

Varel International, an independent manufacturer and supplier of high-quality drill bits, servicing the global oil & gas and mining/industrial drilling markets, sees the Middle East playing a crucial part in its future growth.

# Delivering value through technology

**V**AREL INTERNATIONAL IS the world's largest independent manufacturer of premium drill bits for the oil and gas industry.

In 1999, the original owners sold the company to current CEO, Jim Nixon, at which time he recruited several drill bit industry veterans to join a new management team. During the next few years, this group restructured the company's engineering and manufacturing processes and expanded its product offering to include polycrystalline diamond compact (PDC) bits.

As the company became increasingly successful, it began to attract some of the industry's leading drill bit experts to develop new technologies and to build relationships and performance histories with the company's impressive list of global customers.

In 2005, another important milestone was reached when Varel was purchased by private equity firm, KRG Capital Partners. The purpose of this being to perpetuate the company's growth and opportunities.

Today, Varel International is recognised as the largest independent drill bit company in the world. *Oil Review* recently spoke with Jim Nixon about the reasons behind the company's success.

*Varel has gone from strength to strength since you acquired the company. How did you turn things around so quickly?*

Believe me, it wasn't quickly, nor was it easy, but we are very proud of all that we have accomplished. We bought the company from the Varel family in 1998 when it was primarily a roller cone company for mining and industrial drill bits. It took eight years of consistent effort by our management team and employees with incredible support from our customers to make Varel what it is today - the fastest growing drill bit company in the world. But these efforts compounded to help us build our foundation to be a leading global drill bit company. During this process we focused much of our attention on:

Enhancing our quality systems—ensuring that we are aligned with the finest raw material suppliers to make certain that our final products are of the highest quality; that we have the most efficient processes—in the office, in the plant and in the field; and that our plants have the well-trained people and the right equipment to ensure manufacturing and delivering efficiency.

Implementing lean manufacturing for our roller cone business—lean manufacturing is



**Jim Nixon, CEO of Varel International - the fastest-growing drill bit company in the world**

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when you pull rather than push materials through a manufacturing process. While this process has been operational for more than a year, and we have seen incredible improvements in product cycle times and product delivery timelines, I believe that we have yet to fully comprehend how efficient this process will make us and how it will positively effect our current customers and help us attract new ones.

Doubling our PDC business—we have invested heavily to increase the capacity in our PDC manufacturing facilities in Houston and Tarbes, France. These investments have resulted in new equipment, more skilled personnel and a significant increase in monthly output.

Focusing on customer service—our commitment to continuous improvement to our customers is important to us. It is this philosophy that ensures that we have the right people in the right place at the right time. Our

people have been hand-picked for their skills, technical knowledge and local knowledge and for their ability to understand customer needs. As we continue to grow very quickly, customer service will continue to be a top priority for our organization.

*How can you maintain the growth enjoyed so far in the Middle East?*

We are very proud of the growth we have achieved in the Middle East. We entered this market in 2000, and have grown it to serve customers in Saudi Arabia, Kuwait, Oman, Qatar, UAE, to name a few.

To continue this growth trend, we will expand our sales and service network across the Middle East. We will continue to be flexible and agile, while attracting and training talented personnel who are dedicated to delivering value and solutions to our customers. All the while our commitment to and development of new, differentiated technologies will help us expand our business in this region. We will continue to develop drill bit technologies and features that maximize drilling optimization and thus efficiencies for our customers, especially those operating in the Middle East.

*In which parts of the Middle East do you see the greatest potential for sales?*

The Middle East as a whole is a very important market for the future growth of our industry and for Varel. To date, we have very strong commitments from many regions in the Middle East. Looking ahead, I would say that Saudi Arabia has the highest potential for growth. This projection is primarily due to the shear size of the country and its massive reserves. But other countries, such as Kuwait, Egypt, UAE, to name a few—all have been increasing their drilling activity and will continue to be important regions to the global drilling market.

*What trends do you see emerging in drilling technology?*

Unfortunately, for our customers, I see well construction costs continuing to increase; but advances in drill bit, drilling equipment and technology, such as motors and RSS systems, can improve drilling efficiencies and help reduce and contain costs. Generally speaking, drill bits are sometimes seen as commodities, yet their performance has a direct affect on drilling costs. If, for example, a customer is drilling at 6,000 meters deep and the bit quits performing, the trip time alone will cost them one to two days

worth of work. This is why Varel invests more time upfront with the customer. We want to understand their drilling objectives and parameters and the specifics about the drilling system so that we can design the right bit for the specific project. This process improves drilling optimization and reduces costs.

Other trends I see, particularly where drill bits are concerned as that is where my expertise lies, include more advancements in cutter technology for PDC bits. For several years now cutter technology has been the buzz word in the drill bit industry and justifiably so, as cutters make up about one-third the cost of PDC bits. Advancements in cutter technology, by way of new or advanced manufacturing processes, more R&D and customer-endorsed field testing will improve drilling performance and reduce drilling costs.

