



FORM 10-K

PATTERSON UTI ENERGY INC - PTEN

Exhibit:

Filed: March 31, 1999 (period: December 31, 1998)

Annual report which provides a comprehensive overview of the company for the past year

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

(MARK ONE)

ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF
1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 1998

OR

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934 FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER 0-22664

PATTERSON ENERGY, INC.
(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of incorporation or
organization)

75-2504748
(I.R.S. Employer Identification No.)

P.O. BOX 1416, 4510 LAMESA HIGHWAY,
SNYDER, TEXAS
79550
(Zip Code)
(Address of principal executive offices)

Registrant's telephone number, including area code: (915) 573-1104

Securities Registered Pursuant to 12(b) of the Act: None
Securities Registered Pursuant to 12(g) of the Act:

(TITLE OF CLASS)
Common Stock, \$.01 Par Value

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 No

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

The aggregate market value of the voting and non-voting common equity held
by non-affiliates of the registrant as of March 22, 1999 was \$142,705,758, based
upon the average bid and asked prices of \$4.66 and \$4.69, respectively, on the
Nasdaq National Market.

As of March 22, 1999, the registrant had outstanding 32,471,132 shares of
common stock, \$.01 Par Value, its only class of voting stock.

DOCUMENT INCORPORATED BY REFERENCE

Parts of the following document are incorporated by reference into Part III
of this Annual Report on Form 10-K: Definitive Proxy Statement for the
registrant's 1999 Annual Meeting of Stockholders.

PART I

The "Company" or "Patterson" is used in this report to refer to Patterson Energy, Inc. and its consolidated subsidiaries. The Company may from time to time make written or oral forward-looking statements, including statements contained in the Company's filings with the Securities and Exchange Commission and its reports to stockholders. Items 1 and 2 contain forward-looking statements and are made pursuant to the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. These statements include, without limitation, statements relating to the drilling and completion of wells, well operations, utilization rates of drilling rigs, reserve estimates (including estimates for future net revenues associated with such reserves and the present value of such future net reserves), business strategies and other plans and objectives of the Company's management for future operations and activities and other such matters. The words "believes," "budgeted," "plans," "intends," "strategy," or "anticipates" and similar expressions identify forward-looking statements. The Company does not undertake to update, revise or correct any of the forward-looking information. Readers are cautioned that such forward-looking statements should be read in conjunction with the Company's disclosures under the heading: "Cautionary Statement for Purposes of the 'Safe Harbor' Provisions of the Private Securities Litigation Reform Act of 1995" beginning on page 13.

 ALL NUMERICAL INFORMATION CONTAINED IN THIS REPORT RELATING TO THE COMPANY'S COMMON STOCK REFLECTS THE TWO-FOR-ONE SPLITS OF THE COMPANY'S COMMON STOCK EFFECTED IN JULY 1997 AND IN JANUARY 1998, RESPECTIVELY.

ITEMS 1 AND 2. BUSINESS AND PROPERTIES.

OVERVIEW

Patterson is one of the leading providers of domestic land drilling services to major and independent oil and natural gas companies. Formed in 1978 and reincorporated in 1993 as a Delaware Corporation, the Company focuses its operations primarily in Texas and southeast New Mexico. The Company currently has a drilling fleet of 119 drilling rigs, 114 of which are currently operable. The Company is also engaged in the development, exploration, acquisition and production of oil and natural gas and, to a lesser extent, provides contract drilling fluid services to other oil and natural gas operators.

CONTRACT DRILLING OPERATIONS. The Company has established a reputation for reliable, high quality drilling equipment and well-trained crews. The Company continually seeks to modify and upgrade its equipment to maximize the performance and capabilities of its drilling rig fleet, which the Company believes provides it with a competitive advantage. Additionally, the Company has the in-house capability to design, manufacture, repair and modify its drilling rigs. Of the Company's drilling rigs, 82 are capable of drilling to depths greater than 10,000 feet, including 11 that are capable of drilling to depths greater than 15,000 feet. During the fiscal year ended December 31, 1998, the Company drilled 1,028 wells for 251 non-affiliated customers maintaining an average utilization rate of 54%.

Over the past five years, the Company's operations have expanded significantly through a series of acquisitions. Since 1993, the Company has increased its contract drilling fleet by 106 drilling rigs. From 1993 (prior to giving effect to the 1996 merger with Tucker Drilling Company, Inc. which was treated as a pooling of interests for financial accounting purposes) to 1998, the Company's consolidated operating revenues increased from \$25.0 million to \$187.0 million, and earnings before interest expense, income taxes, depreciation, depletion and amortization (EBITDA) increased from \$4.3 million to \$36.1 million.

OIL AND NATURAL GAS OPERATIONS. The Company's oil and natural gas activities are designed to complement its land drilling operations and diversify the Company's overall business strategy. These activities are primarily focused in mature producing regions in the Austin Chalk Trend, the Permian Basin and South Texas. Oil and natural gas operations comprised approximately 4% of the Company's consolidated operating revenues for the year ended December 31, 1998. At December 31, 1998, the Company's proved developed reserves were approximately 1.5 million BOE and had a present value (discounted at 10% before income taxes) of estimated future net revenues of approximately \$6.8 million. The industry's significantly reduced

commodity prices, primarily the price of crude oil, have had a negative impact on the valuation of the Company's oil and natural gas reserves. For the year end December 31, 1998, the Company incurred a \$3.8 million impairment charge to its oil and natural gas properties.

The Company's business strategy for its oil and natural gas operations is to increase its oil and natural gas reserves primarily through developmental and exploratory drilling in producing areas. Although Patterson from time to time will participate through a working interest in exploratory drilling, the focus of the Company's drilling activities for the foreseeable future will be exploration and development drilling in the Austin Chalk Trend, the Permian Basin of West Texas and Southeastern New Mexico and in South Texas.

DRILLING FLUID OPERATIONS. In addition, the Company also provides contract drilling fluid services to numerous operators in the oil and natural gas industry. Operating revenues derived from these activities constitute approximately 7% of the Company's consolidated operating revenues. Patterson believes that these contract services integrate well with its other core operating activities. The drilling fluid operations were added by the Company during the current fiscal year with its acquisition of Lone Star Mud, Inc. during January 1998 and Tejas Drilling Fluids, Inc. in September 1998.

The Company's headquarters are located at 4510 Lamesa Highway, Snyder, Texas, and its telephone number at that address is (915) 573-1104. The Company also has small offices in Austin, Houston, Dallas, Midland, San Angelo, Corpus Christi, Texas, and twelve yard facilities variously located in its areas of operations.

BUSINESS STRATEGY

The Company's strategy is to increase cash flow and earnings per share by enhancing its position as a leading domestic land drilling contractor. The principal components of this strategy are as follows:

STRONG INDUSTRY REPUTATION. The Company believes that it has a strong reputation within its existing markets for providing well maintained equipment, high quality service and experienced personnel. The Company intends to build on existing customer relationships in each of its areas of operation by offering technically sophisticated drilling equipment and providing quality service to its customers with an emphasis on efficiency, dependability and safety.

HIGH QUALITY ASSET BASE. The Company's drilling rigs are maintained in good operating condition through an established program of modifications and upgrades. The Company believes that the quality and operating condition of its drilling equipment allow it to maximize utilization rates and pricing.

CONTINUED GROWTH THROUGH ACQUISITION. The Company believes that attractive acquisition opportunities continue to exist to further expand its drilling rig fleet in its core geographic operating areas as well as into other areas. Following an acquisition, the Company refurbishes the drilling rigs to the Company's standards of quality and dependability.

EFFICIENT OPERATIONS. Based on publicly available information, the Company believes that it had one of the most competitive ratios of EBITDA to revenues in the U.S. land drilling industry during 1998. The Company has produced these results from the combination of providing premium contract drilling services and operating under an efficient cost structure. In addition, the Company has achieved cost reductions and efficiencies through acquisition related synergies. The Company uses its fleet of trucks and trailers to rig down, transport and rig up its drilling rigs, which further increases efficiency by reducing the time and costs associated with these ancillary operations.

RECENT ACQUISITIONS

On January 5, 1998, the Company acquired 100% of the outstanding stock of Lone Star Mud, Inc. ("Lone Star"), a privately-owned, non-affiliated company based in Midland, Texas. The purchase price of approximately \$13.0 million consisted of \$1.4 million in cash, 571,328 shares of the Company's common stock valued at \$17.41 per share, the assumption of \$1.6 million of debt and approximately \$3,300 of other direct costs incurred relative to the transaction. Pursuant to certain terms of the Company's existing loan agreement

with Norwest Bank Texas, N.A. ("Norwest"), the outstanding balance of the above mentioned assumed debt was paid in full.

On February 6, 1998, the Company completed the merger of Robertson Onshore Drilling Company ("Robertson") a privately-owned, non-affiliated, contract drilling company based in Dallas, Texas, with and into Patterson Onshore Drilling Company, a wholly-owned subsidiary of Patterson Drilling Company. The purchase price of approximately \$42.2 million was funded using cash on hand of approximately \$3.25 million, proceeds of \$36.75 million provided by the Company's line of credit, the assumption of \$1.8 million of debt and approximately \$444,000 of direct costs incurred related to the acquisition. The assets acquired consisted of 15 operable drilling rigs and a shop and yard located in Liberty City, Texas.

On September 17, 1998, the Company acquired 100% of the outstanding stock of Tejas Drilling Fluids, Inc. ("Tejas"), a privately-owned, non-affiliated company based in Corpus Christi, Texas for \$3.5 million cash and approximately \$74,000 of other direct costs incurred relative to the transaction.

On January 27, 1999, the Company completed the acquisition of five drilling rigs and other related equipment from a non-affiliated entity based in South Texas. The Company's consideration for the acquired assets included 800,000 unregistered shares of the Company's common stock valued at \$4.00 per share and an additional cash payment to be determined one year from the acquisition date. The contingent cash payment will be based on the sales price of the Company's common stock in January 2000. The payment may be as high as \$880,000 or as low as zero.

INDUSTRY SEGMENTS

The Company's revenues, operating profits and identifiable operating assets are primarily attributable to three industry segments: (i) contract drilling, (ii) oil and natural gas exploration, development, acquisition and production and (iii) drilling fluids. The contract drilling segment operated at a profit during each of the years in the three-year period ended December 31, 1998. The oil and natural gas segment operated at a profit for the years ended December 31, 1996 and 1997 and at a loss for the year ended December 31, 1998. The drilling fluids segment generated a profit for the year ended December 31, 1998. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Note 14 of Notes to Consolidated Financial Statements included as a part of Items 7 and 8, respectively, of this Report for financial information pertaining to these industry segments.

CONTRACT DRILLING OPERATIONS

GENERAL. The Company markets its contract drilling services to major oil companies and independent oil and natural gas producers. The Company owns 119 drilling rigs, 114 of which are currently operable. Currently, 99 of the operable drilling rigs are based in Texas (60 in west Texas, 22 in south Texas, 12 in east Texas and five in north Texas), nine are based in southeast New Mexico, five in Mississippi and one in Utah. The drilling rigs have rated maximum depth capabilities ranging from 7,000 feet to 25,000 feet.

The drilling rigs are equipped with engines, drawworks or hoists, derricks or masts, pumps to circulate the drilling fluid (mud), blowout preventers, drill string (pipe) and related equipment. Depth of the well and drill site conditions are the principal factors in determining the size and type of drilling rig used for a particular job. The Company's drilling rigs are utilized for both exploration and development drilling and can be used for either vertical or horizontal drilling.

In order to drill a well, the operator of the well assembles a number of different contractors to provide the necessary services. Included among these contractors are the drilling contractors, such as the Company, as well as other contractors specializing in such matters as logging, completion and, in the case of horizontal wells, specialists in the technical aspects of such drilling.

The Company has achieved its current position as a leading provider of contract drilling services in its areas of operations by providing high quality services to its customers at competitive rates. Although generally of lesser importance than price, the Company believes that the condition of a drilling fleet, the reputation of the contract driller and the quality and experience of the drilling supervisors in the field are of significant

importance to prospective customers. The Company has and will continue to strive to maintain its drilling fleet in good working condition. In addition to normal repair and maintenance expenses, the Company spends significant funds each year on an ongoing program of modifying and upgrading its drilling rigs. The Company also strives to employ experienced and dedicated drilling supervisors for its various drilling rigs in the field. The Company intends to continue its ongoing rig maintenance program and to continue to retain high quality, experienced drilling supervisors in order to build upon its reputation in the market place. In addition, if favorable opportunities arise, the Company may seek to further expand its drilling rig fleet through selected acquisitions.

