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BORING BUSINESS: Varel International has made drill bits for oil, gas and mining uses for 58 years. It now has a new owner, Denver's KRG Capital Partners L.L.P.

Denver equity firm buys local drill bit co.

BY CHAD ERIC WATT | STAFF WRITER

A Carrollton-based maker of drill bits has been scooped up by a Denver private equity firm.

KRG Capital Partners L.L.C. sees a strong future for Varel International, a privately held company that makes specialized drill bits for use in oil, gas and mining operations.

The companies did not disclose the transaction price.

Privately held Varel competes with units of some very large companies, so having the resources of a \$450 million private equity group will be welcome, said Jim Nixon, president of Varel.

Varel's leadership will stay in place as the ownership changes.

"We're going to continue the journey of growth we embarked upon," Nixon said.

Varel is 58 years old. It has 1,000 employees between its Carrollton headquarters and operations in Houston; Matamoros, Mexico; and France.

The founding Varel family sold the company in 1998 to Nixon and others in a management buyout backed by 3i P.L.C. and the University of Texas Investment Co., also known as Utimco.

Varel is the second North Texas drilling equipment business to be bought by investors in recent months.

In May, Boston-based Cherington Capital L.L.C. bought Fort Worth's Rock Bit International for about \$30 million, according to published reports.

"Private equity firms have a ton of money, and they're looking to do all kinds of deals," said Jason Wilcox, a vice president at Growth Capital Partners, a Dallas investment bank which advised Rock Bit on its sale. "Plus, energy is strong."

Further, not all private equity groups are willing to get involved in energy, so that means less competition in that marketplace.

New to energy

For KRG, the energy sector is new territory. It has previously bought into companies in manufacturing, health care and decorative flowers.

Energy is a segment KRG's leaders are particularly bullish about.

They have been looking at the sector for a while, said Chuck Hamilton, managing partner of KRG.

"We've kicked a lot of tires, but this is the first car we've bought," he said.

From KRG's perspective, Varel is a well-run company in a flourishing industry.

"They know how to run a business and make money," Hamilton said. "On top of that, we believe that we're in the beginning of a positive secular trend in oil, mining and gas exploration."

Energy prices have been high for a while, but there's little concern from buyers that they're paying too much, Wilcox said.

"A lot of underlying fundamentals say they will remain high," he said.

In both instances, the buyers see some opportunities to bring capital and their expertise to make a good company run better.

For example, Rock Bit is introducing new products into its marketplace, and Cherington is aiming to put its money and business skill behind those launches, Wilcox said.

More activity, more complex

Industry factors have also driven new opportunities for Varel and KRG.

Sustained high energy prices have prompted drillers and explorers to get more aggressive in the hunt for fuel.

Varel now has 5% to 6% of the oil and gas drill bit market, Nixon said. That's up from 2% a few years ago. (It has a larger portion of the smaller mining industry.)

Expanding that market share is important to KRG, but it's not the top priority.

"We know we're not going to be the biggest business in this industry in my lifetime," Hamilton said.

More important is making top-quality products and good margins, he said.

The places explorers have to go to find hydrocarbons will be continually less hospitable to drilling.

"Wells are getting deeper and more complex," Nixon said.

That plays into Varel's hands. Its marching orders from KRG are to put profits to work on research, materials science and hiring top people for the company.

Varel also is keen on developing customized drill bits.

Oil explorers collect detailed data on where they drill. Using a custom system to link that data to Varel's design process gives it the wherewithal to construct drill bits customized for a particular hole.

And as the volume of drilling increases, the demand for drill bits will grow.

After all, Hamilton notes, no one has ever drilled a well without a drill bit.

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