**Are there any plans to manufacture drill bits in the Middle East?**

Varel's philosophy is to be flexible and agile in order to meet customer needs and expectations. Ultimately, manufacturing efficiencies increase and costs decrease when you can strategically locate your supply point as close to the customer as possible. Obviously there is a significant capital

**Varel's philosophy is to be flexible and agile in order to meet customer needs and expectations**

investment required to implement this. To date, we have not planned building a manufacturing facility in the Middle East, but because of the projected growth of this region and their culture of quick adoption of emerging technologies, it is an attractive market to consider for such a possibility.

**What benefits have been derived since 2005 from KRG's involvement?**

The inclusion of KRG Capital Partners as an investor has significantly changed the foundation of Varel's business and for the better. During preliminary discussions it became evident that KRG believed in the vision we had for Varel and was willing to quickly fund this vision to help us achieve our goal—to be a leading global drill bit company. In less than two years, KRG has invested and seen an incredible return on investment by funding many of the capital investment

projects we needed. When you are a smaller company growing as fast as we were, your, what I call, "internal systems" are often sacrificed. Such internal systems are accounting, procurement, IT to name a few. But when KRG bought Varel they quickly came in and helped us revamp and even establish all of these important internal systems—systems critical to the overall foundation and ultimate growth of a company. In addition, KRG has funded most of our lean manufacturing project for our growing roller cone business; their support has helped us double our PDC manufacturing capacity and they have enriched our talent pool by introducing systems and efficiencies that help us attract, train and retain top talent.

**Does Varel suffer from counterfeiting of its products in the Middle East?**

The global drill bit market is extremely competitive. Companies have to be well-funded to break-even and well-funded with the right processes, differentiating technologies, and strong customer base to be successful. All drill bit companies are looking to deliver new and differentiating technologies, but the reality is that companies that attempt to counterfeit such technologies will never fully catch up to

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the competition they are chasing. Because as a new technology is launched and is becoming accepted in the marketplace, the company trying to follow the leader tries to catch up and deliver a similar technology. But while they are trying to "catch up" to the leader, the leader is already working on the next product evolution. So it's a no-win situation for counterfeiters.

*What's important to your customers in the Middle East, simply price? Or are they more demanding in terms of enhanced bit life, improved penetration rates etc?*

The increase of global drilling activity has increased drilling costs, especially in the Middle East. But during this time, the Middle East has become a market of early adopters of new technologies. Historically, the North Sea and the Gulf of Mexico were the playgrounds for new and emerging technologies. But as the Middle East market has grown they have focused on improving their drilling efficiency which has modified their culture to embrace new and emerging drilling technologies. They have done this so well that I would say the Middle East is on par with the North Sea and Gulf of Mexico for testing new and emerging drill bit technologies. For example, PDC drill bits were once seldom used in the Middle East. But in recent years, operators and drilling contractors working in this area have upgraded their rigs, improved their motors and drilling systems all in the name of drilling efficiency and drilling performance. Customers in the Middle East have their eye on value, but value for total cost of ownership. With the onset of more advanced drilling systems, along with a commitment to safety and safe drilling practices, and a strong focus to performance and drilling efficiency, allowed PDC bits to enter into and thrive in this market. Varel has experienced this change in attitude about technology adoption first-hand.

We often leverage our customer relationships in the Middle East to allow us to field test and refine new and emerging technologies. Our customers are very receptive to these opportunities and we are very appreciative of them as they result in win-win scenarios.

*What is Varel's philosophy for designing drill bits?*

At Varel, it is our goal to provide customers with a total drilling solution rather than just a drill bit. We believe drill bits have a special relationship to directional drilling systems in that they should not be looked as separate, independent tools. They should be considered a total drilling package and, therefore, should be designed as one package. To do this, we use data and information supplied by the customer and numerous proprietary software applications, design tools and manufacturing processes. ■

## Arcapita to acquire Varel International for US\$369mn

ARCAPITA INC., A leading private equity investment firm, announced that its affiliates have signed a definitive purchase agreement to acquire Varel Holdings, Inc. from KRG Capital Partners for approximately US\$369mn. Varel is the world's fastest growing manufacturer of drill bits for the oil and gas, and mining and industrial industries. Stockton Croft, Director at Arcapita, said, "Varel's growth is being driven by excellent industry dynamics, superior customer service and a talented and highly experienced management team. In addition, Arcapita is excited about the opportunity to assist Varel in expanding its presence in the important markets of the Middle East, where Arcapita's local knowledge and extensive contacts will be a major competitive advantage for Varel."

Jim Nixon, Chief Executive Officer of Varel International, stated, "We are excited about continuing our growth journey with our new partner Arcapita. We look forward to leveraging Arcapita's strong relationships in the Middle East and to expanding our global position in Energy and Mining applications."

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