DRILLING CONTRACTS. Most of the Company's drilling contracts are with established customers and are obtained on a competitive bid basis, although some contracts are obtained on a negotiated basis. Generally, the contracts are entered into for short-term periods and cover the drilling of a single well with the terms and rates varying depending upon the nature and duration of the work, the equipment and services supplied and other matters. The contracts obligate the Company to pay certain operating expenses, including wages of drilling personnel and maintenance expenses and to furnish incidental drilling rig supplies and equipment. The contracts are subject to termination by the customer on short notice, usually upon payment of a fee. The Company generally indemnifies its customers against claims by the Company's employees and claims arising from surface pollution caused by spills of fuel, lubricants and other solvents within the control of the Company. These customers generally indemnify the Company against claims arising from other surface and subsurface pollution, except claims arising from the Company's gross negligence.

The contracts provide for compensation to the Company on a daywork, footage or turnkey basis, or a combination thereof, with rates bid by the Company which are dependent upon the anticipated complexity of drilling the well, the on-site drilling conditions, the type of equipment to be used, the Company's estimate of the risks involved and the estimated duration of the work to be performed, among other considerations. All of the horizontal wells drilled by the Company have been done either on a turnkey or footage basis to the point where the vertical drilling ends and horizontal drilling begins, and on a daywork basis beyond that point.

Under daywork contracts, the Company provides the drilling rig, including the required personnel, to the operator who supervises the drilling of the contracted well. Compensation to the Company is based on a negotiated rate per day that the drilling rig is utilized. Daywork contracts generally specify the type of equipment to be used, the size of the hole and the depth of the proposed well. Under a daywork contract, the Company generally does not incur any costs due to "in hole" losses (such as time delays for various reasons, including stuck drill strings and blow-outs).

Footage contracts usually require the Company to bear some of the drilling costs in addition to providing the drilling rig. Under a footage contract, the Company would normally determine the manner of drilling and type of equipment to be used, subject to certain customer specifications, and also would bear the risk and expense of mechanical malfunctions, equipment shortages and other delays arising from drilling problems. Compensation is based on a rate-per-foot-drilled basis at completion of the well. Prices of both footage and daywork contracts vary depending upon various factors such as the location, depth, duration and complexity of the well to be drilled, operating conditions and other factors peculiar to each proposed well.

Under turnkey contracts, the Company contracts to drill a well to a contract depth under specified conditions and provides most of the equipment and services required. The Company bears the risk of drilling the well to the contract depth and is usually compensated substantially more than on wells drilled on a daywork or footage basis because the Company assumes substantially greater economic risk associated with drilling operations. If severe drilling problems are encountered in drilling wells under turnkey contracts, the Company could sustain substantial losses.

The following table sets forth for each of the periods indicated the approximate percentage of the Company's drilling revenues attributable to daywork, footage and turnkey contracts:

TYPE OF REVENUES	YEAR ENDED DECEMBER 31,		
	1996	1997	1998
Daywork.....	52%	62%	64%
Footage.....	40	35	24
Turnkey.....	8	3	12

Contract drilling operations depend on the availability of drill pipe and bits, fuel and qualified personnel, some of which have been in short supply from time to time. As favorable buying opportunities arise, the Company stockpiles bits and other drilling rig parts.

The Company's ability to drill wells for which it has contracts may be delayed by inclement weather. Sustained periods of inclement weather may have a material adverse effect on the Company's revenues and cash flows.

CONTRACT DRILLING ACTIVITY. The following table sets forth certain information regarding the Company's contract drilling activity for each of the years in the three year period ended December 31, 1998.

	YEAR ENDED DECEMBER 31,		
	1996	1997	1998
Number of wells drilled.....	464	1,115	1,028
Average rigs available for service.....	42	73	106
Average rig utilization rate(1).....	76%	89%	54%

(1) Rig utilization is based on a 365-day year for rigs available for service during the periods indicated. A rig is utilized when it is operating or being moved, assembled or dismantled under contract.

CUSTOMERS. For the year ended December 31, 1998, the Company drilled wells for 251 nonaffiliated customers. This compares with 193 nonaffiliated customers for the year ended December 31, 1997. No single customer accounted for 10% or more of the Company's consolidated operating revenues for the fiscal year ended December 31, 1998. The Company does not believe that the loss of any one customer would have a material adverse effect on the Company's operations.

The Company's customers in the past 12 months have included, among others, Abraxas Production, Apache Corporation, ARCO Permian, Burlington Resources Oil & Gas Company, Chevron U.S.A., Cobra Oil and Gas, Costilla Petroleum, Louis Dreyfuss Natural Gas Company, Enron Oil & Gas Company, Mitchell Energy Corporation, Oryx Energy, Santa Fe Energy and Union Pacific Resources, Co.

As of December 31, 1998 the Company was drilling a total of 17 wells, none of which were being drilled for affiliated parties.

DRILLING RIGS AND RELATED EQUIPMENT. The following table provides certain information concerning the drilling rigs owned by the Company to date:

DEPTH RATING (FT.)	MECHANICAL	DIESEL ELECTRIC
7,000 to 10,000.....	37 (1)	--
10,001 to 15,000.....	64	7
15,001 to 25,000.....	7 (2)	4
Totals.....	108	11

(1) Includes 4 inoperable rigs.

(2) Includes 1 inoperable rig.

The Company owns 101 trucks and 137 trailers. This equipment is used to rig down, transport and rig up the Company's drilling rigs which minimizes the Company's dependency upon third parties for these ancillary services and further enhances the efficiency of the Company's contract drilling operations.

Most repair work and overhaul of the Company's drilling rig equipment is performed at the Company's yard facilities variously located in Texas and New Mexico. The Company believes that its operable drilling rigs and related equipment are in good operating condition. In addition to normal repair and maintenance expenses, the Company historically has spent significant funds for its ongoing program of modifying and upgrading its equipment.

OIL AND NATURAL GAS OPERATIONS

GENERAL. The Company has been engaged in the development, exploration, acquisition and production of oil and natural gas since 1982. The Company's oil and natural gas activities have been designed to complement its land drilling operations and are primarily concentrated in three operating areas of Texas: (i) the Austin Chalk Trend, (ii) the Permian Basin and (iii) South Texas.

The Company's strategy for its oil and natural gas operations is to increase its reserve base primarily through development drilling, as well as selected acquisitions of leasehold acreage and producing properties. At December 31, 1998, the Company was the operator of 130 wells, of which it was the drilling contractor for 122 wells.

OIL AND NATURAL GAS RESERVES. The Company engaged M. Brian Wallace, P.E. Dallas, Texas, an independent petroleum engineer, to estimate the Company's proved developed reserves, projected future production and estimated future net revenues from production of proved developed reserves on its properties as of December 31, 1996, 1997 and 1998. Mr. Wallace's estimates were based upon a review of production histories and other geologic, economic, ownership and engineering data provided by the Company. In determining the estimates of the reserve quantities that are economically recoverable, Mr. Wallace used oil and natural gas prices and estimated average development and production costs provided by the Company.

The following table sets forth information as of the end of each of the years in the three year period ended December 31, 1998 derived from the reserve reports of Mr. Wallace. The present values (discounted at 10% before income taxes) of estimated future net revenues shown in the table are not intended to represent the current market value of the estimated oil and natural gas reserves owned by the Company. For further information concerning the present value of estimated future net revenue from these proved developed reserves, see Note 16 of Notes to Consolidated Financial Statements included as a part of Item 8 of this Report.

	AS OF DECEMBER 31,		
	1996	1997	1998
	----	----	----
	(IN THOUSANDS)		
Proved Developed Reserves:			
Oil (Bbls).....	1,062	945	946
Gas (Mcf).....	7,627	3,788	3,490
Total (BOE).....	2,333	1,576	1,528
Estimated future net revenue before income taxes....	\$25,637	\$15,012	\$9,232
Present value of estimated future net revenues			
before income taxes, discounted at 10%.....	\$17,893	\$11,422	\$6,770

The reserve data set forth above represents only estimates. The estimates are based on various assumptions and, therefore, are inherently imprecise. Actual future production, revenues, taxes, production costs and development costs may vary substantially from those assumed in the estimates. Any significant variance could materially affect the estimates set forth in this Form 10-K. In addition, the reserve data may be subject to upward or downward revisions depending upon, among other factors, production history and prevailing oil and natural gas prices. Oil and natural gas prices have fluctuated widely in recent years. There is no assurance that prices will be higher or lower than prices used in estimating the Company's reserves.

PRODUCTION. The Company's wells in the Austin Chalk Trend and South Texas primarily produce natural gas and in the Permian Basin primarily produce oil. The following table sets forth the Company's net oil and natural gas production, average sales price and average production (lifting) costs associated with such production during the periods indicated.

	YEAR ENDED DECEMBER 31,		
	1996	1997	1998
Average net daily production:			
Oil (Bbls).....	641	1,159	835
Gas (Mcf).....	4,586	4,024	2,742
Total (BOE).....	1,406	1,830	1,292
Average sales prices:			
Oil (per Bbl).....	\$20.99	\$17.86	\$12.16
Gas (per Mcf).....	2.01	2.19	1.93
Average production (lifting) costs (per BOE).....	\$ 3.91	\$ 3.41	\$ 4.08

PRODUCTIVE WELLS. The following table sets forth information regarding the number of productive wells in which the Company held a working interest as of December 31, 1998. One or more completions in the same well bore are counted as one well.

	PRODUCTIVE WELLS	
	GROSS	NET
Oil.....	185	56.56
Gas.....	56	4.73
Total.....	241	61.29

DEVELOPED AND UNDEVELOPED ACREAGE. The following table sets forth the developed and undeveloped acreage in which the Company owned a working or leasehold interest as of December 31, 1998:

LOCATION	DEVELOPED		UNDEVELOPED	
	GROSS	NET	GROSS	NET
Austin Chalk Trend and South Texas.....	34,118	6,260	89,330	22,459
Permian Basin.....	24,275	3,150	37,390	7,994
Total.....	58,393	9,410	126,720	30,453

Many of the leases summarized in the table above as undeveloped acreage will expire at the end of their respective primary terms unless production has been obtained from the acreage subject to the lease prior to that date, in which event the lease will remain in effect until the cessation of production. The following table sets forth the gross and net acres subject to leases summarized in the table of undeveloped acreage that will expire.

	LEASE ACRES EXPIRING	
	GROSS	NET
PERIOD ENDING:		
December 31, 1999.....	35,397	6,767
December 31, 2000.....	40,485	8,901
December 31, 2001 and later.....	50,838	14,785
Total.....	126,720	30,453

DRILLING ACTIVITIES. The following table set forth the results of the Company's participation in the drilling of development and exploratory wells during each of the years ended December 31, 1996, 1997 and 1998.

YEAR ENDED DECEMBER 31, -----	DEVELOPMENT WELLS				EXPLORATORY WELLS			
	PRODUCTIVE		DRY HOLES		PRODUCTIVE		DRY HOLES	
	GROSS	NET	GROSS	NET	GROSS	NET	GROSS	NET
1996.....	29	4.35	16	3.87	1	.16	6	1.00
1997.....	24	5.44	8	1.53	7	1.13	15	3.06
1998.....	23	4.45	6	1.74	3	.55	13	2.16
Total.....	76	14.24	30	7.14	11	1.84	34	6.22
	==	=====	==	=====	==	=====	==	=====

MARKETING OF CRUDE OIL AND NATURAL GAS. Crude oil is sold based upon 30-day automatically renewable contracts with oil purchasers. Prices vary as world oil prices fluctuate. Due to competitive conditions, the Company does not believe that the loss of any one of its major crude oil purchasers would have a material adverse effect on its business. The Company markets oil produced from Company operated wells through a wholly-owned subsidiary. A company owned in part by the son of Cloyce A. Talbott, the Company's Chairman and Chief Executive Officer, is a first purchaser of substantially all of the oil produced from Company-operated leases. See Note 18 of Notes to Consolidated Financial Statements included as a part of Item 8 of this Report.

Most of the Company's natural gas is sold through third-party natural gas brokers at spot market prices and is transported to market by interstate pipelines. Contracts with these brokers are currently for less than five years and allow for prices to adjust to the marketplace. The Company believes that because of the competitive nature of the industry today, the loss of any one of its natural gas purchasers would not have a material adverse effect on its business. While the Company has not experienced any inability to market its natural gas, if transportation space in the pipelines is restricted or is unavailable, the Company's cash flow could be adversely affected.

No customer for oil and natural gas accounted for more than 10% of the Company's consolidated revenues for the year ended December 31, 1998.

TITLE TO OIL AND NATURAL GAS PROPERTIES. Title to the Company's oil and natural gas properties is subject to royalty, overriding royalty, carried working, and other similar interests and cost sharing arrangements customary in the oil and natural gas industry (including farmout agreements, operating agreements and joint venture arrangements), liens for current taxes not yet due, and to other minor defects and encumbrances. The Company believes that such burdens do not materially detract from the value of such properties or from the Company's interest therein or materially interfere with the operation of the Company's business.

As is customary in the oil and natural gas industry in the case of undeveloped properties, an in-house title review is made prior to or at the time of acquisition. More comprehensive title investigations, including in most cases receipt of a title opinion of legal counsel, are generally made before commencement of drilling operations on undeveloped properties and also are generally made before consummation of an acquisition of developed properties.

