KEY ENERGY SERVICES INC
Form 10-K
August 13, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

ý **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2006

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 1-8038

KEY ENERGY SERVICES, INC.

(Exact name of registrant as specified in its charter)

Maryland	**04-2648081**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1301 McKinney Street
Suite 1800
Houston, Texas 77010
(Address of principal executive offices, including ZIP Code)

(713) 651-4300
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Exchange on Which Registered
None	None

Securities registered pursuant to Section 12(g) of the Act:

Title of Each Class
Common Stock, $0.10 par value

Indicate by check mark if the Registrant is a well-known seasoned issuer (as defined in Rule 405 of the Securities Act). Yes o No ý

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes o No ý

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes o No ý

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statement incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. /x/

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ý Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No ý

As of June 30, 2007, the aggregate market value of the common stock of the Registrant held by non-affiliates of the Registrant, based on the $18.53 per share price for the registrant's common stock as quoted by the National Quotation Bureau's Pink Sheets on June 29, 2007 was $2,145,411,905 (for purposes of calculating these amounts, only directors, officers and beneficial owners of 10% or more of the outstanding capital stock of the Registrant have been deemed affiliates).

As of June 30, 2007, the number of outstanding shares of common stock of the Registrant was 131,593,695.

DOCUMENTS INCORPORATED BY REFERENCE

None.

KEY ENERGY SERVICES, INC.

ANNUAL REPORT ON FORM 10-K
For the Year Ended December 31, 2006

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CAUTIONARY NOTE REGARDING FORWARD LOOKING STATEMENTS

In addition to statements of historical fact, this report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Statements that are not historical in nature or that relate to future events and conditions are, or may be deemed to be, forward-looking statements. These "forward-looking statements" are based on our current expectations, estimates and projections about current expectations, estimates and projections about the Company, our industry and management's beliefs and assumptions concerning future events and financial trends affecting our financial condition and results of operations. In some cases, you can identify these statements by terminology such as "may," "will," "predicts," "projects," "potential" or "continue" or the negative of such terms and other comparable terminology. These statements are only predictions and are subject to substantial risks and uncertainties. In evaluating those statements, you should carefully consider the information above and as well as the risks outlined in Item 1A. "Risk Factors." Actual performance or results may differ materially and adversely.

We undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date of this report except as required by law. All of our written and oral forward-looking statements are expressly qualified by these cautionary statements and any other cautionary statements that may accompany such forward-looking statements.

NOTE REGARDING OUR FINANCIAL REPORTING PROCESS

This report has been delayed due to our restatement and financial reporting process for periods ending December 31, 2003, which began in March 2004. That process was completed on October 19, 2006. Our 2003 Financial and Informational Report on Form 8-K/A, filed with the Securities and Exchange Commission ("SEC") on October 26, 2006, included an audited 2003 consolidated balance sheet which presented our financial condition as of December 31, 2003 in accordance with Generally Accepted Accounting Principles ("GAAP"). We did not present other consolidated financial statements in accordance with GAAP as we were unable to determine with sufficient certainty the appropriate period(s) in 2003 or before in which to record certain write-offs and write-downs that were identified in our restatement process. Our former registered public accounting firm expressed an unqualified opinion that the 2003 balance sheet fairly presented our financial condition on December 31, 2003. The firm also audited the other financial statements presented in the 2003 Financial and Informational Report. It opined that the financial statements other than the 2003 balance sheet did not fairly present our financial condition or results of operations or cash flows for the periods covered in accordance with GAAP. Investors should refer to the 2003 Financial and Informational Report for a full description of the restatement and financial reporting process for periods prior to 2004. **Investors are strongly cautioned not to rely on any of the financial statements contained in the 2003 Financial and Informational Report, other than the 2003 balance sheet, as fairly presenting, for the periods covered, our financial condition or our results of operations or cash flows, in accordance with GAAP. Any information set forth in that report that incorporates or discusses information contained in the financial statements is subject to the same caution.** You also should not rely on any of our previously-filed Annual Reports on Form 10-K or Quarterly Reports on Form 10-Q for the periods that ended prior to and including September 30, 2003.

Since we filed the 2003 Financial and Informational Report, we have been working to complete this Annual Report on Form 10-K for the year ended December 31, 2006, which included completing our financial statements for the years 2004, 2005 and 2006. This Annual Report contains audited financial statements for the three years ended December 31, 2006. Due to our inability to present our financial statements for the 2002 and 2003 fiscal years (other than the 2003 balance sheet) in accordance with GAAP, we are not including selected financial data for those years.

After filing this report, we expect to file Quarterly Reports on Form 10-Q for the first three quarters of each of 2005 and 2006. The 2005 Reports on Form 10-Q will also include 2004 quarterly information. After the 2005 and 2006 quarterly reports have been filed, we will file Quarterly Reports on Form 10-Q for the quarters ended March 31 and June 30, 2007, respectively. Once we have filed the quarterly reports for the first two quarters of 2007, and the quarterly report for the third quarter of 2007, if then due, we will have filed all required filings with the SEC for the previous 12 months. In light of our inability to provide financial statements in accordance with GAAP for periods prior to 2004, we will not be filing any other earlier reports, including annual reports for 2004 and 2005, or quarterly reports for the first three quarters of 2004.

PART I

ITEM 1. *Business*

THE COMPANY

Key is a Maryland corporation that was organized in April 1977 and commenced operations in July 1978 under the name National Environmental Group, Inc. We emerged from a prepackaged bankruptcy plan in December 1992 as Key Energy Group, Inc. On December 9, 1998, we changed our name to Key Energy Services, Inc. We believe that we are now the leading onshore, rig-based well servicing contractor in the United States. From 1994 through 2002, we grew rapidly through a series of over 100 acquisitions, and today 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, well completion and recompletion services, oilfield transportation services, cased-hole electric wireline services and ancillary oilfield services, fishing and rental services and pressure pumping services. During 2006, Key conducted well servicing operations onshore in 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 and North Texas regions), Four Corners (including the San Juan, Piceance, Uinta, and Paradox Basins), the Appalachian Basin, 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. We began operating in Mexico during 2007. During 2006, we also provided limited onshore drilling services in the Rocky Mountains, the Appalachian Basin and in Argentina. During 2006, we conducted pressure pumping and cementing operations in a number of major domestic producing basins including California, the Permian Basin, the San Juan Basin, the Mid-Continent region, and in the Barnett Shale of North Texas. Our fishing and rental services are located primarily in the Gulf Coast region of Texas as well as in the Permian Basin, California and the Mid-Continent region.

Key's principal executive office is located at 1301 McKinney Street, Suite 1800, Houston, Texas 77010. Our phone number is (713) 651-4300 and website address is *www.keyenergy.com*. We make available free of charge through our website our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with the SEC. Information on our website is not a part of this report.

DESCRIPTION OF BUSINESS SEGMENTS

Key operated in three primary business segments during 2006, which were well servicing, pressure pumping and fishing and rental services. Key's operations during 2006 were conducted in various regions in the continental United States and internationally in Argentina. The following is a description of these three business segments. For financial information regarding these business segments, see Item 8. "Consolidated Financial Statements and Supplementary Data," Note 16 "Segment Information."

