of Financial Accounting Standards No.

133, Accounting for Derivative Instruments and Hedging Activities, ("SFAS No. 133"), as amended by SFAS No. 137 and 138, these collars were accounted for as cash flow type hedges. Accordingly, the July 1, 2000 transition adjustment resulted in recording a $778,000 liability for the fair value of the collars to accumulated other comprehensive income. Approximately $97,000 of the transition adjustment was recognized in earnings during the three months ended December 31, 2001. The unamortized balance of the transition adjustment, approximately $64,000, will be recognized in earnings over the next three months. As of July 1, 2001, the Company has documented the May 25, 2001 options as cash flow hedges. During the quarter ended December 31, 2001, the Company recorded a net decrease in net derivative assets of approximately $105,000, which included an earnings charge of approximately $392,000 from ineffectiveness.

EMBEDDED DERIVATIVES. The Company is party to a volumetric production payment of which certain terms meet the definition of an embedded derivative under SFAS No. 133. Effective July 1, 2000, the Company has determined and documented that the production payment is excluded from the scope of SFAS No. 133 under the normal purchases/sales exclusion as set forth in SFAS 138.

8. CONDENSED CONSOLIDATING FINANCIAL INFORMATION

The Company's senior notes are guaranteed by all of the Company's subsidiaries (except for the foreign subsidiaries), all of which are wholly-owned. The guarantees are joint and several, full, complete and unconditional. There are currently no restrictions on the ability of the subsidiary guarantors to transfer funds to the parent company.

The accompanying condensed consolidating financial information has been prepared and presented pursuant to SEC Regulation S-X Rule 3-10, Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered. The information is not intended to present the financial position, results of operations and cash flows of the individual companies or groups of companies in accordance with generally accepted accounting principles.

CONDENSED CONSOLIDATING BALANCE SHEETS

	DECEMBER 31, 2001			
	PARENT COMPANY	GUARANTOR SUBSIDIARIES	NON-GUARANTOR SUBSIDIARIES	
			(IN THOUSANDS)	
Assets:				
Current assets.................	$ 13,689	$ 145,963	$ 20,422	$
Net property and equipment.....	25,716	739,181	35,605	
Goodwill, net	3,502	188,389	1,326	
Deferred costs, net...........	14,257	--	--	
Intercompany receivables.......	578,459	--	--	
Other assets..................	21,470	6,772	61	
Total assets......................	$ 657,093	$ 1,080,305	$ 57,414	$
Liabilities and equity:				

	PARENT COMPANY	GUARANTOR SUBSIDIARIES	NON-GUARANTOR SUBSIDIARIES	
Current liabilities...........	$ 31,603	52,910	$ 7,592	$
Long-term debt................	379,269	--	--	
Capital lease obligations......	352	15,875	--	
Intercompany payables..........	--	538,818	39,641	
Deferred tax liability.........	151,305	--	--	
Other long-term liabilities....	9,716	11,641	--	
Stockholders' equity..........	84,848	461,061	10,181	
Total liabilities and stockholders' equity...........	$ 657,093	$ 1,080,305	$ 57,414	$

JUNE 30, 2001

	PARENT COMPANY	GUARANTOR SUBSIDIARIES	NON-GUARANTOR SUBSIDIARIES	
			(IN THOUSANDS)	
Assets:				
Current assets................	$ 10,680	165,653	29,817	
Net property and equipment.....	21,418	717,989	54,309	
Goodwill, net	3,374	184,379	2,122	
Deferred costs, net...........	17,624	-	-	
Intercompany receivables.......	664,592	-	-	
Other assets..................	15,303	5,616	-	
Total assets......................	$ 732,991	$ 1,073,637	$ 86,248	$
Liabilities and equity:				
Current liabilities...........	35,671	64,679	15,203	$
Long-term debt................	470,578	15,331	(38)	
Capital lease obligations......				
Intercompany payables..........	-	608,764	55,828	
Deferred tax liability.........	127,400	-	-	
Other long-term liabilities....	8,240	14,252	-	
Stockholders' equity..........	91,012	370,611	15,255	
Total liabilities and stockholders' equity............	$ 732,991	1,073,637	$86,248	

CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS

THREE MONTHS ENDED DECEMBER 31

	PARENT COMPANY	GUARANTOR SUBSIDIARIES	NON-GUARANTOR SUBSIDIARIES

			(IN THOUSANDS)	
Revenues..........................	$ 329	$ 201,119	$ 11,889	$
Costs and expenses:				
Direct expenses...............	--	125,799	9,783	
Depreciation, depletion and amortization............	429	18,283	1,012	
General and administrative.....	5,137	10,854	764	
Interest......................	10,692	136	269	
Argentine foreign currency transaction loss............	--	--	1,844	
Other expenses................	--	64	--	
Total costs and expenses..........	16,258	155,136	13,672	
Income (loss) before income taxes..................	(15,929)	45,983	(1,783)	
Income tax (expense) benefit.......	6,145	(17,736)	688	
Income (loss) before extraordinary items...........	(9,784)	28,247	(1,095)	
Extraordinary items, net of tax....	2,091	--	--	
Net income (loss).................	$ (7,693)	$ 28,247	$ (1,095)	$

	THREE MONTHS ENDED DECEMBER 31			
	PARENT COMPANY	GUARANTOR SUBSIDIARIES	NON-GUARANTOR SUBSIDIARIES	
			(IN THOUSANDS)	
Revenues..........................	$ 195	$ 190,404	$ 13,312	$
Costs and expenses:				
Direct expenses...............	--	127,013	10,135	
Depreciation, depletion and amortization............	474	16,653	1,019	
General and administrative.....	3,230	11,152	882	
Interest......................	14,135	389	57	
Other expenses................	311	398	--	
Total costs and expenses..........	18,150	155,605	12,093	
Income (loss) before income taxes..................	(17,955)	34,799	1,219	
Income tax (expense) benefit.......	6,927	(13,426)	(470)	
Income (loss) before extraordinary items...........	(11,028)	21,373	749	
Extraordinary items, net of tax....	68	--	--	
Net income (loss).................	$ (10,960)	$ 21,373	$ 749	$

CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS

	SIX MONTHS ENDED DECEMBER 31,			
	PARENT COMPANY	GUARANTOR SUBSIDIARIES	NON-GUARANTOR SUBSIDIARIES	
			(IN THOUSANDS)	
Revenues	$ 822	$ 437,760	$ 23,992	$
Costs and expenses:				
Direct expenses	--	271,449	19,286	
Depreciation, depletion and amortization	740	34,791	2,062	
General and administrative	10,465	22,606	1,568	
Interest	22,093	341	612	
Argentine foreign currency transaction loss	--	--	1,844	
Other expenses	--	308	--	
Total costs and expenses	33,298	329,495	25,372	
Income (loss) before income taxes	(32,476)	108,265	(1,380)	
Income tax (expense) benefit	12,292	(40,784)	537	
Income (loss) before extraordinary items	(20,184)	67,391	(843)	
Extraordinary items, net of tax	2,271	--	--	
Net income (loss)	$ (17,913)	$ 67,391	$ (843)	$

	SIX MONTHS ENDED DECEMBER 31,			
	PARENT COMPANY	GUARANTOR SUBSIDIARIES	NON-GUARANTOR SUBSIDIARIES	
			(IN THOUSANDS)	
Revenues	$ 1,574	$ 367,477	$ 26,539	$
Costs and expenses:				
Direct expenses	--	247,299	20,316	
Depreciation, depletion and amortization	778	33,695	1,984	
General and administrative	6,985	20,932	1,714	
Interest	29,589	793	310	
Other expenses	311	592	--	
Total costs and expenses	37,663	303,311	24,324	

Income (loss) before income taxes	(36,089)	64,166	2,215
Income tax (expense) benefit	13,925	(24,795)	(854)
Income (loss) before extraordinary items	(22,164)	39,407	1,361
Extraordinary items, net of tax	1,265	--	--
Net income (loss)	$ (20,899)	$ 39,407	$ 1,361

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS

	THREE MONTHS ENDED DECEMBER 31		
	PARENT COMPANY	GUARANTOR SUBSIDIARIES	NON-GUARANTOR SUBSIDIARIES
			(IN THOUSANDS)
Net cash provided by (used in) operating activities	$ 34,549	$ 21,084	$ 1,953
Net cash provided by (used in) investing activities	(7,431)	(18,862)	(1,223)
Net cash provided by (used in) financing activities	(21,963)	(2,442)	--
Effect of exchange rate changes on cash	--	--	(192)
Net increase (decrease) in cash	5,155	(220)	538
Cash at beginning of period	(2,648)	3,996	1,145
Cash at end of period	$ 2,507	$ 3,776	$ 1,683