COMPETITION

CONTRACT DRILLING OPERATIONS. The contract drilling industry is highly competitive. Price is generally the most important competitive factor in the drilling industry. Other competitive factors include the availability of drilling equipment and experienced personnel at or near the time and place required by customers, the reputation of the drilling contractor in the drilling industry and its relationship with existing customers. The Company believes that it competes favorably with respect to all of these factors. Competition is usually on a regional basis, although drilling rigs are mobile and can be moved from one region to another in response to increased demand. An oversupply of drilling rigs in any region may result. Demand for land drilling equipment is also dependent on the exploration and development programs of oil and natural gas companies, which are in

turn influenced primarily by the financial condition of such companies, by general economic conditions, by prices of oil and natural gas and, from time to time, by political considerations and policies.

It is impracticable to estimate the number of contract drilling competitors of the Company, some of which have substantially greater resources and longer operating histories than the Company. Also, in recent years, many drilling companies have consolidated or merged with other companies. Although this consolidation has decreased the total number of competitors, management of the Company believes that competition for drilling contracts will continue to be intense for the foreseeable future.

OIL AND NATURAL GAS OPERATIONS. There is substantial competition for the acquisition of oil and natural gas leases suitable for exploration and for the hiring of experienced personnel. The Company's competitors in oil and natural gas exploration, development and production include major integrated oil and natural gas companies, numerous independent oil and natural gas companies, drilling and production purchase programs and individual producers and operators. The ability of the Company to increase its holdings of oil and natural gas reserves in the future is directly dependent upon the Company's ability to select, acquire and develop suitable prospects in competition with these companies. Many competitors have financial resources, staffs, facilities and other resources significantly greater than those of the Company.

GOVERNMENT REGULATION AND ENVIRONMENTAL

The domestic drilling of oil and natural gas wells is subject to numerous state and federal laws, rules and regulations. State statutory provisions relating to oil and natural gas generally include requirements as to well spacing, waste prevention, production limitations, disposal of produced waters, pollution prevention and clean-up, obtaining drilling permits and similar matters. Within the state of Texas, where substantially all of the Company's operations are currently conducted, these regulations are principally enforced by the Texas Railroad Commission. To date, the Company has not been required to expend significant resources in order to satisfy applicable environmental laws and regulations. The Company does not anticipate any material capital expenditures for environmental control facilities or extraordinary expenditures associated with compliance with environmental rules and regulations in the foreseeable future. However, compliance costs under existing laws or under any new requirements could become material and the Company could incur liability for noncompliance. The Company has not been fined or incurred liability for noncompliance, pollution or other environmental damage in connection with its operations and is not currently aware of any environmental hazards which would materially affect its operations.

The contract drilling industry is dependent on demand for services from the oil and natural gas exploration industry and, accordingly, is affected by changing tax laws, price controls and other laws relating to the energy business generally. The Company's business is affected generally by political developments and by federal, state, foreign and local laws and regulations, which relate to the oil and natural gas industry. The adoption of laws and regulations affecting the oil and natural gas industry for economic, environmental and other policy reasons could increase costs relating to drilling and production, which could have an adverse effect on the Company's operations. Several state and federal environmental laws and regulations currently apply to the Company's operations and may become more stringent in the future. Although the Company has utilized operating and disposal practices that were or are currently standard in the industry, hydrocarbons and other materials may have been disposed of or released in or under properties currently or formerly owned or operated by the Company or its predecessors in interest. In addition, some of these properties have been operated by third parties over whom the Company has no control as to such entities' treatment of hydrocarbon and other materials in the manner in which such materials may have been disposed of or released. The federal Comprehensive Environmental Response Compensation and Liability Act of 1980, as amended by the Superfund Amendments and Reauthorization Act of 1986 (collectively, "CERCLA"), and comparable state statutes impose strict liability on owners and operators of sites and on persons who disposed of or arranged for the disposal of "hazardous substances" found at sites. The federal Resource Conservation and Recover Act ("RCRA") and comparable state statutes govern the disposal of "hazardous wastes." Although CERCLA currently excludes petroleum from the definition of "hazardous substances," and RCRA also excludes certain classes of exploration and production wastes from regulation, such exemptions by Congress under both CERCLA and RCRA may be deleted, limited or modified in the future. If such changes are made to

CERCLA and/or RCRA, the Company could be required to remove and remediate previously disposed of materials (including materials disposed of or released by prior owners or operators) from properties (including ground water contaminated with hydrocarbons) and to perform removal or remedial actions to prevent future contamination.

The Federal Water Pollution Control Act ("FWPCA") and the Oil Pollution Act of 1990 ("OPA") and implementing regulations govern the prevention of discharges, including oil and produced water spills, and liability for damages into waters. The OPA is more comprehensive and stringent than previous oil pollution liability and prevention laws and imposes strict liability for a comprehensive and expansive list of damages from an oil spill into waters from facilities. Liability may be imposed for oil removal costs and a variety of public and private damages. Penalties may also be imposed for violation of federal safety, construction and operating regulations, and for failure to report a spill or to cooperate fully in a clean-up. The OPA also expands the authority and capability of the federal government to direct and manage oil spill clean-up and operations, plus requires operators to prepare oil spill response plans in cases where it can reasonably be expected that substantial harm will be done to the environment by discharges on or into navigable waters. The Company has spill protection control countermeasure (SPCC) plans in place for its oil and natural gas properties in each of the areas in which it operates. Failure to comply with ongoing requirements or inadequate cooperation during a spill event may subject a responsible party to civil or criminal actions. Although the liability for owners and operators is the same under the FWPCA, the damages recoverable under the OPA are potentially much greater and can include natural resource damages.

The operations of the Company are also subject to federal, state and local regulations for the control of air emissions. The federal Clean Air Act ("CAA"), as amended, and various state and local laws impose certain air quality requirements on the Company. Amendments to the CAA revised the definition of "major source" such that emissions from both wellhead and associated equipment involved in oil and gas production may be added to determine if a source is a "major source." As a consequence, more facilities may become major sources and thus would be required to obtain operating permits. This permitting process may require capital expenditures in order to comply with permit limits.

RISKS AND INSURANCE

The Company's operations are subject to the many hazards inherent in the drilling business, including blow-outs, cratering, fires and explosions. These hazards could cause personal injury or death, suspend drilling operations or seriously damage or destroy the equipment involved and, in addition to environmental damage, could cause substantial damage to producing formations and surrounding areas. Damage to the environment, including property contamination in the form of either soil or ground water contamination, could also result from the Company's operations, particularly through oil or produced water spillage, natural gas leaks and extensive, uncontrolled fires. In addition, the Company could become subject to liability for reservoir damages. The occurrence of a significant event, including pollution or environmental damages, could materially affect the Company's operations and financial condition. As a protection against operating hazards, the Company maintains insurance coverage considered by the Company to be adequate, including all-risk physical damages, employer's liability, commercial general liability and workers compensation insurance. The Company currently has general liability insurance of \$2.0 million per occurrence with an aggregate of \$2.0 million and excess liability and umbrella coverage's of up to \$50.0 million per occurrence with a \$50.0 million aggregate. The Company's customers generally require the Company to have at least \$1.0 million of third party liability coverage. Since April 1, 1992, the Company has carried workers' compensation insurance, with a deductible of \$100,000 per occurrence. If multiple workers' compensation claims are filed, the Company could incur significant expenses, which in turn could have a material adverse impact on its financial condition and operations.

The Company believes that it is adequately insured for public liability and property damage to others with respect to its operations. However, such insurance may not be sufficient to protect the Company against liability for all consequences of well disasters, extensive fire damage or damage to the environment. The Company also carries insurance to cover physical damage to or loss of its drilling rigs; however, it does not carry insurance against loss of earnings resulting from such damage or loss. In view of the difficulties that may

be encountered in renewing such insurance at reasonable rates, no assurance can be given that the Company will be able to maintain the type and amount of coverage that it considers adequate at reasonable rates or that any particular types of coverage will be available.

EMPLOYEES

The Company employed approximately 1,202 full-time persons (83 office personnel and 1,119 field personnel) at December 31, 1998. The number of drilling rig employees will fluctuate depending upon the number of operable drilling rigs and the demand for contract drilling services. The Company considers its employee relations to be satisfactory. None of the Company's employees are represented by a union.

ITEM 3. LEGAL PROCEEDINGS.

The Company is party to various legal proceedings arising in the normal course of its business. Management of the Company does not believe that the outcome of these proceedings will have a material adverse effect on the financial condition of the Company.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

None.

CAUTIONARY STATEMENT FOR PURPOSES OF THE "SAFE HARBOR"
PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

The Company is including the following cautionary statement to take advantage of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995 for any forward-looking statement made by, or on behalf of, the Company. The factors identified in this cautionary statement are important factors (but not necessarily all of the important factors) that could cause actual results to differ materially from those expressed in any forward-looking statement made by, or on behalf of, the Company. Where any such forward-looking statement includes a statement of the assumptions or bases underlying such forward-looking statement, the Company cautions that, while it believes such assumptions or bases to be reasonable and makes them in good faith, assumed facts or bases almost always vary from actual results, and the differences between assumed facts or bases and actual results can be material, depending upon the circumstances. Where, in any forward-looking statement, the Company, or its management, expresses an expectation or belief as to the future results, such expectation or belief is expressed in good faith and believed to have a reasonable basis, but there can be no assurance that the statement of expectation or belief will result, or be achieved or accomplished. Taking into account the foregoing, the following are identified as important risk factors that could cause actual results to differ materially from those expressed in any forward-looking statement made by, or on behalf of, the Company:

VOLATILITY OF OIL AND NATURAL GAS PRICES. The Company's revenue, profitability and future rate of growth are substantially dependent upon prevailing prices for oil and natural gas. In recent years, oil and natural gas prices and, therefore, the level of drilling, exploration, development and production, have been extremely volatile. Prices are affected by market supply and demand factors as well as actions of state and local agencies, the U.S. and foreign governments and international cartels. All of these factors are beyond the control of the Company. Any significant or extended decline in oil and/or natural gas prices will have a material adverse effect on the Company's financial condition and operations and could impair access to sources of capital. The price of oil rose to a six-year high of \$25.75 per barrel in January 1997, and fell to a low since then of \$8.60 per barrel in December 1998. These low level oil prices have materially adversely impacted the Company's operations. See "Market Conditions for Contract Drilling Services," below. Should oil prices remain at these levels or continue to decline or natural gas prices decline, the Company's operations would be further adversely affected.

MARKET CONDITIONS FOR CONTRACT DRILLING SERVICES. The contract drilling business experienced increased demand for drilling services from 1995 through the third quarter of 1997 due to stronger oil and natural gas prices. However, except for that period and other occasional upturns, the market for onshore contract drilling services has generally been depressed since mid-1982. Since this time and except during the occasional upturns, there have been substantially more drilling rigs available than necessary to meet demand in most operating and geographic segments of the domestic drilling industry. As a result, drilling contractors have had difficulty sustaining profit margins. In addition to adverse effects that future declines in demand could have on the Company, ongoing movement or reactivation of onshore drilling rigs or new construction of drilling rigs could adversely affect rig utilization rates and pricing, even in an environment of stronger oil and natural gas prices and increased drilling activity. The Company cannot predict either the future level of demand for its contract drilling services or future conditions in the contract drilling industry. The Company's rig utilization rate reached an all time high of approximately 91.5% in the third quarter of 1997 and fell to a low since then of 29% during December 1998 due to low oil prices.

SUBSTANTIAL BANK DEBT -- IMPACT OF DEPRESSED OIL AND NATURAL GAS PRICES ON ABILITY TO MAKE LOAN PAYMENTS AND TO SATISFY LOAN COVENANTS. The Company has a bank term loan with a remaining principal balance of \$55.7 million at December 31, 1998. All of the Company's contract drilling rigs and all of its oil and natural gas properties are pledged as collateral on the loan and the remainder of its assets are subject to a negative pledge. The loan is payable in monthly principal installments of \$714,286 until January 1, 2001, when the loan matures and the then remaining principal balance and accrued interest becomes due and payable. The loan agreement contains a number of covenants including financial covenants, the failure of which to satisfy could at the bank's election cause acceleration of the maturity date of the loan and require immediate

repayment. At December 31, 1998, the Company was in violation of one of the loan covenants which required positive net income. The bank waived the breach of this covenant and agreed to replace the covenant with an earnings before interest expense, income taxes, depreciation, depletion and amortization to interest expense covenant. Failure of the Company to meet this amended covenant or any of the other covenants could at the bank's election cause the maturity date of the loan to be accelerated and become immediately due and payable. Failure of the Company to pay the loan principal and interest could result in foreclosure on the drilling rigs and oil and natural gas properties. The Company believes it has sufficient working capital to pay monthly principal and interest payments under the loan for at least the next 12 months without improvement in commodity prices. The ability to meet the various loan covenants without improvement in commodity prices could be more difficult.