Well Servicing Segment

Key provides a broad range of well services, including rig-based services, oilfield transportation services and other ancillary oilfield services necessary to complete, stimulate, maintain and workover oil and natural gas producing wells. Rig-based services include the maintenance of existing wells, workover of existing wells, completion of newly drilled wells, recompletion of existing wells (re-entering a well to complete the well in a new geologic zone or formation) and plugging and abandonment of wells at the end of their useful lives. Our well servicing segment includes contract drilling and cased-hole electric wireline services.

Maintenance Services. Key provides the well service rigs, equipment and crews for maintenance services, which are performed on both oil and natural gas wells, but more frequently 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. Because few natural gas wells have mechanical pumping systems in the wellbore, maintenance work on natural gas wells is less frequent.

Maintenance services are required throughout the life of most producing 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 production of existing wells. Such services include extensions of existing wells to drain new formations either by deepening wellbores to new zones or by drilling horizontal or lateral wellbores to improve reservoir drainage. In less extensive workovers, Key's 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 pumped into the formation for enhanced recovery operations. Other workover services include: conducting major subsurface repairs such as casing repair or replacement, recovering tubing and removing foreign objects in the wellbore, repairing downhole equipment failures, plugging back a section 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 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. Demand for workover services is closely related to capital spending by oil and natural gas producers, which is generally a function of oil and natural gas prices. As commodity prices increase, oil and natural gas producers tend to increase capital spending for workover services in order to increase oil and natural gas production.

Completion Services. Key's 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. However, during periods of weak drilling rig demand, some drilling contractors may compete with service rigs for completion work. Also, for some completion work on natural gas wells, coiled tubing units can be used in place of a well service rig.

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 we provide 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 shutting-in 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. They require compliance with state regulatory requirements. The demand for oil and natural gas does not significantly affect the demand for plugging and abandonment services because well operators are required by state regulations to plug wells that are no longer productive. The need for these services is also driven by lease or operator policy requirements.

Oilfield Transportation. Key provides oilfield transportation services, which primarily include vacuum truck services, fluid transportation services and disposal services for operators whose oil or natural gas wells produce salt water and other fluids. In addition, we are a supplier of frac tanks which are used for temporary storage of fluids in conjunction with the fluid hauling operations.

Fluid hauling trucks are utilized in connection with drilling and workover projects, which tend to use large amounts of various oilfield fluids. We transport fresh water to the well site and provide temporary storage and disposal of produced salt water and drilling/workover fluids. These fluids are removed from the well site and transported for disposal in a salt water disposal well. Key owned or leased 47 active salt water disposal wells at December 31, 2006. In addition, we provide equipment trucks that are used to move large pieces of equipment from one wellsite to the next, and we operate a fleet of hot oilers which are capable of pumping heated fluids that are used to clear soluable restrictions in a wellbore. Demand and pricing for these services generally correspond to demand for Key's well service rigs. Fluid hauling and equipment hauling services are typically priced on a per barrel or per hour basis while frac tank rentals are typically billed on a per day basis.

Ancillary Oilfield Services. Key provides ancillary oilfield services, which include, among others: electric wireline operations (conveying downhole tools and information); wellsite construction (preparation of a wellsite for drilling activities); roustabout services (provision of manpower to assist with activities on a wellsite); foam air services (drilling technique using air or gas to which a foaming agent has been added); and air drilling services (drilling technique using compressed air). Demand and pricing for these services are generally related to demand for our well service operations.

Although we sold the majority of our contract drilling assets in 2005, we continue to provide limited drilling services to oil and natural gas producers, with approximately 13 rigs onshore in the continental United States in the Appalachian Basin and the Powder River Basin of Wyoming, and internationally in Argentina. The drilling services are primarily provided under standard dayrate, and, to a lesser extent, footage contracts, although our coal bed methane drilling rigs in the Powder River Basin are typically priced on a footage basis. The drilling rigs vary in size and capability. The rigs located in Argentina are equipped with mechanical power systems and have depth ratings of approximately 10,000 feet, although one rig can drill up to approximately 15,000 feet. In 2007, we elected to shut down our coal bed methane drilling operations in the Powder River Basin. We are now seeking to redeploy these assets to other regions. The coal bed methane drilling rigs have depth ratings between 1,200 to 1,800 feet. Like workover services, the demand for contract drilling is directly related to expectations about, and changes in, oil and natural gas prices which, in turn, are driven by the supply of and demand for these commodities.

Pressure Pumping Services Segment

Key Energy Pressure Pumping Services provides well stimulation and cementing services to oil and natural gas producers. Well stimulation services include fracturing, nitrogen services, and acidizing. These services (which may be completion or workover services) are provided to oil and natural gas producers and are used to enhance the production of oil and natural gas wells from formations which exhibit restricted flow of oil and natural gas. In the fracturing process, we typically pump fluid and sized sand, or proppants, into a well at high pressure in order to fracture the formation and thereby increase the flow of oil and natural gas. With our cementing services, we pump cement into a well between the casing and the wellbore. Key offers a full complement of acidizing, fracturing and nitrogen and cementing services. At December 31, 2006, Key operated approximately 166,000 horsepower in stimulation and cementing equipment. Key's pressure pumping services in 2006 were provided in the Permian Basin, the San Juan Basin, the Barnett Shale region of North Texas and the Mid-Continent region. The Company also provides cementing services in California.

In February 2004, we expanded our pressure pumping operations through the acquisition of Fleet Cementers, Inc., a wholly owned subsidiary of Precision Drilling Corporation, for approximately $20 million in cash (of which $6 million was paid back to us in 2005 in consideration of our agreeing to remove certain noncompete restrictions from the agreement). Fleet Cementers provided pressure pumping services, including cementing, fracturing, acidizing, coiled tubing pumping and nitrogen pumping, with primary operations in California and Texas. In connection with the Fleet acquisition, we relocated certain of the Fleet assets to the Barnett Shale region of North Texas. During 2004, 2005 and 2006, we expanded our pressure pumping operation with the purchase of approximately 100,000 horsepower of new pressure pumping equipment. We have additional pumping equipment on order today, and we anticipate that once we receive the equipment, which we expect to receive in the third quarter of 2007, we will operate approximately 212,000 horsepower.

Fishing and Rental Services Segment

Key Energy Fishing & Rental Services provides fishing and rental services to major and independent oil and natural gas production companies in the Gulf Coast, Mid-Continent, and Permian Basin regions of the United States, as well as in California. Fishing services involve recovering lost or stuck equipment in the wellbore and a "fishing tool" is a downhole tool designed to recover any such equipment lost in the well. The fishing tool supervisors who manage the fishing process have extensive experience with downhole problems. In addition, Key offers a full line of services and rental equipment designed for use both on land and offshore for drilling and workover services. Our rental tool inventory consists of tubulars, handling tools, pressure-control equipment and a fleet of power swivels.