	THREE MONTHS ENDED DECEMBER 31		
	PARENT COMPANY	GUARANTOR SUBSIDIARIES	NON-GUARANTOR SUBSIDIARIES
			(IN THOUSANDS)
Net cash provided by (used in) operating activities	$ 20,880	$ 10,175	$ 2,052
Net cash provided by (used in) investing activities	(5,933)	(10,658)	(2,135)
Net cash provided by (used in) financing activities	(12,544)	(2,540)	(13)

Net increase (decrease) in cash	2,403	(3,023)	(96)
Cash at beginning of period	5,074	(3,364)	925
Cash at end of period	$ 7,477	$ (6,387)	829

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS

	SIX MONTHS ENDED DECEMBER 31,		
	PARENT COMPANY	GUARANTOR SUBSIDIARIES	NON-GUARANTOR SUBSIDIARIES
			(IN THOUSANDS)
Net cash provided by (used in) operating activities	$ 55,161	$ 46,885	$ 771
Net cash provided by (used in) investing activities	(12,381)	(36,228)	(1,339)
Net cash provided by (used in) financing activities	(41,920)	(4,876)	(13)
Effect of exchange rate changes on cash	--	--	(192)
Net increase (decrease) in cash	860	5,781	(773)
Cash at beginning of period	1,647	(2,005)	2,456
Cash at end of period	$ 2,507	$ 3,776	$ 1,683

	SIX MONTHS ENDED DECEMBER 31,		
	PARENT COMPANY	GUARANTOR SUBSIDIARIES	NON-GUARANTOR SUBSIDIARIES
			(IN THOUSANDS)
Net cash provided by (used in) operating activities	$ 21,389	$ 19,924	$ 4,152
Net cash provided by (used in) investing activities	(7,906)	(20,754)	(3,249)
Net cash provided by (used in) financing activities	(117,172)	(4,311)	(27)
Net increase (decrease) in cash	(103,689)	(5,141)	876
Cash at beginning of period	111,166	(1,246)	(47)
Cash at end of period	$ 7,477	$ (6,387)	$ 829

9. GOODWILL AND OTHER INTANGIBLE ASSETS - ADOPTION OF SFAS 142

The Company has adopted Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets ("SFAS 142") on July 1, 2001. SFAS 142 eliminates the amortization for goodwill and other intangible assets with indefinite lives. Intangible assets with lives restricted by contractual, legal, or other means will continue to be amortized over their useful lives. Goodwill and other intangible assets not subject to amortization are tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. SFAS 142 requires a two-step process for testing impairment. First, the fair value of each reporting unit is compared to its carrying value to determine whether an indication of impairment exists. If impairment is indicated, then the fair value of the reporting unit's goodwill is determined by allocating the unit's fair value to its assets and liabilities (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination. The amount of impairment for goodwill and other intangible assets is measured as the excess of its carrying value over its fair value.

The Company completed its assessment of goodwill impairment during the three months ended December 31, 2001, as allowed by SFAS 142. The assessment did not result in an indication of goodwill impairment.

Intangible assets subject to amortization under SFAS 142 consist of noncompete agreements. Amortization expense is calculated using the straight-line method over the period of the agreement, ranging from 3 to 5 years.

The gross carrying amount of noncompete agreements subject to amortization totaled approximately $8,863,000 and $8,099,000 at December 31, 2001 and June 30, 2001, respectively. Accumulated amortization related to these intangible assets totaled approximately $4,986,000 and $4,953,000 at December 31, 2001 and June 30, 2001, respectively. Amortization expense for the three months ended December 31, 2001 and 2000 was approximately $370,000 and $244,000, respectively. Amortization expense for the six months ended December 31, 2001 and 2000 was approximately $770,000 and $729,000. Amortization expense for the next five fiscal years is estimated to be $1,783,000, $1,054,000, $400,000, $373,000 and $267,000.

The Company has identified its reporting segments to be well servicing and contract drilling. Goodwill allocated to such reporting segments at December 31, 2001 is $178,952,000 and $14,265,000, respectively. The change in the carrying amount of goodwill for the three and six months ended December 31, 2001 of $2,238,000 and $3,144,000, respectively, relates principally to goodwill from well servicing assets acquired during the period and the translation adjustment for Argentina at December 31, 2001.