FLUCTUATIONS IN SHORTAGES OF DRILL PIPE IN THE CONTRACT DRILLING INDUSTRY. The increase in domestic drilling demand from mid-1995 through the third quarter of 1997 and related increase in contract drilling activity resulted in a shortage of drill pipe in the industry. This shortage caused the price of drill pipe to increase significantly and required that orders for new drill pipe be placed one year in advance. A return to higher demand levels for contract drilling services could reinstate the problems associated with drill pipe shortages.

RECENT RAPID GROWTH; ASSOCIATED RISKS. The Company has experienced rapid and substantial growth over the past four years and, if favorable opportunities arise in the future, intends to further expand its drilling fleet through selected acquisitions. Continued growth could strain the Company's management, operations, employees and resources. There can be no assurance that the Company will be able to manage growth effectively or that it will be successful in maintaining the market share attributable to operable drilling rigs acquired by the Company. If the Company is unable to manage its growth, its business, results of operations or financial condition could be materially adversely affected.

NO ASSURANCE OF ADDITIONAL GROWTH THROUGH ACQUISITIONS. The Company's growth has been enhanced materially by strategic acquisitions that have substantially increased the Company's drilling rig fleet. Although the land drilling industry has experienced significant consolidation over the past couple of years, the Company believes that significant acquisition opportunities are still available. However, there can be no assurance that suitable acquisition candidates can be found, and the Company is likely to continue to face competition from other companies for available acquisition opportunities. In addition, if the prices paid by buyers of drilling rigs remain at current levels or continue to rise, the Company may find fewer acceptable acquisition opportunities. There can be no assurance that the Company will have sufficient capital resources to complete acquisitions, that acquisitions can be completed on terms acceptable to the Company or that any completed acquisition would improve the Company's financial condition, results of operations, business or prospects in any material manner.

FLUCTUATIONS IN AVAILABILITY OF QUALIFIED DRILLING RIG PERSONNEL. The increase in domestic drilling demand from mid-1995 through the third quarter of 1997 and related increase in contract drilling activity resulted in a shortage of qualified drilling rig personnel in the industry. This increase adversely impaired the Company's ability to attract and retain sufficient qualified personnel and to market and operate its drilling rigs. Further, the labor shortages resulted in wage increases, which impacted the Company's operating margins. A return to higher demand levels for contract drilling services could reinstate the problems associated with labor shortages.

RELIANCE ON KEY PERSONNEL. The Company is highly dependent upon its executive officers and key employees. The unexpected loss of the services of any of these individuals, particularly Cloyce A. Talbott or A. Glenn Patterson, the Chief Executive Officer and the President of the Company, respectively, could have a detrimental effect on the Company. The Company has no employment agreements with any of its executive officers. The Company maintains key man insurance on the lives of Messrs. Talbott and Patterson in the amount of \$3 million each.

COMPETITION. The Company encounters intense competition in its contract drilling operations from other drilling contractors. The competitive environment for contract drilling services involves such factors as drilling rates, availability and condition of drilling rigs and equipment, reputation and customer relations. Many of the

competitors in each of the Company's lines of business have substantially greater financial and other resources than the Company.

OPERATING HAZARDS AND UNINSURED RISKS. Contract drilling and oil and natural gas activities are subject to a number of risks and hazards which could cause serious injury or death to persons, suspension of drilling operations and serious damage to equipment or property of others and, in addition to environmental damage, could cause substantial damage to producing formations and surrounding areas. Damages to the environment could result from the Company's operations, particularly through oil spills, gas leaks, discharges of toxic gases or extensive uncontrolled fires. In addition, the Company could become subject to liability for reservoir damages. The occurrence of a significant event, including pollution or environmental damage, could materially affect the Company's operations and financial condition. Although the Company believes that it is adequately insured against normal and foreseeable risks in its operations in accordance with industry standards, such insurance may not be adequate to protect the Company against liability from all consequences of well disasters, extensive fire damage or damage to the environment. No assurance can be given that the Company will be able to maintain adequate insurance in the future at rates it considers reasonable or that any particular types of coverage will be available. Furthermore, a portion of the Company's contract drilling is done on a turnkey basis, which involves substantial economic risks. Under turnkey drilling contracts, the Company contracts to drill a well to a contract depth under specified conditions for a fixed price. The risks to the Company under this type of drilling contract are substantially greater than on a well drilled on a daywork or footage basis since the Company assumes most of the risks associated with the drilling operations generally assumed by the operator of the well in a daywork or footage contract, including risk of blowout, machinery breakdowns and abnormal drilling conditions. Accordingly, if severe drilling problems are encountered in drilling wells under a turnkey contract, the Company could suffer substantial losses associated with that contract. For the years ended December 31, 1997 and 1998, the percentage of the Company's contract drilling revenues attributable to turnkey contracts was 3.0% and 12.0%, respectively.

ENVIRONMENTAL AND OTHER GOVERNMENTAL REGULATION MATTERS. The Company's operations are subject to numerous domestic laws and regulations that relate directly or indirectly to the drilling of oil and natural gas wells, including laws and regulations controlling the discharge of materials into the environment, requiring removal and cleanup under certain circumstances or otherwise relating to the protection of the environment. Laws and regulations protecting the environment have generally become more stringent in recent years, and may in certain circumstances impose strict liability, rendering a person liable for environmental damage without regard to negligence or fault on the part of such person. To date, the Company has not been required to expend significant resources in order to comply with applicable environmental laws and regulations nor has it incurred any fines or penalties for noncompliance. However, compliance costs under existing legal requirements and under any new requirements could become material, and the Company could incur liability in the future for noncompliance. Additional matters subject to governmental regulation include discharge permits for drilling operations, performance bonds, reports concerning operations, spacing of wells, unitization and pooling of properties, disposal of produced water and taxation. From time to time, regulatory agencies have imposed price controls and limitations on production by restricting the rate of flow of oil and natural gas wells below actual production capacity in order to conserve supplies of oil and natural gas.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

The Company's common stock, par value \$0.01 per share is publicly traded on the Nasdaq National Market and is quoted under the symbol "PTEN."

The following table sets forth the high and low sales prices of the Company's common stock for the periods indicated:

	HIGH ----	LOW ---
1997:		
First quarter.....	\$ 8.75	\$5.50
Second quarter.....	11.69	6.63
Third quarter.....	26.56	11.13
Fourth quarter.....	32.63	14.38
1998:		
First quarter.....	\$20.00	\$8.88
Second quarter.....	15.63	9.25
Third quarter.....	10.06	4.06
Fourth quarter.....	7.00	3.44

As of March 22, 1999, there were approximately 408 holders of record (approximately 18,000 beneficial holders) of the Company's common stock.

The Company has not declared or paid cash dividends on its common stock in the past and does not expect to declare or pay any cash dividends on its common stock in the foreseeable future. The Company instead intends to retain its earnings to support the operations and growth of its business. Any future cash dividends would depend on future earnings, capital requirements, the Company's financial condition and other factors deemed relevant by the Board of Directors.

The following subparagraph sets forth information concerning equity securities sold by the Company during 1998 but not registered under the Securities Act of 1993, as amended (the "Act"):

During January 1998, the Company issued a total of 571,328 shares of its Common Stock valued at \$17.41 per share as partial consideration for the acquisition of 100% of the outstanding stock of Lone Star Mud, Inc. See Items 1 and 2, "Business and Properties -- Recent Acquisitions," for additional information. No underwriter was involved in the transaction and no sales commissions, fees or similar compensation were paid to any person in connection with the issuance of the shares. The Company believes that the issuance of the shares was exempt from the registration requirements of Section 5 of the Act by virtue of Rule 506 under Regulation D of the Act.

ITEM 6. SELECTED FINANCIAL DATA.

The selected consolidated financial data of the Company as of December 31, 1994, 1995, 1996, 1997 and 1998 and for each of the five years then ended were derived from the consolidated financial statements of the Company which have been audited by PricewaterhouseCoopers LLP, independent accountants. This financial data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Consolidated Financial Statements and related Notes thereto, included as Items 7 and 8, respectively, of this Report.

	YEAR ENDED DECEMBER 31,				
	1994	1995	1996	1997	1998
	(IN THOUSANDS, EXCEPT PER SHARE DATA) (UNAUDITED)				
INCOME STATEMENT DATA:					
Operating revenues:					
Drilling.....	\$54,823	\$57,599	\$73,590	\$178,332	\$165,997
Oil and natural gas.....	4,707	6,845	10,118	12,445	7,170
Drilling fluids.....	--	--	--	--	13,397
Total.....	59,530	64,444	83,708	190,777	186,564
Operating costs and expenses:					
Drilling.....	43,036	46,505	59,564	128,416	128,838
Oil and natural gas.....	2,654	2,669	3,465	4,402	3,676
Drilling fluids.....	--	--	--	--	10,205
Impairment of oil and natural gas properties.....	--	159	549	355	3,816
Depreciation, depletion and amortization.....	4,912	7,523	9,960	17,497	28,091
General and administrative.....	4,793	5,063	5,416	6,786	9,313
Total.....	55,395	61,919	78,954	157,456	183,939
Operating income.....	4,135	2,525	4,754	33,321	2,625
Other income (expense).....	679	(111)	(2,737)	1,787	(2,857)
Income (loss) before income taxes.....	4,814	2,414	2,017	35,108	(232)
Income tax expense (benefit).....	(193)	(787)	(2,254)	12,866	93
Net income (loss).....	\$ 5,007	\$ 3,201	\$ 4,271	\$ 22,242	\$ (325)
Net income (loss) per common share:					
Basic.....	\$ 0.31	\$ 0.18	\$ 0.22	\$ 0.78	\$ (0.01)
Diluted.....	\$ 0.31	\$ 0.18	\$ 0.21	\$ 0.75	\$ (0.01)
Weighted average number of common shares outstanding:					
Basic.....	16,120	17,517	19,167	28,492	31,645
Diluted.....	16,120	18,082	20,086	29,505	31,645

BALANCE SHEET DATA:

Total assets.....	\$49,509	\$62,991	\$87,913	\$203,200	\$236,605
Notes payable.....	6,886	13,816	25,849	23,250	55,714
Stockholders' equity.....	30,310	37,656	43,482	146,932	156,852

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

This Item 7 contains forward-looking statements, which are made pursuant to the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. These statements include, without limitation, statements relating to liquidity, financing of operations, continued volatility of oil and natural gas prices, source and sufficiency of funds required for capital needs and additional rig acquisitions (if further opportunities arise), future utilization of net operating loss carryforwards, impact of inflation on the

Company's financial position and on the Company's earnings per share, and other such matters. The words "believes," "budgeted," "expects" or "estimates" and similar expressions identify forward-looking statements. The Company does not undertake to update, revise or correct any of the forward-looking information. Readers are cautioned that such forward-looking statements should be read in conjunction with the Company's disclosures under the heading: "Cautionary Statement for Purposes of the 'Safe Harbor' Provisions of the Private Securities Litigation Reform Act of 1995" beginning on page 13.

LIQUIDITY AND CAPITAL RESOURCES

As of December 31, 1998, the Company had working capital of approximately \$31.0 million and cash and cash equivalents of approximately \$9.0 million as compared to working capital of approximately \$46.5 million and cash and cash equivalents of approximately \$23.3 million as of December 31, 1997. The decrease in the Company's working capital at December 31, 1998 was largely attributable to cash expended by the Company related to acquisitions completed during fiscal year 1998. Approximately \$8.7 million of the aggregate \$58.8 million purchase price for the related acquisitions was funded using cash on hand at the respective dates of acquisition. In addition, the Company assumed approximately \$3.4 million of debt, which was paid in full using cash on hand immediately following the consummation of such acquisitions and made an \$8.0 million payment to the Internal Revenue Service for the Company's estimated Federal tax liability. For the year ended December 31, 1998, the Company generated net cash from operations of approximately \$30.0 million, received proceeds of approximately \$299,000 from the exercise of stock options, sold property and equipment for proceeds of approximately \$1.4 million, received approximately \$566,000 from the sale of investment securities and borrowed \$40.2 million under a then existing credit facility. These funds were used primarily to acquire drilling rigs, related equipment and associated intangible assets of approximately \$45.5 million, to provide certain necessary refurbishment of approximately \$26.4 million to the Company's operable drilling fleet, to reduce certain notes payable by approximately \$7.7 million and to fund leasehold acquisition, exploration and development of approximately \$7.7 million.

On January 5, 1998, the Company completed the acquisition of Lone Star Mud, Inc. ("Lone Star"), a privately-owned, non-affiliated company based in Midland, Texas for a purchase price of approximately \$13.0 million consisting of \$1.4 million in cash, 571,328 shares of the Company's common stock valued at \$17.41 per share, which was the market price on the acquisition date, the assumption of \$1.6 million of debt and approximately \$3,300 of direct costs incurred related to the acquisition. Lone Star is a provider of drilling fluids to the oil and natural gas industry. Management of the Company viewed the acquisition as an opportunity to enter into a related segment of the oilfield service industry, which would integrate well with the Company's existing operations.