Equipment Overview

Well Service Rigs

We use our well service rig fleet to perform four major categories of rig services for oil and natural gas producers. Our rigs typically are billed to customers on a per hour basis but in certain cases may be billed on a dayrate. We categorize our rigs as active, stacked or inactive. We consider an active rig or piece of equipment to be a unit that is working, on standby, or down for repairs but with work orders assigned to it or available for work, which means that the equipment has a crew and is ready to work. A stacked rig or piece of equipment is defined as a unit that is in the remanufacturing process or a unit that does not have a crew assigned to it and could not be put to work without significant investment in repairs and additional equipment. A rig or piece of equipment is considered inactive if we intend to salvage the unit for parts, if we intend to sell the unit or if we intend to scrap the unit. The definitions of active, stacked and inactive are used for the majority of our equipment, including rigs.

As of December 31, 2006, our active fleet of well service rigs totaled 900 rigs. These rigs are located throughout the United States and internationally in Argentina. The geographic diversification provides us with a balanced mix of oil versus natural gas exposure. We estimate that approximately 60% of our rigs are located in predominantly oil regions while 40% of our rigs are located in predominantly natural gas regions.

Our fleet is diverse and allows us to work on all types of wells, ranging from very shallow wells to wells as deep as 20,000 feet. The following table classifies our rigs based on size. Typically, heavy duty rigs will be utilized on deep wells while light duty rigs will be used on shallow wells. In most cases, these rigs can be reassigned to other regions should market conditions warrant the transfer of equipment.

	Swab(1)	Light Duty(2)	Medium Duty(3)	Heavy Duty(4)	Total
Appalachia	3	13	6	1	23
Argentina	1	2	32	9	44
Ark-La-Tex	5	11	41	16	73
California	0	59	40	13	112
Gulf Coast	2	10	50	12	74
Mid-Continent	13	5	91	20	129
Permian Basin	13	22	243	74	352
Rockies	2	8	37	46	93
Total	39	130	540	191	900

(1) Swab rigs include rigs used in shallow-depth wells.

(2) Light Duty rigs include rigs with rated capacity of less than 90 tons.

(3) Medium Duty rigs include rigs with rated capacity of 90 tons to 125 tons.

(4) Heavy Duty rigs include rigs with rated capacity of greater than 125 tons. This also includes seven drilling rigs in Argentina.

DISCONTINUED OPERATIONS

During 2004, we provided contract drilling services to major oil companies and independent oil and natural gas producers onshore in the continental United States in the Permian Basin, the Four Corners region, the Appalachian Basin and the Rocky Mountains. On January 15, 2005, we completed the sale of the majority of our contract drilling assets, which included the drilling rigs and associated equipment in the Permian Basin and Four Corners regions and certain rigs from the Rocky Mountain region. In consideration of the sale, we received approximately $62.0 million in cash. The sale included approximately 25 active rigs and 10 stacked rigs as well as a number of rigs which had been classified as either scrap or salvage. Prior to the sale, our drilling rigs varied in size and capability and in some cases included specialized equipment. The majority of Key's drilling rigs were equipped with mechanical power systems and had drilling depth capabilities ranging from approximately 4,500 to 12,000 feet. We operated one drilling rig with a depth rating of approximately 18,000 feet. As a result of the sale, we treated our land drilling business as a discontinued operation for all periods and recorded an after-tax loss from discontinued operations of $3.4 million, or $0.03 per diluted share, for the year ended December 31, 2005 and an after-tax loss of $5.6 million, or $0.04 per diluted share, during the year ended December 31, 2004.

SEASONALITY

Our operations are impacted by seasonal factors. Historically, our business has been negatively impacted during the winter months due to inclement weather, fewer daylight hours and holidays. Our well service rigs are mobile, and we operate a significant number of oilfield vehicles. During periods of heavy snow, ice or rain, we may not be able to move our equipment between locations, thereby reducing our ability to generate rig or truck hours. In addition, the majority of our well service rigs work only during daylight hours. In the winter months when days become shorter, this reduces the amount of time that the rigs can work and therefore has a negative impact on total hours worked.

Finally, during the fourth quarter, we historically have experienced significant slowdown during the Thanksgiving and Christmas holiday seasons.

PATENTS, TRADE SECRETS, TRADEMARKS AND COPYRIGHTS

Key is the owner of numerous patents, trademarks and proprietary technology that we believe provide us with a competitive advantage in the various markets in which we operate or intend to operate. Key has devoted significant resources to developing technological improvements in our well service business and has sought patent protection both inside and outside the United States for products and methods that appear to have commercial significance. In the United States, as of December 31, 2006, we had 26 patents issued and 15 patents pending. As of December 31, 2006, we had 6 patents issued and 91 patents pending in foreign countries. All the issued patents have varying remaining durations and begin expiring between 2013 and 2025. The most notable of our technologies include numerous patents surrounding the KeyView® system, a field data acquisition system that captures vital wellsite operating data from service equipment. We believe this information helps us and our customers improve safety, reduce costs, and increase productivity.

We own several trademarks that are important to our business both in the United States and in foreign countries. In general, depending upon the jurisdiction, trademarks are valid as long as they are in use or their registrations are properly maintained and they have not been found to become generic. Registrations of trademarks can generally be renewed indefinitely as long as the trademarks are in use. While our patents and trademarks, in the aggregate, are of considerable importance to maintaining our competitive position, no single patent or trademark is considered to be of a critical or essential nature.

We also rely on a combination of trade secret laws, copyright and contractual provisions to establish and protect proprietary rights in our products and services. We typically enter into confidentiality agreements with our employees, strategic partners and suppliers and limit access to the distribution of our proprietary information.

FOREIGN OPERATIONS

At December 31, 2006, we operated internationally in Argentina. During 2006, our operations in Argentina operated 37 well service rigs, seven drilling rigs and oilfield transportation vehicles, all of which we include in our well servicing segment. The Company previously operated in Ontario, Canada as well as in Egypt. During 2004, we closed our Ontario, Canada operation and relocated those assets to our Michigan operation, which was subsequently sold on May 17, 2005. As described below, during 2005, our contract in Egypt terminated. Revenue from our international operations during 2006 totaled $78.3 million, or 5% of total revenue. For a discussion of the effects of Argentina foreign currency transactions, see Item 8. "Consolidated Financial Statements and Supplementary Data," Note 10 "Argentina Foreign Currency Translation Loss."

In Egypt we operated five well service rigs and a number of oilfield service vehicles under a two-year contract we signed with Apache Corporation on March 28, 2002. While Apache extended the contract for limited periods, Apache did not exercise its right to extend the agreement for two additional one-year periods. In July 2005, the remaining work under the contract was completed, and as of December 2005, all five rigs and oilfield service vehicles were shipped back to the United States and redeployed. Under the terms of the agreement, Apache paid all demobilization costs associated with these rigs. For information on the risks associated with our international operations, see Item 1A. "Risk Factors Business and Debt-Related Risk Factors."

CUSTOMERS

Our customers include major oil companies, independent oil and natural gas production companies, and foreign national oil and natural gas production companies. During the years ended

December 31, 2006, 2005, and 2004, no single customer accounted for 10% or more of our consolidated revenues.