The effect of the adoption of SFAS 142 on net income and earnings per share is as follows:

	THREE MONTHS ENDED DECEMBER 31,		S
	2001	2000	200
	(IN THOUSANDS, EXCEPT		(IN

	PER SHARE DATA)		P
Reported net income (loss) before extraordinary gain (loss).....................................	$ 17,368	$11,094	$46,3
Add back: goodwill amortization....................	-	2,204	-
Adjusted net income (loss) before extraordinary gain (loss).....................................	17,368	13,298	46,3
Extraordinary gain (loss), net of tax...............	2,091	68	2,2
Adjusted net income (loss)..........................	$ 19,459	$13,366	$48,6
BASIC EARNINGS (LOSS) PER SHARE:			
Reported net income (loss) before extraordinary gain (loss).....................................	$ 0.17	$ 0.11	$ 0.
Add back: goodwill amortization....................	-	0.02	-
Adjusted net income (loss) before extraordinary gain (loss).....................................	$ 0.17	$ 0.13	$ 0.
Extraordinary gain (loss), net of tax...............	0.02	-	0.
Adjusted net income (loss)..........................	$ 0.19	$ 0.13	$ 0.
DILUTED EARNINGS (LOSS) PER SHARE:			
Reported net income (loss) before extraordinary gain (loss).....................................	$ 0.17	$ 0.11	$ 0.
Add back: goodwill amortization....................	-	0.02	-
Adjusted net income (loss) before extraordinary gain (loss).....................................	$ 0.17	$ 0.13	$ 0.
Extraordinary gain (loss), net of tax...............	0.02	-	0.
Adjusted net income (loss)..........................	$ 0.19	$ 0.13	$ 0.

10. ARGENTINA FOREIGN CURRENCY TRANSACTION LOSS

The local currency is the functional currency for all of the Company's foreign operations (Argentina and Canada). The cumulative translation gains and losses, resulting from translating each foreign subsidiary's financial statements from the functional currency to U.S. dollars are included in other comprehensive income and accumulated in stockholders' equity until a partial or complete sale or liquidation of the Company's net investment in the foreign entity.

Since 1991, the Argentine peso has been tied to the U.S. dollar at a conversion ratio of 1:1. However, in December 2001, the Government of Argentina announced an exchange holiday and, as a result, Argentine pesos could not be exchanged into other currencies at December 31, 2001. On January 5 and 6, 2002, the Argentine Congress and Senate gave the President of Argentina emergency powers and the ability to suspend the law that created the fixed conversion ratio of 1:1. The Government subsequently announced the creation of a dual currency system in which certain qualifying transactions will be settled at an expected fixed conversion ratio of 1.4:1 while all other transactions will be settled using a free floating market conversion ratio. Under existing guidance, dividends would not receive the fixed conversion ratio. On January 11, 2002, the

exchange holiday was lifted, making it possible again to buy and sell Argentine pesos. Banks were legally allowed to exchange currencies, but transactions were limited and generally took place at exchange houses. These transactions were conducted primarily by individuals as opposed to commercial transactions, and occurred at free conversion ratios ranging between 1.6:1 and 1.7:1.

Due to the events described above, which resulted in the temporary lack of exchangeability of the two currencies at December 31, 2001, the Company has translated the assets and liabilities of its Argentine subsidiary at December 31, 2001 using a conversion ratio of 1.6:1, which management believes is indicative of the free floating conversion ratio when the currency market re-opened on January 11, 2002. As a result, a foreign currency translation loss of approximately $24.2 million is included in other comprehensive income, a component of stockholders' equity, in the accompanying December 31, 2001 consolidated balance sheet. Since the 1:1 conversion ratio was in existence prior to December 2001, income statement and cash flows information has been translated using the historical 1:1 conversion ratio.

Additionally, the Argentine government has indicated that as part of its monetary policy changes, it will re-denominate certain consumer loans from U.S. dollar-denominated to Argentine peso-denominated. As a result, the Company recorded a foreign currency transaction loss of $1.8 million in the three months ended December 31, 2001 related to accounts receivable subject to certain U.S. dollar-denominated contracts held by its Argentine subsidiary which are subject to re-denomination. These receivables are subject to additional negotiation with the Company's customers which may result in recovery of a portion of this loss.