On February 6, 1998, the Company completed its merger with Robertson Onshore Drilling Company ("Robertson"), a privately-owned, non-affiliated contract drilling company based in Dallas, Texas. The purchase price of \$42.2 million consisted of \$3.25 million in cash, \$36.75 million provided by the Company's line of credit, the assumption of \$1.8 million of debt and approximately \$444,000 of direct costs incurred related to the acquisition. As a result of the merger, the Company acquired 15 operable drilling rigs, increasing the Company's rig fleet to 114 drilling rigs, and a shop and yard located in Liberty City, Texas.

On September 17, 1998, the Company completed the acquisition of Tejas Drilling Fluids, Inc. ("Tejas"), a privately-owned, non-affiliated company based in Corpus Christi, Texas for a purchase price of approximately \$3.5 million cash and approximately \$74,000 of direct costs incurred related to the acquisition. Tejas is a provider of drilling fluids to the oil and natural gas industry with its primary focus of operations in the south Texas region.

At May 31, 1998, the Company's existing \$70.0 million line of credit with Norwest Bank Texas, N.A. ("Norwest") converted to a term note with a maturity date of January 1, 2001 with a seven-year, level-principal amortization. The note bears interest at the 30-day LIBOR rate plus 2.375%. At the time of conversion, the Company had drawn \$60.0 million under the available credit facility. The Company is currently making monthly principal and interest payments of approximately \$1.1 million as required by the underlying agreement until its maturity at January 1, 2001.

At December 31, 1998, the Company was in violation of the positive net income covenant provision of such credit agreement. The Company obtained a waiver of such violation from Norwest as of December 31, 1998. In addition, the credit agreement was further amended to replace the positive net income covenant with an earnings before interest expense, income taxes, depreciation, depletion and amortization (EBITDA) to quarterly interest expense provision. The Company must maintain on a quarterly basis an EBITDA to interest expense of at least 2.25 to 1.0. Although there can be no assurances, management does not anticipate a future violation of such covenant.

Management believes that the current level of cash and short-term investments, together with cash generated from operations should be sufficient to meet the Company's immediate capital needs. From time to time, the Company reviews acquisition opportunities relating to its business. The timing, size or success of any acquisition and the associated capital commitments are unpredictable. Should further opportunities for growth requiring capital arise, the Company believes it would be able to satisfy these needs through a combination of working capital, cash from operations, and either debt or equity financing. However, there can be no assurance that such capital would be available.

RESULTS OF OPERATIONS

COMPARISON OF THE YEARS ENDED DECEMBER 31, 1998 AND 1997

For the year ended December 31, 1998, contract drilling revenues were approximately \$166.0 million as compared to \$178.3 million for the same period in 1997, a decrease of approximately 7%. Average rig utilization was 54% on an average of 106 rigs available for service for the year ended December 31, 1998 as compared to 89% on an average of 73 rigs available for service for the twelve months ended December 31, 1997. Direct drilling costs were \$128.8 million or 78% of drilling revenues for the year ended December 31, 1998, while direct drilling costs were \$128.4 million or 72% of related drilling revenues for 1997. General and administrative expense for the contract drilling operations was approximately \$6.1 million for the year ended December 31, 1998 as compared to approximately \$5.4 million in 1997. The increase in general and administrative expense was largely attributable to additional expense associated with the administrative offices of Lone Star Mud Company and Robertson Onshore Drilling Company acquired by the Company during January and February 1998, respectively. The administrative responsibilities of the Robertson Onshore operations were terminated during July 1998 and absorbed by the Company's personnel in Snyder, Texas. Depreciation and amortization expense for the contract drilling segment increased from \$12.5 million for the year ended December 31, 1997 to approximately \$22.4 million for the same twelve-month period in 1998. The increase in depreciation and amortization expense was largely attributable to the increased number of drilling rigs added by acquisitions completed during fiscal years 1997 and 1998. For the twelve months ended December 31, 1998, operating income from the Company's contract drilling operations was approximately \$9.3 million as compared to approximately \$32.7 million in 1997. The decreased profitability was largely attributable to the 35% decrease in the Company's rig utilization rates, a change in drilling contracts which required the Company to bear certain costs in associated with drilling wells that in 1997 was paid by the Company's customers, and, to a lesser extent, moderate decrease during 1998 by the Company in its daily drilling rates. These three factors are reflective of the detrimental impact the industry's weakened commodity prices had on the Company's operations.

Oil and natural gas sales revenues were approximately \$5.6 million for the year ended December 31, 1998, as compared to approximately \$10.8 million in 1997. The volume of oil and natural gas sold by the Company decreased by approximately 29% in 1998, as compared to fiscal year 1997. The average price per Bbl of crude oil received by the Company was \$12.16 in 1998, as compared to \$17.86 in 1997, and the average price per Mcf of natural gas was \$1.93 in 1998, as compared to \$2.19 in 1997. Lease operating and production costs were \$4.08 per BOE in 1998, as compared to \$3.41 per BOE in 1997. General and administrative expense for the oil and natural gas segment was approximately \$1.3 million and \$1.4 million for the years ended December 31, 1998 and 1997, respectively. Exploration costs increased moderately by approximately 3% to \$669,000 for the year ended December 31, 1998. Depreciation and depletion expense was approximately \$4.8 million in 1998, as compared to approximately \$5.0 million in 1997. During 1998, primarily as a result of the industry's significantly reduced commodity prices, the Company impaired certain of its oil and natural gas

properties by \$3.8 million. The Company incurred impairment expense of approximately \$355,000 in 1997. Other revenues generated by the oil and natural gas segment, consisting primarily of fees generated from lease operating activities, were approximately \$1.5 million and \$1.6 million for the years ended December 31, 1998 and 1997, respectively. For the year ended December 31, 1998, the oil and natural gas segment generated a loss from operations of approximately \$6.2 million as compared to income of approximately \$2.4 million for the year ended December 31, 1997. The decrease in the segment's operating results was primarily attributable to the decrease in the underlying commodity prices, particularly the 32% decrease in the price received for crude oil, as discussed above.

Although the contract drilling and oil and natural gas segments represent the Company's core operations, the Company derived operating revenues of approximately \$13.4 million from its drilling fluid services. For the year ended December 31, 1998, the Company incurred approximately \$13.0 million of operating costs associated with its drilling fluid activities, including depreciation and amortization expense of approximately \$895,000 and general and administrative expense of approximately \$1.9 million. The Company generated approximately \$360,000 of operating income from its contract drilling fluid services for the year ended December 31, 1998.

For the year ended December 31, 1998, the Company incurred interest expense of approximately \$4.5 million as compared to \$1.0 million in 1997. This increase was due to the additional \$36.75 million borrowed during February 1998 in the Company's acquisition of Robertson. In 1998, the Company recognized a net gain on the sale of property and equipment of \$636,000 as compared to approximately \$1.5 million in 1997. The decrease in 1998 was largely attributable to the sale of the Company's interest in an oil and natural gas property of approximately \$813,000 during fiscal year 1997.

COMPARISON OF THE YEARS ENDED DECEMBER 31, 1997 AND 1996

For the year ended December 31, 1997, contract drilling revenues were approximately \$178.3 million as compared to \$73.6 million for the same period in 1996, an increase of approximately 142%. Average rig utilization increased approximately 13% to 89% for the twelve months ended December 31, 1997. Direct drilling costs were \$128.4 million or 72% of drilling revenues for the year ended December 31, 1997, while direct drilling costs were \$59.6 million or 81% of related drilling revenues for 1996. The increase in contract drilling revenues and associated drilling costs was primarily attributable to the addition of 35 drilling rigs to the Company's operable drilling fleet during fiscal year 1997 and the addition of 13 operable drilling rigs during the fourth quarter of 1996. General and administrative expense for the contract drilling operations was approximately \$5.4 million for the year ended December 31, 1997 as compared to approximately \$4.0 million in 1996. As a result of the Company's recent capital acquisitions, depreciation expense increased from approximately \$6.8 million in 1996 to approximately \$12.5 million for the year ended December 31, 1997. These increased levels of depreciation expense are expected to continue for the foreseeable future. For the twelve months ended December 31, 1997, income from the Company's contract drilling operations was approximately \$32.7 million as compared to approximately \$3.9 million in 1996. This increased profitability was largely attributable to the increased rig utilization rate attained during 1997 and, to a lesser extent, moderate increases realized by the Company during 1997 in its daily drilling rates.

Oil and natural gas sales revenues were approximately \$10.8 million for the year ended December 31, 1997, as compared to approximately \$8.3 million in 1996. The volume of oil and natural gas sold by the Company increased by approximately 30% in 1997, as compared to fiscal year 1996. The average price per Bbl of crude oil received by the Company was \$17.86 in 1997, as compared to \$20.99 in 1996, and the average price per Mcf of natural gas was \$2.19 in 1997, as compared to \$2.01 in 1996. Lease operating production costs were \$3.41 per BOE in 1997, as compared to \$3.91 per BOE in 1996. General and administrative expense for the oil and natural gas segment was approximately \$1.4 million for each of the years ended December 31, 1997 and 1996. Exploration costs were \$647,000 for the year ended December 31, 1997, as compared to approximately \$466,000 in 1996. Depreciation and depletion expense was approximately \$5.0 million in 1997, as compared to approximately \$3.1 million in 1996. The Company incurred impairment expense of approximately \$355,000 and \$549,000 for the years ended December 31, 1997 and 1996, respectively. Other revenues generated by the oil and natural gas segment, consisting primarily of fees generated from lease

operating activities, were approximately \$1.6 million and \$1.8 million for the years ended December 31, 1997 and 1996, respectively. For the year ended December 31, 1997, the oil and natural gas segment generated income from operations of approximately \$2.4 million as compared to income of approximately \$1.6 million for the year ended December 31, 1996.

For the year ended December 31, 1997, the Company incurred interest expense of \$1.045 million as compared to \$1.6 million in 1996. The decrease in interest expense related to the Company's early retirement of its notes payable during the first quarter of 1997 using proceeds provided by its equity offering completed during that time. In 1997, the Company recognized a net gain on the sale of property and equipment of \$1.5 million as compared to approximately \$546,000 in 1996. The increase in 1997 was largely attributable to the sale of the Company's interest in an oil and natural gas property of approximately \$813,000.

In 1997, as a result of the Company's increased profitability and reduced benefit of certain deferred tax assets, the Company incurred income tax expense of approximately \$12.9 million as compared to a net income tax benefit of \$2.3 million in 1996. As previously reported, the Company fully reduced its valuation allowance existing against its deferred tax assets in prior periods recognizing the related benefit. To the degree that the Company generates income in excess of its remaining deferred tax assets, it will incur income tax expense at its effective statutory rate.

INCOME TAXES

At December 31, 1998, the Company had tax net operating loss ("NOL") carryforwards of approximately \$4.2 million. These NOL carryforwards expire at various dates from 1999 through 2012, subject to certain limitations. Prior to August 3, 1995, the Company realized substantial federal income tax savings due to the NOL carryforwards. The utilization of these NOL carryforwards prior to that date effectively reduced the current federal income tax rate. During 1995, the Company's NOL carryforwards became subject to an annual limitation due to a change of over 50% in the stock ownership of the Company as defined in Internal Revenue Service Code Section 382(g). The NOL carryforwards that can be utilized to offset net income in any year will be equal to approximately \$3.3 million. The NOL limitation is determined by the value of the Company's equity on August 2, 1995, the day prior to the ownership change, times 5.88%, the Federal long-term exempt rate on that date as published by the U.S. Treasury Department, or \$1.8 million, and approximately \$1.5 million which is determined by the value of Tucker Drilling Company, Inc.'s equity on July 29, 1996, the day prior to consummation of the Merger, times 5.78%, the Federal long-term exempt rate on that date.

During the year ended December 31, 1996, the Company began recording non-cash Federal deferred income taxes based primarily on the relationship between the amount of the Company's unused Federal NOL carryforwards and the temporary differences between the book basis and tax basis in the Company's assets. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the year in which those temporary differences are expected to be recovered or settled. As a result of fully recognizing the benefit of its deferred income taxes, the Company will incur deferred income tax expense as these benefits are utilized. The Company incurred deferred income tax expense of approximately \$6.5 million and \$2.5 million for the years ended December 31, 1998 and 1997, respectively.

VOLATILITY OF OIL AND NATURAL GAS PRICES

The Company's revenue, profitability and future rate of growth are substantially dependent upon prevailing prices for oil and natural gas, both with respect to its contract drilling and its oil and natural gas segments. Historically, oil and natural gas prices and markets have been extremely volatile. Prices are affected by market supply and demand factors as well as actions of state and local agencies, the United States and foreign governments and international cartels. All of these are beyond the control of the Company. Any significant or extended decline in oil and/or natural gas prices will have a material adverse effect on the Company's financial condition and results of operations. The sharp decline in crude oil prices beginning in the fourth quarter of 1997 has materially impacted the Company's operations. Should oil prices remain at current

levels or continue to decline or natural gas prices decline significantly from current prices, the Company's operations would be further adversely affected.