COMPETITION AND OTHER EXTERNAL FACTORS

In the well servicing markets, we believe that we are the largest provider of well service rigs based on available industry data. At June 30, 2007, we had 850 active rigs in the United States. Based on the Weatherford-AESC well service rig count, which is available on Weatherford International's internet website, there were approximately 2,798 well service rigs in the United States at May 31, 2007 and approximately 2,849 well service rigs in the United States in December 2006. Despite the significant consolidation in the domestic well servicing industry, there are numerous small companies that compete in Key's well servicing markets. In addition, in May 2007 Nabors Industries announced that it operates 438 well service rigs, while Basic Energy Services, Inc. stated in a June 2007 press release that it has 371 well service rigs. We do not believe that any other competitors have greater numbers of active well service rigs than Key. In Argentina, our largest competitors are Pride International, Nabors Industries, and Allis-Chalmers Energy.

We believe that 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 Key's larger customers have placed increased emphasis on the safety performance and quality of the crews, equipment and services provided by their contractors. Key has devoted, and will continue to devote, substantial resources toward employee safety and training programs. In addition, we believe that the KeyView® system has provided and will continue to provide important safety enhancements. Further, we believe that most customers are willing to pay a slight premium for the quality and efficient service we provide.

The pressure pumping market is dominated by three large competitors, Schlumberger Ltd., Halliburton Company and BJ Services Company. These three companies have a substantially larger asset base than Key and are believed to operate in all major U.S. oil and natural gas producing basins. Other competitors include Weatherford International, Superior Well Service, Basic Energy Services, Complete Production Services and RPC. The pressure pumping industry is very competitive, and the three major competitors generally lead pricing in any particular region. Our pressure pumping services operate in niche markets and historically have competed effectively with these competitors based on performance and strong customer service. Where feasible, we cross-market our pressure pumping services along with our well service rigs and fishing and rental services, thereby offering our customers the ability to minimize vendors, which, we believe, will improve efficiency. This cross marketing capability is unique to Key, because none of the three major pressure pumping contractors operate well service rigs in the United States.

The U.S. fishing and rental tool market is fragmented compared to our other product lines. Companies which provide fishing services generally compete based on the reputation of their fishing tool operators and their relationships with customers. Competition for rental tools is sometimes based on price; however, in most cases, when a customer chooses a specific fishing tool operator for a particular job, then the necessary rental tools will be part of that job as well. Our primary competitors include: Baker Oil Tools, Smith International, Weatherford International, Basic Energy Services, Superior Energy Services and Knight Oil Tools.

The need for well servicing, pressure pumping and fishing and rental services fluctuates, primarily, in relation to the price (or anticipated price) of oil and natural gas, which, in turn, is driven by the supply of and demand for oil and natural gas. Generally, as supply of those commodities decreases and demand increases, service and maintenance requirements increase as oil and natural gas producers attempt to maximize the productivity of their wells in a higher priced environment.

The level of Key's revenues, earnings and cash flows are substantially dependent upon, and affected by, the level of domestic and international oil and gas exploration and development activity. For a more detailed discussion, please see Item 7. "Management's Discussion and Analysis of Results of Operations and Financial Condition."

EMPLOYEES

As of December 31, 2006, we employed approximately 9,400 persons. Our domestic employees are not represented by a labor union and are not covered by collective bargaining agreements. Many of our field employees in Argentina are represented by unions. We have not experienced any material work stoppages associated with labor disputes or grievances and consider our relations with our employees to be satisfactory. We historically have experienced an annual employee turnover rate of over 50%, although our turnover rate during 2006 improved to approximately 43%. The high turnover rate is caused, in part, by the nature of the work, which is physically demanding and sometimes performed in harsh outdoor conditions. As a result, workers may choose to pursue employment in fields that offer a more desirable work environment at wage rates that are competitive with ours. Alternatively, some employees may leave Key if they can earn a higher wage with a competitor. A discussion of the risks associated with our high turnover is presented in Item 1A. "Risk Factors Business and Debt-Related Risk Factors."

ENVIRONMENTAL REGULATIONS

Key's operations are subject to various federal, state, and local laws and regulations intended to protect the environment. Key's operations routinely involve the storage, handling, transport and disposal of bulk waste materials, some of which contain oil, contaminants, and regulated substances. Various environmental laws and regulations require prevention, and where necessary, cleanup of spills and leaks of such materials, and some of our operations must obtain permits limiting the discharge of materials. Failure to comply with such environmental requirements or permits may result in fines and penalties, remediation orders and revocation of permits. Laws and regulations protecting the environment have become more stringent over the years, and in certain circumstances may impose "strict liability," rendering us liable for environmental damage without regard to negligence or fault on our part. Cleanup costs, penalties, 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 Key's financial condition, results of operations and cash flows. From time to time, claims have been made and litigation has been brought against Key under such laws. However, the costs incurred in connection with such claims and other costs of environmental compliance have not had a material adverse effect on Key's operations or financial statements in the past. Management believes that Key conducts its operations in substantial compliance with current federal, state and local requirements as they relate to the environment.

Our underground injection operations are subject to the federal, state and local laws and regulations, including those established by the Underground Injection Control program. The Underground Injection Control program establishes the minimum program requirements for state and local programs regulating underground injection activities. Those regulations include requirements for permitting, testing and record keeping. The substantial majority of our salt water disposal wells are located in the State of Texas and regulated by the Texas Railroad Commission, also known as the "RRC." We also operate salt water disposal wells in Arkansas, Louisiana and New Mexico and are subject to similar regulatory controls in those states. Regulations in these states require us to obtain a permit from the applicable regulatory agencies to operate each of our underground injection wells. These regulatory agencies have the general authority to suspend or modify one or more of these permits if continued operation of one of our underground injection wells is likely to result in pollution of freshwater, substantial violation of permit conditions or applicable rules, or leaks to the environment.

We maintain insurance against some risks associated with underground contamination that may occur as a result of well service activities. However, this insurance is limited to activities at the wellsite and there can be no assurance that this insurance will continue to be commercially available or that this insurance will be available at premium levels that justify its purchase by us. The occurrence of a significant event that is not fully insured or indemnified against us could have a materially adverse effect on our financial condition and operations.

Certain of our wireline activities are regulated by the U.S. Nuclear Regulatory Commission and specified agencies of applicable agreement states that work cooperatively in implementing the federal regulations. In addition, our down-hole surveying services involve the use of explosive charges that are regulated by the U.S. Department of Justice, Bureau of Alcohol, Tobacco, Firearms, and Explosives. Standards implemented by these regulatory agencies require us to obtain licenses or other approvals for the use of such densitometers as well as explosive charges. We have obtained these licenses and approvals when necessary and believe that we are in substantial compliance with these federal requirements.

ITEM 1A. *Risk Factors*

In addition to the other information in this report, the following factors should be considered in evaluating us and our business.

