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

TABLE OF CONTENTS

PROSPECTUS SUPPLEMENT

	Page
The Offering	S-1
Risk Factors	S-2
Use Of Proceeds	S-4
Price Range Of Common Stock And Dividend Policy	S-4
Selected Financial Data	S-5

Cautionary Note Regarding Forward-Looking Statements S-6
Management's Discussion And Analysis Of Financial Condition And Results Of Operations S-6
Liquidity and Capital Resources S-12
Interest Rate Risk S-14
Foreign Currency Risk S-14
Commodity Price Risk S-14
Business S-15
Management S-22
Certain Relationships And Related Transactions S-29
Ownership Of Capital Stock S-29
Plan Of Distribution S-31
Legal Matters S-31
Experts S-31
Index to Consolidated Financial Statements F-1

PROSPECTUS

Where You Can Find More Information 3
Key Energy Services, Inc. 4
The Offering 4
Ratio of Earnings of Fixed Charges 5
Forward-Looking Statements 6
Risk Factors 6
Acquisition Terms 11
Selling Security Holders and Plan of Distribution 12
Description of Debt Securities 13
Description of Capital Stock 17
Description of Warrants 18
Legal Matters 18
Experts 19

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.

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.

S-2

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.

S-11

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

S-12

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.

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

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.

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.

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.

(1