IMPACT OF INFLATION

The Company believes that inflation will not have a significant impact on its financial position.

RECENTLY-ISSUED ACCOUNTING STANDARDS

During 1998, the Company adopted Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income" ("SFAS No. 130"), which establishes standards for reporting and presentation of comprehensive income and its components (revenues, expenses, gains and losses) in a full set of general-purpose financial statements. SFAS No. 130 requires that all items that are required to be recognized under accounting standards as components of comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. SFAS No. 130 requires that an enterprise (i) classify items of other comprehensive income by their nature in a financial statement and (ii) display the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of a statement of financial position. The Company's adoption of SFAS No. 130 did not result in any significant changes to its related reporting disclosures.

During the quarter ended March 31, 1998, the Company adopted Statement of Financial Accounting Standards No. 131, "Disclosures About Segments of an Enterprise and Related Information" ("SFAS No. 131"). SFAS No. 131 establishes revised guidelines for determining an entity's operating segments and the type and level of financial information to be disclosed. The Company's adoption of SFAS No. 131 did not result in any significant changes to its related reporting disclosures.

The FASB issued Statement of Financial Accounting Standards No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits," ("SFAS No. 132") in February 1998. SFAS No. 132 revises employers' disclosures about pension and other postretirement benefit plans. It does not change the measurement recognition of those plans. This statement is effective for fiscal years beginning after December 15, 1998. The Company's adoption of SFAS No. 132 in September 1998 did not result in any changes to the Company.

The FASB issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities," ("SFAS No. 133") in June 1998. SFAS No. 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. This statement is effective for all fiscal quarters of fiscal years beginning after June 15, 1999. The provisions of SFAS No. 133 are not expected to have a material impact to the Company.

YEAR 2000 COMPLIANCE PROGRAM

During fiscal year 1997, the Company began implementation of its program for alleviating potential business interruptions that could be caused by the year 2000. The Company's program identified two principal areas of concern: supporting information technology systems ("IT systems") and the Company's related vulnerability to external providers of services and materials.

The Company currently maintains three separate infrastructures to facilitate the processing of daily transactions and financial reporting. Each of the lines of business engaged in by the Company function separately from the other and therefore operates on individual computer platforms. The Company has completed its conversion of each of the computer platforms resulting in the replacement and modification of certain hardware and software applications that previously were determined not to be compliant with year 2000 issues.

The ability of the Company to conduct its business efficiently and productively requires that providers of services and materials to the Company, as well as, major customers to the Company (collectively referred to herein as "external agents") be year 2000 compliant. The Company has implemented a process whereby

external agents are identified and prioritized by level of exposure. Management of the Company is in the process of assessing the readiness and effectiveness of its external agents for the year 2000. Surveys, solicitations and other forms of inquiry are being used to make this determination. Management intends to interpret the responses and information gathered and determine on an individual basis whether the Company is vulnerable to that external agent. This process will continue through January 2000 as a means to provide a continuous update as to the external agents' status and success.

The Company does not expect the total cost associated with the Company's efforts to become year 2000 compliant to be material to the Company's financial position. The total amount expended on the project through December 31, 1998 was approximately \$1.75 million. The Company expects to significantly reduce its level of uncertainty about year 2000 issues and, in particular, about the year 2000 compliance and readiness of its external agents. Accordingly, the Company does not deem it necessary to formally adopt a contingency plan.

The failure to correct a material year 2000 problem could result in an interruption in, or a failure of, certain normal business activities or operations. Such failures could materially and adversely affect the Company's results of operations, liquidity and financial condition. Due to the general uncertainty inherent in the year 2000 problem, resulting in part from the uncertainty of the year 2000 readiness of third-party suppliers and customers, the Company is unable to determine at this time whether the consequences of year 2000 failures will have a material impact on the Company's results of operations, liquidity or financial condition. The Company believes that, with the implementation of new business systems and completion of its program as scheduled, the possibility of significant interruptions of normal operations should be reduced.

The foregoing disclosure constitutes "Year 2000 Readiness Disclosure" within the meaning of the Year 2000 Information and Readiness Disclosure Act.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company has exposure to market risk associated with the floating rate portion of the interest charged on its \$55.7 million term loan with Norwest Bank Texas, N.A. The term loan, which matures on January 1, 2001, bears interest at LIBOR plus 2.375%. The Company's exposure to interest rate risk due to changes in LIBOR is not expected to be material and at December 31, 1998, the fair value of the obligation approximates its related carrying value because the obligation bears interest at the current market rate.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

Financial Statements are filed as a part of this report at the end of Part IV hereof beginning at page F-1, Index to Consolidated Financial Statements, and are incorporated herein by this reference.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None.

PART III

The information required by Part III is omitted from this report because the Company will file a definitive Proxy Statement for the Company's 1999 Annual Meeting of Stockholders (the "Proxy Statement") pursuant to Regulation 14A of the Securities Exchange Act of 1934 not later than 120 days after the end of the fiscal year covered by this Form 10-K and certain information included therein is incorporated herein by reference.

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.

The information required by this Item is incorporated herein by reference to the Proxy Statement.

ITEM 11. EXECUTIVE COMPENSATION.

The information required by this Item is incorporated herein by reference to the Proxy Statement.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.

The information required by this Item is incorporated herein by reference to the Proxy Statement.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

The information required by this Item is incorporated herein by reference to the Proxy Statement.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K.

(a) (1) Financial Statements.

See Index to Consolidated Financial Statements on page F-1 of this report.

(a) (2) Financial Statement Schedules.

Financial Statement Schedules have been omitted because they are not applicable or the information required therein is included elsewhere in the financial statements or notes thereto.

(a) (3) Exhibits.

The following exhibits are filed herewith or incorporated by reference herein.

- 2.1 Plan and Agreement of Merger dated October 14, 1993, between Patterson Energy, Inc., a Texas corporation, and Patterson Energy, Inc., a Delaware corporation, together with related Certificates of Merger.(1)
- 2.2 Agreement and Plan of Merger, dated April 22, 1996 among Patterson Energy, Inc., Patterson Drilling Company and Tucker Drilling Company, Inc.(2)
- 2.2.1 Amendment to Agreement and Plan of Merger, dated May 16, 1996 among Patterson Energy, Inc., Patterson Drilling Company and Tucker Drilling Company, Inc.(3)
- 2.3 Asset Purchase Agreement, dated April 22, 1997, among and between Patterson Drilling Company and Ziadril, Inc.(4)
- 2.4 Asset Purchase Agreement, dated June 4, 1997, among Patterson Energy Inc., Patterson Drilling Company and Wes-Tex Drilling Company.(3)
- 2.4.1 Amendment to Asset Purchase Agreement, dated June 4, 1997, among Patterson Energy Inc., Patterson Drilling Company and Wes-Tex Drilling Company.(5)
- 2.5 Agreement, dated June 4, 1997, among Patterson Energy Inc., Patterson Drilling Company, Greathouse Foundation and Myrle Greathouse, Trustee under Agreement dated June 2, 1997.(5)
- 2.6 Asset Purchase Agreement, dated September 4, 1997, among Patterson Energy Inc., Patterson Drilling Company and McGee Drilling Company.(4)
- 2.7 Agreement and Plan of Merger, dated January 20, 1998, among Patterson Energy, Inc., Patterson Onshore Drilling Company and Robertson Onshore Drilling Company.(7)
- 2.8 Stock Purchase Agreement, dated January 5, 1998, among Patterson Energy, Inc., Spencer D. Armour, III. And Richard G. Price.(19)
- 2.9 Stock Purchase Agreement, dated September 17, 1998, among Lone Star Mud, Inc. and Mark Campbell (shareholder of Tejas Drilling Fluids, Inc.).
- 2.10 Asset Purchase Agreement, dated January 27, 1999, among Patterson Energy, Inc., Patterson Drilling Company and Padre Industries, Inc.
- 3.1 Restated Certificate of Incorporation.(8)
- 3.1.1 Certificate of Amendment to the Certificate of Incorporation.(9)
- 3.2 Bylaws.(1)
- 4.1 Excerpt from Restated Certificate of Incorporation of Patterson Energy, Inc. regarding authorized Common Stock and Preferred Stock.(10)
- 4.2 Registration Rights Agreement, dated June 12, 1997, among Patterson Energy Inc. and Wes-Tex Drilling Company, Greathouse Foundation and Myrle Greathouse, Trustee under Agreement dated June 2, 1997.(11)

- 4.3 Stock Purchase Warrant of Patterson Energy, Inc., dated June 12, 1997.(11)
- 10.1 Credit Agreement dated December 9, 1997 among Patterson Energy, Inc., Patterson Drilling Company, Patterson Petroleum, Inc., Patterson Trading Company, Inc. and Norwest Bank Texas, N.A.(6)
- 10.1.1 Promissory Note dated December 9, 1997 among Patterson Energy, Inc. and Norwest Bank Texas, N.A.(6)
- 10.1.2 Security Agreement dated December 9, 1997 between Patterson Drilling Company and Norwest Bank Texas, N.A.(6)
- 10.1.3 Corporate Guarantees of Patterson Drilling Company, Patterson Petroleum, Inc. and Patterson Petroleum Trading Company, Inc.(6)
- 10.1.4 Amendment to Credit Agreement dated March 4, 1999 among Patterson Energy, Inc., Patterson Drilling Company, Patterson Petroleum, Inc., Patterson Trading Company, Inc. and Norwest Bank Texas, N.A.
- 10.2 Aircraft Lease, dated December 20, 1998, (effective January 1, 1999) between Talbott Aviation, Inc. and Patterson Energy, Inc.
- 10.3 Participation Agreement, dated October 19, 1994, between Patterson Petroleum Trading Company, Inc. and BHT Marketing, Inc.(12)
- 10.3.1 Participation Agreement dated October 24, 1995, between Patterson Petroleum Trading Company, Inc. and BHT Marketing, Inc.(13)
- 10.4 Crude Oil Purchase Contract, dated October 19, 1994, between Patterson Petroleum, Inc. and BHT Marketing, Inc.(14)
- 10.4.1 Crude Oil Purchase Contract, dated October 24, 1995, between Patterson Petroleum, Inc. and BHT Marketing, Inc.(13)
- 10.5 Patterson Energy, Inc. 1993 Stock Incentive Plan, as amended.(15)
- 10.6 Patterson Energy, Inc. Non-Employee Directors' Stock Option Plan, as amended.(16)
- 10.7 Model Form Operating Agreement.(17)
- 10.8 Form of Drilling Bid Proposal and Footage Drilling Contract.(17)
- 10.9 Form of Turnkey Drilling Agreement.(17)
- 21.1 Subsidiaries of the registrant.(18)
- 23.1 Consent of Independent Accountants -- PricewaterhouseCoopers LLP.
- 27.1 Financial Data Schedule as of December 31, 1998 and for the year then ended.

- -----

- (1) Incorporated herein by reference to Item 27, "Exhibits" to Amendment No. 2 to Registration Statement on Form SB-2 (File No. 33-68058-FW); filed October 28, 1993.
- (2) Incorporated by reference to Item 7, "Financial Statements and Exhibits" to Form 8-K dated April 22, 1996 and filed on April 30, 1996.
- (3) Incorporated by reference to Item 7, "Financial Statements and Exhibits" to Form 8-K dated May 16, 1996 and filed on May 22, 1996.
- (4) Incorporated herein by reference to Item 16, "Exhibits" to Amendment No. 1 to Registration Statement on Form S-3 (File No. 333-29035); filed August 5, 1997.
- (5) Incorporated herein by reference to Item 7, "Financial Statements and Exhibits", to Form 8-K dated September 3, 1997; filed September 11, 1997.
- (6) Incorporated herein by reference to Item 7, "Financial Statements and Exhibits" to Form 8-K dated November 14, 1997 and filed December 24, 1997.
- (7) Incorporated herein by reference to Item 7, "Financial Statements and Exhibits," to Form 8-K dated January 23, 1998; filed February 3, 1998.

- (8) Incorporated herein by reference to Item 6, "Exhibits and Reports on Form 8-K" to Form 10-Q for the quarterly period ended September 30, 1996; filed August 12, 1996.
 - (9) Incorporated herein by reference to Item 6. "Exhibits and Reports on Form 8-K" to Form 10-Q for the quarterly period ended June 30, 1997; filed August 14, 1997.
 - (10) Incorporated herein by reference to Item 16, "Exhibits" to Registration Statement on Form S-3 filed with the Securities Exchange Commission on December 18, 1996.
 - (11) Incorporated herein by reference to Item 7, "Financial Statements and Exhibits", to Form 8-K dated September 12, 1997; filed September 19, 1997.
 - (12) Incorporated herein by reference to Item 27, "Exhibits" to Post Effective Amendment No. 1 to Registration Statement on Form SB-2 (File No. 33-68058-FW).
 - (13) Incorporated by reference to Item 7, "Financial Statements and Exhibits" to Form 10-KSB for the year ended December 31, 1995.
 - (14) Incorporated by reference to Item 5, "Other Items" to Form 8-K dated December 1, 1995 and filed on January 16, 1996.
 - (15) Incorporated herein by reference to Item 8, "Exhibits" to Registration Statement on Form S-8 (File No. 333-47917); filed March 13, 1998.
 - (16) Incorporated herein by reference to Item 8, "Exhibits" to Registration Statement on Form S-8 (File No. 33-39471); filed November 4, 1997.
 - (17) Incorporated by reference to Item 27, "Exhibits" to Registration Statement filed with the Securities and Exchange Commission on August 30, 1993.
 - (18) Incorporated by reference to Item 14, "Exhibits, Financial Statement Schedules and Reports on Form 8-K" to Form 10-K dated December 31, 1997.
 - (19) Incorporated herein by reference to Item 16, "Exhibits" to Registration Statement on Form S-3 filed with the Securities Exchange Commission on January 5, 1998.
- (b) Reports on Form 8-K.