Business and Debt-Related Risk Factors

Our business is dependent on conditions in the oil and natural gas industry, especially oil and natural gas prices and capital expenditures by 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. These include changes resulting from the ability of the Organization of Petroleum Exporting Countries to establish and maintain production quotas to support oil prices, domestic and worldwide economic conditions and political instability in oil-producing countries. Weakness in oil and natural gas prices (or the perception by our customers that oil and natural gas prices will decrease) may cause lower rates for, and lower utilization of, available well service equipment. In addition, when oil and natural gas prices are weak, or when our customers expect oil and natural gas prices to decrease, fewer wells are drilled, resulting in less completion and maintenance work for us. Additional factors that affect demand for our services include:

- the level of development, exploration and production activity of, and corresponding capital 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 that prices for oil and natural gas will continue to be volatile and affect the demand for and pricing of our services. Decreases in oil and natural gas prices can result in a reduction in the trading prices and value of our securities, even if the decreases in oil and natural gas prices do not affect our business directly. Moreover, 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. Although we experienced a material decrease in the demand for our services beginning in August 2001 and continuing through September 2002, since September 2002 we have experienced continued strong demand for our services. We believe the previous decrease in demand was due to an overall weakening of demand for onshore well services, which was attributable to general uncertainty about future oil and natural gas prices and the U.S. economy, including the impact of the September 11, 2001 terrorist attacks. If any of these conditions return, demand for our services could again decrease, having a material adverse effect on our financial condition and results of operations. 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.

We may be unable to implement pricing increases on our core services.

A component of our business strategy includes charging higher prices on our core services in order to generate higher returns. During periods of strong industry activity when demand for our services has increased, we have been able to increase our prices. These increases have been initiated to offset our rising cost structure and to enhance our margins. We believe that we have been able to increase our prices due to strong industry conditions, our capabilities and our leading market position. In the event market conditions deteriorate, it may become more difficult for us to increase prices, and if demand for our services declines, some customers may seek pricing concessions. Additionally, in some cases, we have not been able to successfully increase prices without adversely affecting demand for our services. Specifically, some customers have elected to use our competition rather than to pay our higher price.

The inability to secure further price increases could:

- limit our ability to offset rising costs; and

- impact our ability to generate higher free cash flow which would be used to expand our business.

Increases in industry capacity may adversely affect our business.

Over the past three years, new capacity, including new well service rigs, new pressure pumping equipment and new fishing and rental equipment, has entered the market. In some cases, the new capacity is attributable to start-up oilfield service companies and in other cases, the new capacity has been employed by existing service providers to increase their service capacity. Should oilfield service companies continue to add new capacity and demand for services not increase, it is possible that we could experience continued pressure on the pricing of our services. This could have a material negative impact our operating results.

An economic downturn may adversely affect our business.

A downturn in the U.S. economy may cause reduced demand for petroleum-based products and natural gas. In addition, many oil and natural gas production companies often reduce or delay expenditures to reduce costs, which in turn may cause a reduction in the demand for our services during these periods. We view the Baker Hughes U.S. land drilling rig count as a good barometer of oilfield service activity, which is driven by capital spending from oil and natural gas production companies. During 2002, the last economic slowdown in which activity levels fell, the Baker Hughes U.S. land drilling rig count declined to an average of 717. Since that time, activity levels, as measured by the Baker Hughes U.S. land drilling rig count, have improved. According to available industry data, in 2006, the average U.S. land drilling rig count was approximately 1,559 working rigs, as compared to an average of approximately 1,290 working rigs in 2005. The number of land drilling rigs may be seen as indicative of the demand for services such as those we provide. If the economic environment should deteriorate, our business, financial condition and results of operations may be adversely impacted.

Our business involves certain operating risks, which are primarily self-insured, 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, the uncontrolled flow of natural gas, oil or other well fluids into the atmosphere or an underground formation;
- reservoir damage;
- fires and explosions;
- accidents resulting in serious bodily injury and the loss of life or property;
- pollution and other damage to the environment; and
- liabilities from accidents or damage by our fleet of trucks, rigs and other equipment.

If these hazards occur, they could result in suspension of operations, damage to or destruction of our equipment and the property of others, or injury or death to our or a third party's personnel.

We self-insure a significant portion of these liabilities. For losses in excess of our self-insurance limits, we maintain insurance from unaffiliated commercial carriers. However, our insurance may not be adequate to cover all losses or liabilities that we might incur in our operations. Furthermore, our insurance may not adequately protect us against liability from all of the hazards of our business. 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 uninsured or for which we were not fully insured, it could have a material adverse effect on our financial position, results of operations and cash flows.

We are subject to the economic, political and social instability risks of doing business in certain foreign countries.

We currently have operations in Argentina and Mexico and may expand our operations into other foreign countries. As a result, we are exposed to risks of international operations, including:

- increased governmental ownership and regulation of the economy in the markets where we operate;
- inflation and adverse economic conditions stemming from governmental attempts to reduce inflation, such as imposition of higher interest rates and wage and price controls;
- increased trade barriers, such as higher tariffs and taxes on imports of commodity products;
- exchange controls or other currency restrictions;
- war, civil unrest or significant political instability;
- expropriation, confiscatory taxation and nationalization of our assets located in the markets where we operate;

- governmental policies limiting investments by and returns to foreign investors;
- labor unrest and strikes; and
- restrictive governmental regulation and bureaucratic delays.

The occurrence of one or more of these risks may:

- negatively impact our results of operations;
- restrict the movement of funds and equipment;
- inhibit our ability to collect receivables; and
- lead to U.S. government or international sanctions.

We historically have experienced a high employee turnover rate. Any difficulty we experience replacing or adding workers could adversely affect our business.

We historically have experienced an annual employee turnover rate of almost 50%, although our turnover rate during 2006 improved to approximately 43%. The high turnover rate is attributable to the nature of the work, which is physically demanding and performed outdoors. As a result, workers may choose to pursue employment in fields that offer a more desirable work environment at wage rates that are competitive with ours. We cannot assure that at times of high demand we will be able to retain, recruit and train an adequate number of workers. Potential inability or lack of desire by workers to commute to our facilities and job sites and competition for workers from competitors or other industries are factors that could affect our ability to attract and retain workers. We believe that our wage rates are competitive with the wage rates of our competitors and other potential employers. A significant increase in the wages other employers pay could result in a reduction in our workforce, increases in our wage rates, or both. Either of these events could diminish our profitability and growth potential.

We may not be successful in implementing technology development and technology enhancements.

A component of our business strategy is to incorporate our technology into our well service rigs, primarily through the KeyView® system. The inability to successfully develop and integrate the technology could:

- limit our ability to improve our market position;
- increase our operating costs; and
- limit our ability to recoup the investments made in technology initiatives.

We are subject to environmental, health and safety laws and regulations that expose us to potential liability.

Our operations are regulated under a number of federal, state, local and foreign laws that govern, among other things, the handling, storage and disposal of waste materials, some of which are classified as hazardous substances, and the discharge of hazardous materials into the environment. In addition to potential liability if we should fail to comply, environmental regulations may expose us to liability for noncompliance of other parties, without regard to whether we were negligent. Sanctions for noncompliance with applicable environmental laws and regulations may include administrative, civil and criminal penalties, revocation of permits and corrective action orders. Furthermore, we may be liable for costs for environmental clean-up at currently or previously owned or operated properties or off-site locations where we sent, disposed of, or arranged for disposal of hazardous materials.

Our expenditures for environmental compliance have not been significant in the past but may increase in the future. Compliance with existing laws or regulations, adoption of new laws or regulations or more vigorous enforcement of environmental laws or regulations could have a material adverse effect on our operations by increasing our expenses and limiting our future business opportunities.

In addition, we conduct electric wireline logging, which entails the use of various downhole sondes that acquire geologic data from the surrounding well bore. The data is set up downhole using armored, insulated cable which has from one to seven electrical conductors inside. We use radioactive isotopes along with other nuclear, electrical, acoustic, and mechanical devices to evaluate downhole formations, such as Americium, Beryllium 241, Cesium 137, Iodine 131, and other isotopes. Our activities involving the use of isotopes are regulated by the U.S. Nuclear Regulatory Commission and specified agencies of applicable agreement states that work cooperatively in implementing the federal regulations. Additionally, we use high explosive charges for perforating casing and formations, and various explosive cutters to assist in well bore cleanout. Such operations are regulated by the U.S. Department of Justice, Bureau of Alcohol, Tobacco, Firearms, and Explosives. Standards implemented by these regulatory agencies require us to obtain licenses or other approvals for the use of densitometers as well as explosive charges. While we believe we are in substantial compliance with these requirements, failure to obtain necessary licenses or otherwise to comply with the law could adversely affect our business.

We rely on a limited number of suppliers for certain materials used in providing our pressure pumping services.

We rely heavily on three suppliers for sized sand, a principal raw material that is critical for our pressure pumping operations. While the materials are generally available, if we were to have a problem sourcing raw materials or transporting these materials from either of these vendors, our ability to provide pressure pumping services could be limited.

We may not be able to generate sufficient cash flow to meet our debt service obligations.

We had $421.8 million of total indebtedness and capital lease obligations outstanding at December 31, 2006. As of June 30, 2007, we had $424.1 million of total indebtedness and capital lease obligations outstanding.

Our ability to make payments on and to refinance our indebtedness, and to fund planned capital expenditures, will depend on our ability to generate cash in the future. This, to a certain extent, is subject to conditions in the oil and gas industry, general economic and financial conditions, competition in the markets where we operate, the impact of legislative and regulatory actions on how we conduct our business and other factors that are beyond our control.

We cannot assure you that our business will generate sufficient cash flow from operations to service our outstanding indebtedness, or that future borrowings will be available to us in an amount sufficient to enable us to pay our indebtedness or to fund our other capital needs. If our business does not generate sufficient cash flow from operations to service our outstanding indebtedness, we may not able to refinance our indebtedness. We may not be able to continue to implement the parts of our business strategy relating to strengthening our balance sheet by reducing debt, making acquisitions and remanufacturing our rigs and related equipment.

Our debt instruments impose restrictions on us that may affect our ability to successfully operate our business.

Our senior secured credit facility limits our ability to take various actions, such as:

- incurring additional indebtedness;
- paying dividends;
- repurchasing junior indebtedness;
- making investments;
- entering into transactions with affiliates;
- merging or consolidating with other entities; and
- selling all or substantially all of our assets.

These restrictions also could limit our ability to obtain additional financing, make needed capital expenditures, withstand a downturn in our business or the economy in general, or otherwise conduct our business.

Additional indebtedness could materially adversely affect our financial condition, results of operations and business prospects and prevent us from fulfilling our obligations under our outstanding indebtedness.

Under our senior secured credit facility, we are limited in our ability to incur additional debt until we have filed our required periodic reports with the SEC. If and when such restrictions are lifted and we can incur additional debt, increased leverage could, for example:

- make it more difficult for us to satisfy our obligations under our indebtedness; if we fail to comply with the requirements of our indebtedness, that failure could result in an event of default of such indebtedness;
- require us to dedicate a substantial portion of our cash flow from operations to required payments on indebtedness, thereby reducing the availability of cash flow for working capital, capital expenditures and other business activities;
- limit our ability to obtain additional financing in the future for working capital, capital expenditures and other general corporate purposes;
- limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;
- diminish our ability to successfully withstand a downturn in our business or the economy generally; and
- place us at a competitive disadvantage against less leveraged competitors.

If new debt is added to our and our subsidiaries' current debt levels, the related risks that we and they now face could increase.

We may be unable to comply with covenants contained in our senior secured credit facility, which could result in the impairment of our working capital and alter our ability to operate our business.

We are a party to a $547.25 million senior secured credit facility. To maintain the right to borrow under this credit facility and avoid a default, we are required to maintain certain financial covenant ratios and satisfy certain financial condition tests, several of which become more restrictive over time and may require us to take action to reduce our debt or take some other action in order to comply with them. Our ability to satisfy required financial ratios and tests can be affected by events beyond our control, including prevailing economic, financial and industry conditions, and we cannot assure you that we will continue to meet those ratios and tests in the future. A breach of any of these covenants, ratios or tests could result in a default under our credit agreement. If we default, our lender will no longer be obligated to extend credit to us and could elect to declare all amounts outstanding under the credit agreement, together with accrued interest, to be immediately due and payable. The results of such action would have a significant negative impact on our results of operations, financial condition and cash flows.

Our business may be adversely affected if we cannot successfully execute acquisitions that we make or effectively integrate acquired operations.

Our strategy includes acquiring complementary businesses to our domestic operations. In addition, we will also evaluate possible international acquisitions. Any such strategy will involve a number of risks and challenges, including:

- our ability to identify suitable acquisition candidates, to negotiate acceptable terms, documentation and other conditions, and to obtain any necessary regulatory clearances;
- 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.

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Any of these factors could adversely affect our ability to achieve anticipated levels of earnings and cash flow from 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.

The trading price of our common stock could be subject to significant fluctuations.

The trading price of our common stock has been volatile due to, among other factors, the uncertainty associated with the restatement of our prior period financial statements, our ability to become current with respect to our SEC filings, and our ability to relist our common stock on the NYSE. Continued uncertainty or negative developments may cause significant declines in the price of our common stock. Also, factors such as announcements of fluctuations in our or our competitors' operating results and market conditions for oil and gas-related stocks in general could have a significant impact on the future trading prices of our common stock. In particular, the trading price of the common stock of many oilfield service companies has experienced extreme price and volume fluctuations, which have at times been unrelated to the operating performance of the companies whose stocks were affected. In addition, the trading prices and value of our common stock could be subject to significant fluctuations in response to variations in our prospects and operating results, which may in turn be affected by weakness in commodity prices, changes in interest rates and other factors. There can be no assurance that these factors will not have an adverse effect on the trading prices of our common stock.

Our bylaws contain provisions that may prevent or delay a change in control.

Our Amended and Restated Bylaws contain certain provisions designed to enhance the ability of the Board of Directors to respond to unsolicited attempts to acquire control of the Company. These provisions:

- establish a classified Board of Directors, generally providing for three-year staggered terms of office for all members of our Board;
- set limitations on the removal of directors;
- provide our Board of Directors the ability to set the number of directors and to fill vacancies on the Board occurring between shareholder meetings; and
- set limitations on who may call a special meeting of shareholders.

These provisions may have the effect of entrenching management and may deprive investors of the opportunity to sell their shares to potential acquirers at a premium over prevailing prices. This potential inability to obtain a control premium could reduce the price of our common stock.