There were no reports on Form 8-K filed with the Securities and Exchange Commission during the fiscal quarter ended December 31, 1998.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, Patterson Energy, Inc. has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PATTERSON ENERGY, INC.

Date: March 31, 1999

By: /s/ CLOYCE A. TALBOTT

 Cloyce A. Talbott
 Chairman of the Board and Chief
 Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of Patterson Energy, Inc. and in the capacities indicated as of March 30, 1998.

SIGNATURE -----	TITLE -----
/s/ CLOYCE A. TALBOTT ----- Cloyce A. Talbott (Principal Executive Officer)	Chairman of the Board, Chief Executive Officer and Director
/s/ A. GLENN PATTERSON ----- A. Glenn Patterson	President, Chief Operating Officer and Director
/s/ JAMES C. BROWN ----- James C. Brown (Principal Accounting Officer)	Vice President -- Finance, Chief Financial Officer, Secretary and Treasurer
/s/ ROBERT C. GIST ----- Robert C. Gist	Director
/s/ KENNETH E. DAVIS ----- Kenneth E. Davis	Director
/s/ VINCENT A. ROSSI, JR. ----- Vincent A. Rossi, Jr.	Director

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REPORT OF INDEPENDENT ACCOUNTANTS

The Board of Directors and Stockholders of
Patterson Energy, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, stockholders' equity and cash flows present fairly, in all material respects, the financial position of Patterson Energy, Inc. and Subsidiaries as of December 31, 1997 and 1998 and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

PricewaterhouseCoopers LLP

Dallas, Texas
March 1, 1999

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PATTERSON ENERGY, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	DECEMBER 31,	
	1997	1998
	(IN THOUSANDS)	
ASSETS		
Current assets:		
Cash and cash equivalents.....	\$ 23,338	\$ 8,986
Marketable securities.....	566	--
Accounts receivable:		
Trade, less allowance for doubtful accounts of \$378,110 and \$417,519 at December 31, 1997 and 1998, respectively.....	44,732	28,616
Oil and natural gas sales.....	773	426
Costs of uncompleted drilling contracts in excess of related billings.....	--	100
Accrued federal income taxes receivable.....	--	8,400
Inventory.....	--	1,283
Deferred income taxes.....	2,309	1,568
Undeveloped oil and natural gas properties held for resale.....	4,781	3,214
Other current assets.....	515	890
	-----	-----
Total current assets.....	77,014	53,483
Property and equipment, at cost, net.....	100,405	136,677
Intangible assets, net.....	24,644	45,875
Other assets.....	1,137	570
	-----	-----
Total assets.....	\$203,200	\$236,605
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current maturities of note payable.....	\$ 1,467	\$ 8,571
Accounts payable:		
Trade.....	12,126	9,748
Revenue distribution.....	3,352	1,390
Other.....	1,569	73
Accrued expenses.....	5,142	3,170
Accrued state and federal income taxes payable.....	6,874	--
	-----	-----
Total current liabilities.....	30,530	22,952
	-----	-----
Deferred income taxes, net.....	3,268	9,566
Deferred liabilities.....	687	92
Note payable, less current maturities.....	21,783	47,143
	-----	-----
	25,738	56,801
	-----	-----
Commitments and contingencies.....	--	--
Stockholders' equity:		
Preferred stock, par value \$.01; authorized 1,000,000 shares, no shares issued.....	--	--
Common stock, par value \$.01; authorized 50,000,000 shares with 30,967,084 and 31,671,132 issued and outstanding at December 31, 1997 and 1998, respectively.....	310	317
Additional paid-in capital.....	102,306	112,544
Retained earnings.....	44,316	43,991
	-----	-----
Total stockholders' equity.....	146,932	156,852
	-----	-----
Total liabilities and stockholders' equity.....	\$203,200	\$236,605
	=====	=====

The accompanying notes are an integral part of these consolidated financial statements.

PATTERSON ENERGY, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

	YEARS ENDED DECEMBER 31,		
	1996	1997	1998
	-----	-----	-----
	(IN THOUSANDS, EXCEPT PER SHARE DATA)		
Operating revenues:			
Drilling.....	\$73,590	\$178,332	\$165,997
Drilling fluids.....	--	--	13,397
Oil and natural gas sales.....	8,299	10,773	5,641
Well operation fees.....	1,499	1,632	1,442
Other.....	320	40	87
	-----	-----	-----
	83,708	190,777	186,564
	-----	-----	-----
Operating costs and expenses:			
Direct drilling costs.....	59,564	128,416	128,838
Drilling fluids.....	--	--	10,205
Lease operating and production.....	2,012	2,274	1,924
Impairment of oil and natural gas properties.....	549	355	3,816
Exploration costs.....	466	647	669
Dry holes and abandonments.....	987	1,481	1,083
Depreciation, depletion and amortization.....	9,960	17,497	28,091
General and administrative.....	5,416	6,786	9,313
	-----	-----	-----
	78,954	157,456	183,939
	-----	-----	-----
Operating income.....	4,754	33,321	2,625
	-----	-----	-----
Other income (expense):			
Net gain on sale of assets.....	546	1,499	636
Interest income.....	478	1,056	767
Interest expense.....	(1,612)	(1,045)	(4,471)
Non-recurring acquisition costs.....	(2,268)	--	--
Other.....	119	277	211
	-----	-----	-----
	(2,737)	1,787	(2,857)
	-----	-----	-----
Income (loss) before income taxes.....	2,017	35,108	(232)
	-----	-----	-----
Income tax expense (benefit):			
Current.....	174	10,353	(6,358)
Deferred.....	(2,428)	2,513	6,451
	-----	-----	-----
	(2,254)	12,866	93
	-----	-----	-----
Net income (loss).....	\$ 4,271	\$ 22,242	\$ (325)
	=====	=====	=====
Net income (loss) per common share:			
Basic.....	\$ 0.22	\$ 0.78	\$ (0.01)
	=====	=====	=====
Diluted.....	\$ 0.21	\$ 0.75	\$ (0.01)
	=====	=====	=====
Weighted average number of common shares outstanding:			
Basic.....	19,167	28,492	31,645
	=====	=====	=====
Diluted.....	20,086	29,505	31,645
	=====	=====	=====

The accompanying notes are an integral part of these consolidated financial statements.

PATTERSON ENERGY, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	COMMON STOCK		ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	TOTAL
	NUMBER OF SHARES	AMOUNT			
			(IN THOUSANDS)		
December 31, 1995.....	18,988	\$190	\$ 18,904	\$18,562	\$ 37,656
Issuance of common stock.....	208	2	1,428	--	1,430
Exercise of stock options.....	425	4	880	--	884
Conversion of 301,260 redeemable warrants....	153	2	(2)	--	--
Net income.....	--	--	--	4,271	4,271
Adjustment to conform fiscal years (see Note 2).....	--	--	--	(759)	(759)
December 31, 1996.....	19,774	198	21,210	22,074	43,482
Issuance of common stock.....	9,384	94	68,221	--	68,315
Issuance of stock purchase warrant.....	--	--	1,248	--	1,248
Exercise of stock options.....	1,009	10	2,323	--	2,333
Conversion of stock purchase warrant.....	800	8	6,392	--	6,400
Tax benefit related to exercise of stock options.....	--	--	2,912	--	2,912
Net income.....	--	--	--	22,242	22,242
December 31, 1997.....	30,967	310	102,306	44,316	146,932
Issuance of common stock.....	571	5	9,941	--	9,946
Exercise of stock options.....	133	2	297	--	299
Net loss.....	--	--	--	(325)	(325)
December 31, 1998.....	31,671	\$317	\$112,544	\$43,991	\$156,852

The accompanying notes are an integral part of these consolidated financial
statements.

PATTERSON ENERGY, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	YEARS ENDED DECEMBER 31,		
	1996	1997	1998
	----	----	----
	(IN THOUSANDS)		
Cash flows from operating activities:			
Net income (loss).....	\$ 4,271	\$ 22,242	\$ (325)
Adjustments to reconcile net income (loss) to net cash from operating activities:			
Abandonment of oil and natural gas properties.....	121	--	694
Depreciation, depletion and amortization.....	9,960	17,497	28,091
Impairment of oil and natural gas properties.....	549	355	3,816
Net gain on sale of assets.....	(546)	(1,499)	(636)
Tax benefit related to exercise of stock options.....	--	2,912	--
Deferred income tax expense (benefit).....	(2,428)	2,513	6,451
Increase (decrease) in deferred compensation liabilities.....	349	(27)	(595)
Change in operating assets and liabilities:			
(Increase) decrease in trade accounts receivable.....	(10,558)	(20,989)	16,116
(Increase) decrease in oil and natural gas sales receivable.....	(512)	226	347
Increase in inventory held for resale.....	--	--	(1,283)
Increase in accrued Federal income taxes receivable.....	--	--	(8,400)
(Increase) decrease in undeveloped oil and natural gas properties held for resale.....	(2,548)	(111)	873
(Increase) decrease in other current assets.....	(99)	32	(475)
Increase (decrease) in trade accounts payable.....	4,301	(3)	(2,378)
Increase (decrease) in revenue distribution payable.....	828	920	(1,962)
Increase (decrease) in accrued state and federal income taxes payable.....	(13)	6,752	(6,874)
Increase (decrease) in accrued expenses.....	649	3,018	(1,972)
Increase (decrease) in other current payables.....	331	604	(1,496)
	-----	-----	-----
Net cash provided by operating activities.....	4,655	34,442	29,992
	-----	-----	-----
Cash flows from investing activities:			
Net sales (purchases) of investment securities.....	1,927	(22)	566
Acquisitions.....	(17,078)	(49,400)	(45,453)
Purchases of property and equipment.....	(6,895)	(34,861)	(34,148)
Sales of property and equipment.....	1,229	4,164	1,361
Change in other assets.....	(99)	(13)	567
	-----	-----	-----
Net cash used in investing activities.....	(20,916)	(80,132)	(77,107)
	-----	-----	-----
Cash flows from financing activities:			
Proceeds from notes payable.....	17,469	23,250	40,150
Payments on notes payable.....	(5,837)	(25,849)	(7,686)
Issuance of common stock and redeemable warrants.....	--	59,400	--
Proceeds from exercise of stock options.....	914	8,733	299
	-----	-----	-----
Net cash provided by financing activities.....	12,546	65,534	32,763
	-----	-----	-----
Net increase (decrease) in cash and cash equivalents.....	(3,715)	19,844	(14,352)
Cash and cash equivalents at beginning of year.....	7,209	3,494	23,338
	-----	-----	-----
Cash and cash equivalents at end of year.....	\$ 3,494	\$ 23,338	\$ 8,986
	=====	=====	=====
Supplemental disclosure of cash flow information:			
Cash paid during the period for:			
Interest.....	\$ 1,657	\$ 1,045	\$ 4,471
Income taxes.....	174	691	8,000

The accompanying notes are an integral part of these consolidated financial statements.

PATTERSON ENERGY, INC. AND SUBSIDIARIES
 CONSOLIDATED STATEMENTS OF CASH FLOWS -- (CONTINUED)

Noncash investing and financing activities:

During 1998, the Company acquired Lone Star Mud, Inc., Robertson Onshore Drilling Company and Tejas Drilling Fluids, Inc. for an aggregate purchase price of approximately \$58.8 million of which, approximately \$45.5 million was paid in cash as follows (see Note 2):

	(IN THOUSANDS)
Purchase price.....	\$58,799
Less non-cash items:	
Common stock issued.....	(9,946)
Debt assumed.....	(3,400)

Total cash paid.....	\$45,453
	=====

During 1997, the Company completed five separate asset acquisitions for an aggregate purchase price of approximately \$59.6 million of which, approximately \$49.4 million was paid in cash as follows (see Note 2):

	(IN THOUSANDS)
Fair value of assets acquired.....	\$59,563
Less non-cash items:	
Common stock issued.....	(8,915)
Three-year stock purchase warrant.....	(1,248)

Total cash paid.....	\$49,400
	=====

During the year ended December 31, 1996, 301,260 redeemable warrants relative to the Underwriter's Warrant Agreement dated November 2, 1993, as amended on November 15, 1994 and June 18, 1996, were converted in which 152,896 shares of the Company's common stock were issued and 148,364 shares of such common stock were forfeited to the Company in lieu of a cash payment (see Note 9).