Delayed Financial Reporting-Related Risk Factors

The delay in reporting our financial statements and related events has had, and will continue to have, a material adverse effect on us.

Because of the delay in completing our financial statements for the year ended December 31, 2003, and our restatement of prior period financial statements, we have been unable to file our required periodic reports with the SEC for some time. This report is being filed more than four months after it was due. We have not yet filed our quarterly reports for 2005, 2006 and the first two quarters of 2007, and we may be unable to timely file our quarterly report for the third quarter of 2007. As a result of these events, we have become subject to significant risks and occurrences relating to the following matters, which are described in more detail below:

- Possible adverse consequences of failure to file past SEC reports;
- Limitations on access to public capital markets;

Inability of common stock to trade on a recognized exchange and potential inability to re-list on a recognized exchange;

Impact of material weaknesses in internal control over financial reporting;

Potential changes in tax liabilities; and

Civil litigation.

Our inability to file past annual and quarterly reports with the SEC could have adverse consequences.

We have not filed, and will be unable to file, annual reports that comply with SEC rules for years prior to 2006. Nor will we be able to file compliant quarterly reports for the first three quarters of 2004 or prior periods. We cannot rule out the possibility of regulatory action by the SEC due to the failure to file these required reports. Any such action could have adverse effects on us, including possible impact on our compliance with lending agreements, on the trading market for our common stock, or on our ability to access the capital markets.

We cannot register securities for a public offering or acquisitions until we are current in our financial reporting. We also will be unable to repurchase our common stock until we are current.

The securities laws require that we supply current annual and quarterly financial statements in order for us to be able to register securities for a public offering or an acquisition. In order to become current, we must file, in addition to this report, our Quarterly Reports on Form 10-Q for the first three quarters of 2005 and 2006, respectively. We also must file our Quarterly Report on Form 10-Q for the first and second quarters of 2007, which are overdue. Although we should be able to register securities for public offerings and acquisitions after we become current, we will be ineligible to use "short-form" registration that allows us to incorporate by reference our SEC reports into our registration statements, or to use shelf registration until we have filed all of our periodic reports in a timely manner for a period of twelve months. This could increase the costs of selling securities publicly and could significantly delay such sales. We will also be unable to engage in other transactions involving our common stock, including a stock repurchase, until we have become current in our financial disclosures.

We cannot be re-listed on a securities exchange until we are current in our financial reporting.

Due to our failure to file current financial statements, we became ineligible for listing on a stock exchange, and our common stock has been trading on the Pink Sheets Electronic Quotation Service since April 2005. We intend to seek to be re-listed on a securities exchange when we become current in our financial reporting. There can be no assurance whether we will satisfy the standards for listing on an exchange or that the exchange will approve our listing. Nor can there be any assurance at this time when the re-listing would occur. Continuing to be quoted only on Pink Sheets could adversely affect the trading market and potentially the market price of our common stock.

Taxing authorities may determine that we owe additional taxes from previous years.

As a result of the restatement and delay in our financial reporting, we will likely have to amend previously filed tax returns and reports. Where legal, regulatory or administrative rules require or allow us to amend our previous tax filings, we intend to comply with our obligations under applicable law. To the extent that tax authorities do not accept our conclusions about the tax effects of the restatement, liabilities for taxes could differ from those which have been recorded in our consolidated financial statements. If it is determined that we have additional tax liabilities, there could be an adverse effect on our financial condition, results of operations and cash flows.

If we are unable to file all financial reports by the dates currently required in our credit facility, we would have to seek a waiver from our lenders. There is no assurance such waiver would be obtained.

Our senior secured credit facility, as amended, requires that we file our first and second quarterly reports on Form 10-Q for 2007 no later than October 31, 2007. Although we believe that we will be able to file our 2007 quarterly reports by October 31, 2007, we can make no assurances that will be able to do so. If we cannot meet the filing deadline, we will be required either to seek a waiver from our lenders or refinance the credit facility, or risk an event of default. We can make no assurances that a waiver will be granted by our lenders or about the terms on which it might be granted. If we default, our lenders will no longer be obligated to extend credit to us and could elect to declare all amounts outstanding under the credit agreement, together with accrued interest, to be immediately due and payable. The results of such action would have a significant negative impact on our results of operations and financial condition.

We have identified material weaknesses in our internal control over financial reporting. These material weaknesses, if not corrected, could affect the reliability of our financial statements and have other adverse consequences.

Section 404 of the Sarbanes-Oxley Act and the related SEC rules require management of public companies to assess the effectiveness of their internal control over financial reporting annually and to include in Annual Reports on Form 10-K a management report on that assessment, together with an attestation report by an independent registered public accounting firm. Under Section 404 and the SEC rules, a company cannot find that its internal control over financial reporting is effective if there exist any "material weaknesses" in its financial controls. A "material weakness" is a control deficiency, or combination of control deficiencies, that results in a more than remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

We have identified material weaknesses in internal control over financial reporting as of December 31, 2006. We have taken and will take actions to remediate the material weaknesses and improve the effectiveness of our internal control over financial reporting; however, we cannot assure you that we will be able to correct these material weaknesses by the end of 2007. Any failure in the effectiveness of internal control over financial reporting, if it results in misstatements in our financial statements, could have a material effect on financial reporting or cause us to fail to meet reporting obligations, and could negatively impact investor perceptions.

Litigation arising in connection with the restatement of our financial statements could adversely affect our financial condition and operations.

The restatement led to litigation. Several securities class action lawsuits and derivative cases are pending against us, members of our Board of Directors and present and former members of management. We have also been named in a lawsuits by our former general counsel and our former chief financial officer. Further, our former controller and assistant controller filed a joint complaint against us. The lawsuits and other legal matters in which we have become involved following the announcement of the restatement are described in Item 3. "Legal Proceedings."

Due to our inability to issue shares of common stock upon exercise of options because we have been unable to maintain an effective SEC registration statement for those shares, or to rely on an exemption from registration, some previously granted options that were in-the-money have expired without the optionees being able to exercise them. Although we believe the plan agreements permit our actions taken thus far with respect to stock options, we are defending lawsuits by some option holders and may face lawsuits from other option holders.

Other than actions that have been previously settled, we are unable at this time to predict the outcome of pending legal actions. The ultimate resolution of the securities class action lawsuits and derivative cases could have a material adverse impact on our financial results, financial condition or liquidity, and on the trading price of our common stock.

These lawsuits and other legal matters also could have a disruptive effect upon the operation of our business and consume the time and attention of our senior management. In addition, we are likely to incur substantial expenses in connection with such matters, including substantial fees for attorneys.

We maintain insurance that may provide coverage for some or all of these matters. We have given notice to our insurers of the claims. The insurers have responded by requesting additional information and by reserving their rights under the policies, including the rights to deny coverage under various policy exclusions or to rescind the policies in question as a result of our restatement of our financial statements. There is risk that the insurers will rescind the policies; that some or all of the claims will not be covered by such policies; or that, even if covered, our ultimate liability will exceed the available insurance.

ITEM 1B. *Unresolved Staff Comments*

None.

ITEM 2. *Properties*

Key leases executive office space in Houston, Texas (principal executive office) and Midland, Texas. In addition, we conduct our operations using a combination of owned and leased properties to support our operations in each of our geographic markets. Our leased properties are subject to various lease terms and expirations. As of December 31, 2006, we owned 135 properties, twelve of which were inactive. We also operated 84 leased office and yard locations. We owned or leased 57 salt water disposal wells, ten of which were inactive at December 31, 2006. The majority of our salt water disposal wells are located in Texas.

We believe all properties that we currently occupy are suitable for their intended use. We believe that we have sufficient facilities to conduct our operations during 2007. However, we continue to evaluate the purchase or lease of additional properties or the consolidation of our properties, as our business requires.

ITEM 3. *Legal Proceedings*

Class Action Lawsuits

Since June 2004, we have been named as a defendant in six class action complaints for alleged violations of federal securities laws, which have been filed in federal district court in Texas. They are as follows:

Cause No. MO-04-CV-082; *Peter Kaltman, on behalf of himself and all others similarly situated v. Key Energy Services, Inc., Francis D. John, Royce W. Mitchell, Richard J. Alario and James J. Byerlotzer*, filed in the United States District Court for the Western District of Texas

Cause No. MO-04-CV-083; *Malcolm Lord, Individually and on Behalf of all Others Similarly situated v. Key Energy Services, Inc., Francis D. John, Richard J. Alario, James J. Byerlotzer and Royce W. Mitchell,* filed in the United States District Court for the Western District of Texas

Cause No. MO-04-CV-090; *Celeste Navon, on behalf of herself and all others similarly situated v. Key Energy Services, Inc., Francis John, Royce Mitchell, James Byerlotzer and Richard Alario*, filed in the United States District Court for the Western District of Texas

Cause No. MO-04-CV-104; *David W. Ortbals, on Behalf of Himself and All Others Similarly situated v. Key Energy Services, Inc., Richard J. Alario, James J. Byerlotzer, Francis D. John, and Royce W. Mitchell,* filed in the United States District Court for the Western District of Texas

Cause No. MO-04-CV-0254; *Paul E. Steward, on Behalf of Himself and All Others Similarly situated v. Key Energy Services, Inc., Francis D. John and Royce W. Mitchell*, filed in the United States District Court for the Western District of Texas

Cause No. MO-04-CV-0227; *Garco Investment LLP Individually and on Behalf of all Others Similarly Situated v. Key Energy Services, Inc., Richard J. Alario, James J. Byerlotzer, Francis D. John and Royce W. Mitchell,* filed in the United States District Court for the Western District of Texas

These six actions have been consolidated into one action. On November 1, 2005, the plaintiffs filed a consolidated amended class action complaint. The complaint is brought on behalf of a putative class of purchasers of our securities between April 29, 2003 and June 4, 2004. The complaint names Key, Francis D. John, Royce W. Mitchell, Richard J. Alario and James J. Byerlotzer as defendants. The complaint generally alleges that we made false and misleading statements and omitted material information from our public statements and SEC reports during the class period in violation of the Securities Exchange Act of 1934, including alleged: (i) overstatement of revenues, net income, and earnings per share, (ii) failure to take write-downs of assets, consisting of primarily idle equipment, (iii) failure to amortize the Company's goodwill, (iv) failure to disclose that the Company lacked adequate internal controls and therefore was unable to ascertain the true financial condition of the Company, (v) material inflation of the Company's financial results at all relevant times, (vi) misrepresentation of the value of acquired businesses, and (vii) failure to disclose misappropriation of funds by employees. We filed a motion to dismiss the case. The individual defendants also filed motions to dismiss the case. On August 11, 2006, the court denied our motion to dismiss, but granted dismissals as to Messrs. Alario and Byerlotzer. We filed our answer to the consolidated amended complaint on September 11, 2006. Trial is set for March 3, 2008.

The Plaintiffs have filed a motion for class certification. The class certification hearing is scheduled to be held on September 6, 2007. The parties are engaged in written discovery and document production.

Derivative Actions

Four shareholder derivative suits have been filed by certain of our shareholders. They are as follows:

Cause No. 2004-CV-44728*; Moonlight Investments, LTD. on Behalf of Nominal Defendant Key Energy Services, Inc., v. Francis D. John, Richard J. Alario, James J. Byerlotzer, Royce W. Mitchell, Kevin P. Collins, W. Phillip Marcum, and Ralph S. Michael, III, and Key Energy Services, Inc.,* filed in the 385th Judicial District Court, Midland County, Texas

Cause No. EP-04-CA-0457; *Sandra Weissman, Derivatively on Behalf of Key Energy Services, Inc., v. Francis D. John, David J. Breazzano, Kevin P. Collins, William D. Fertig, W. Phillip Marcum, Ralph S. Michael III, J. Robinson West, James J. Byerlotzer, Royce W. Mitchell, Richard J. Alario and Key Energy Services, Inc., a Maryland Corporation*, filed in the United States District Court Western District of Texas

Cause No. EP-04-CA-0456; *Daniel Bloom, Derivatively on Behalf of Key Energy Services, Inc., v. Francis D. John, David J. Breazzano, Kevin P. Collins, William D. Fertig, W. Phillip Marcum, Ralph S. Michael III, J. Robinson West, James J. Byerlotzer, Royce W. Mitchell, Richard J. Alario and Key Energy Services, Inc., a Maryland Corporation*, filed in the United States District Court Western District of Texas

Cause No. 2007-31254; *Sandra Weissman, Derivatively on Behalf of Key Energy Services, Inc., v. Francis D. John, David J. Breazzano, Kevin P. Collins, William D. Fertig, W. Phillip Marcum, Ralph S. Michael III, J. Robinson West, James J. Byerlotzer, Royce W. Mitchell, Richard J. Alario and Key Energy Services, Inc., a Maryland Corporation* filed in the 270th Judicial District, Harris County, Texas.

Francis D. John, David J. Breazzano, Kevin P. Collins, William D. Fertig, W. Phillip Marcum, Ralph S. Michael III, J. Robinson West, James J. Byerlotzer, Royce W. Mitchell, and Richard J. Alario have been named as defendants in one or more of those actions. Those actions are filed by individual shareholders purporting to act on our behalf, asserting various claims against the named officer and director defendants. The derivative actions generally allege the same facts as those in the shareholder class action suits. Those suits also allege breach of fiduciary duty, abuse of control, waste of corporate assets, and unjust enrichment by these defendants.

The first derivative suit was filed on August 9, 2004 in state court in Midland, Texas. The plaintiff subsequently amended that suit to assert claims against our former independent public accountants, KPMG LLP. We filed a motion to dismiss all claims in that action, which was granted by the court on March 29, 2005 for failure to make demand on the directors before filing suit. The plaintiff appealed that ruling. On May 18, 2006, the intermediate Court of Appeals issued an opinion affirming the trial court's ruling that the plaintiff had not pleaded sufficient facts to excuse its failure to make demand, but reversing on procedural grounds. We filed a motion for rehearing, which was denied June 15, 2006, and we appealed to the Texas Supreme Court. On June 8, 2007 the Texas Supreme Court denied Key's Petition For Review (appeal). The case has been sent back to the trial court for further proceedings.