During the year ended December 31, 1996, the Company acquired three drilling rigs from a non-affiliated entity. The related purchase price consisted of \$100,000 cash, a promissory note of \$400,000 payable to the seller and the issuance of 208,000 shares of the Company's common stock valued at \$1.4 million (see Notes 2 and 9).

The accompanying notes are an integral part of these consolidated financial statements.

PATTERSON ENERGY, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A summary of the significant accounting policies follows:

Principles of consolidation -- The consolidated financial statements include the accounts of Patterson Energy, Inc. ("Patterson") and its wholly-owned subsidiaries, Patterson Drilling Company, Patterson Onshore Drilling Company, Lone Star Mud, Inc., Patterson Petroleum, Inc., Patterson Petroleum Trading Company, Inc. and Patterson Drilling Programs, Inc. (collectively referred to herein as the "Company"). All significant intercompany accounts and transactions have been eliminated.

Description of business -- The Company engages in onshore contract drilling of oil and natural gas, the development, exploration, acquisition and production of oil and natural gas and provides contract drilling fluid services to the oil and natural gas industry. The Company provides contract drilling services to major oil and gas companies and independent producers primarily in Texas and southeast New Mexico.

The contract drilling business experienced increased demand for drilling services from 1995 through the third quarter of 1997 due to stronger crude oil and natural gas prices. However, except for that period and other occasional upturns, the market for onshore contract drilling and other related services has generally been depressed since mid-1982, when crude oil and natural gas prices began to weaken. A particularly sharp decline in demand for these services occurred in 1986 because of the worldwide collapse in crude oil prices. Since this time and except during the occasional upturns, there have been substantially more drilling rigs available than necessary to meet demand in most operating and geographic segments of the domestic drilling industry. In addition to adverse effects that future declines in demand could have on the Company, ongoing movement or reactivation of onshore drilling rigs or new construction of drilling rigs could adversely affect rig utilization rates and pricing, even in an environment of stronger oil and natural gas prices and increased drilling activity. The Company cannot predict either the future level of demand for its contract drilling and other related services or future conditions in the oil and natural gas industry. The Company's rig utilization rate reached an all time high of approximately 91.5% in the third quarter of 1997, but has weakened since then due to a significant reduction in the price of crude oil. Should crude oil or natural gas prices remain at these levels or continue to decline, the Company's operations could be further adversely affected.

Management estimates -- The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Drilling operations -- The Company follows the percentage-of-completion method of accounting for footage and day work drilling arrangements. Under this method all drilling revenues, direct costs and appropriate portions of indirect costs, related to the contracts in progress, are recognized as contract drilling services are performed.

The Company follows the completed contract method of accounting for turnkey drilling arrangements. Under this method, all drilling advances, direct costs and appropriate portions of indirect costs (including maintenance, repairs and depreciation) related to the contracts in progress are deferred and recognized as revenues and expenses in the period the contracts are completed.

Provisions for losses are made on incomplete contracts when significant losses are anticipated.

Inventory -- Inventory consists primarily of chemical products to be used in conjunction with the Company's contract drilling fluid activities. The inventory is stated at the lower of cost or market. Cost is determined by the first-in, first-out method.

PATTERSON ENERGY, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES -- (CONTINUED)

Undeveloped oil and natural gas properties held for resale -- Undeveloped oil and natural gas properties held for resale represent leasehold interests in unproven oil and natural gas properties which the Company expects to sell. Also included are leasehold costs programmed for development under arrangements which will provide for reimbursement of such costs to the Company. Such properties are carried at the lower of cost or net realizable value. The Company recognizes gains or losses upon disposition or impairment of the properties.

Property and equipment -- Property and equipment (other than oil and natural gas) -- Depreciation is provided on the straight-line method over the estimated useful lives as defined below. The Company incurred depreciation expense of approximately \$7.0 million, \$11.7 million and \$20.2 million for the years ended December 31, 1996, 1997 and 1998, respectively.

	LIVES (YEARS)
Drilling rigs and related equipment.....	2-15
Office furniture.....	3-10
Buildings.....	5-20
Automotive equipment.....	2-7
Other.....	3-7

Oil and natural gas properties -- The Company follows the successful efforts method of accounting, using the field as its accumulation center for capitalized costs. Under the successful efforts method of accounting, costs which result directly in the discovery of oil and natural gas reserves and all development costs are capitalized. Exploration costs which do not result directly in discovering oil and natural gas reserves are charged to expense as incurred. The capitalized costs, consisting of lease and well equipment, lease acquisition costs and intangible development costs are depreciated, depleted and amortized on the units-of-production method, based on petroleum engineer estimates of recoverable proved developed oil and natural gas reserves of each respective field. The Company incurred depletion expense of approximately \$3.0 million, \$4.8 million and \$4.6 million for the years ended December 31, 1996, 1997 and 1998, respectively.

Impairment of long-lived assets -- In accordance with Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of," net capitalized costs of long-lived assets, certain identifiable intangibles and goodwill in excess of estimated future net revenues are reduced to reflect an amount which is expected to be recovered through the future cash flows generated by the use of the related assets. Impairment of oil and natural gas properties is periodically assessed on a field basis as determined by an independent reserve engineer. The Company incurred approximately \$549,000, \$355,000 and \$3.8 million of impairment to such properties at December 31, 1996, 1997 and 1998, respectively. Impairment to the Company's oil and natural gas properties was primarily attributable to a significant decline in the market price of crude oil.

Maintenance and repairs -- Maintenance and repairs are charged against operations. Renewals and betterments which extend the life or improve existing properties are capitalized.

Retirements -- Upon disposition or retirement of property and equipment (other than oil and natural gas properties), the cost and related accumulated depreciation are removed and the gain or loss thereon, if any, is credited or charged to income. The Company recognizes the gain or loss on the sale of either a part of a proved oil and natural gas property or an entire proved oil and natural gas property constituting a part of a field upon the sale or disposition of such. The unamortized cost of the property or group of properties, a part of which was sold or otherwise disposed of, is apportioned to the interest sold and the interest retained on the basis of the fair value of those interests.

Intangible assets -- Intangible assets consist primarily of goodwill and covenants not to compete arising from business combinations (see Notes 2 and 5). The values assigned to intangible assets, based in part upon

PATTERSON ENERGY, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES -- (CONTINUED)

independent appraisals, are amortized on a straight line basis. Goodwill, representing the excess of the purchase price over the estimated fair value of the net assets of the acquired business, is amortized over the period of expected benefit of 15 years. Covenants not to compete are amortized over their contractual lives. Amortization expense charged to operations at December 31, 1997 and 1998 was approximately \$942,452 and \$3.3 million, respectively.

Earnings per share -- The Company provides a dual presentation of its earnings per share; Basic Earnings per Share ("Basic EPS") and Diluted Earnings per Share ("Diluted EPS") in its Consolidated Statements of Operations. Basic EPS is based on the weighted average number of shares outstanding during the year. Diluted EPS includes common stock equivalents, which are dilutive to earnings per share. For the years ended December 31, 1996 and 1997, the dilutive securities, consisting of certain stock options and warrants as described in Notes 9 and 10, were approximately 919,000 and 1.0 million, respectively. Dilutive securities of 1.5 million were excluded from the 1998 calculation of Diluted EPS as a result of the Company's net loss for the year.

Stock splits -- On July 25, 1997 and January 23, 1998, the Company effected two-for-one splits of its common stock. All information regarding earnings per share, weighted average number of common shares outstanding, stock options and warrants issued and exercised and all other related disclosures herein reflect the effects of such stock splits for all periods presented (see Note 9).

Income taxes -- Income taxes are based on earnings reported for financial statement purposes. The provision for income taxes differs from the amounts currently payable because of permanent and temporary differences in the recognition of certain income and expense items for financial reporting and tax reporting purposes.

Deferred tax assets and liabilities are determined based on the temporary differences between the financial statement and tax basis of assets and liabilities using enacted statutory rates in effect for the year in which the differences are expected to reverse. Deferred tax assets primarily result from net operating loss carryforwards, certain accrued but unpaid insurance losses, alternative minimum tax credit carryforwards and investment tax credit carryforwards. Deferred tax liabilities primarily result from differences between the financial statement and tax basis of the Company's fixed assets.

Investment tax credits are recorded under the flow through method as a reduction of the provision for income taxes.

The Company files a consolidated Federal income tax return.

Stock based compensation -- The Company grants stock options under stock-based incentive compensation plans, (the "Plans"). The Company applies APB Opinion 25 and related Interpretations in accounting for the Plans. In 1995, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 123 "Accounting for Stock-Based Compensation" ("SFAS No. 123") which, if fully adopted by the Company, would change the methods the Company applies in recognizing the cost of the Plans. Adoption of the cost recognition provisions of SFAS No. 123 is optional and the Company decided not to elect these provisions. However, pro forma disclosures as if the Company adopted the cost recognition provisions of SFAS No. 123 in 1995 are required by SFAS No. 123 and are presented in Note 10.

Statement of cash flows -- For purposes of reporting cash flows, cash and cash equivalents include cash on hand, cash on deposit and unrestricted certificates of deposit with original maturities of 90 days or less.

Recently Issued Accounting Standards -- During 1998, the Company adopted Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income" ("SFAS No. 130"), which establishes standards for reporting and presentation of comprehensive income and its components (revenues, expenses,

PATTERSON ENERGY, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES -- (CONTINUED)

gains and losses) in a full set of general-purpose financial statements. SFAS No. 130 requires that all items that are required to be recognized under accounting standards as components of comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. SFAS No. 130 requires that an enterprise (i) classify items of other comprehensive income by their nature in a financial statement and (ii) display the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of a statement of financial position. The Company's adoption of SFAS No. 130 did not result in any changes to its related reporting disclosures.

During the quarter ended March 31, 1998, the Company adopted Statement of Financial Accounting Standards No. 131, "Disclosures About Segments of an Enterprise and Related Information" ("SFAS No. 131"). SFAS No. 131 establishes revised guidelines for determining an entity's operating segments and the type and level of financial information to be disclosed. The Company's adoption of SFAS No. 131 did not result in any significant changes to its related reporting disclosures.

The FASB issued Statement of Financial Accounting Standards No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits," ("SFAS No. 132") in February 1998. SFAS No. 132 revises employers' disclosures about pension and other postretirement benefit plans. It does not change the measurement recognition of those plans. This statement is effective for fiscal years beginning after December 15, 1998. The Company's adoption of SFAS No. 132 in September 1998 did not result in any changes to the Company.

The FASB issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities," ("SFAS No. 133") in June 1998. SFAS No. 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. This statement is effective for all fiscal quarters of fiscal years beginning after June 15, 1999. The provisions of SFAS No. 133 are not expected to have a material impact to the Company.

Reclassifications -- Certain reclassifications have been made to the 1996 and 1997 consolidated financial statements in order for them to conform with the 1998 presentation. The reclassifications had no effect on net income or stockholders' equity for these years.

2. MERGER AND ACQUISITIONS

1998 MERGER AND ACQUISITIONS

Lone Star Mud, Inc. -- On January 5, 1998, the Company acquired 100% of the outstanding stock of Lone Star Mud, Inc. ("Lone Star"), a privately-owned, non-affiliated company based in Midland, Texas. The purchase price of approximately \$13.0 million consisted of \$1.4 million in cash, 571,328 shares of the Company's common stock valued at \$17.41 per share, the assumption of \$1.6 million of debt and approximately \$3,300 of other direct costs incurred relative to the transaction. Pursuant to certain terms of the Company's existing loan agreement with Norwest Bank Texas, N.A. ("Norwest"), the outstanding balance of the above mentioned debt was paid in full. The fair market values of the assets acquired were estimated and the purchase price, as of the date of the acquisition, was allocated as follows (in thousands):

Net assets acquired.....	\$ 3,069
Goodwill.....	9,911

Total purchase price.....	\$12,980
	=====

PATTERSON ENERGY, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

2. MERGER AND ACQUISITIONS -- (CONTINUED)

Robertson Onshore Drilling Company -- On February 6, 1998, the Company completed the merger of Robertson Onshore Drilling Company ("Robertson") a privately-owned, non-affiliated, contract drilling company based in Dallas, Texas, with and into Patterson Onshore Drilling Company, a wholly-owned subsidiary of Patterson Drilling Company. The purchase price of approximately \$42.2 million was funded using cash on hand of approximately \$3.25 million, proceeds of \$36.75 million provided by the Company's line of credit, the assumption of \$1.8 million of debt and approximately \$444,000 of direct costs incurred related to the acquisition. The assets acquired consisted of 15 operable drilling rigs and a shop and yard located in Liberty City, Texas. The purchase price, as of the date of the acquisition, was allocated based on estimated fair values as follows (in thousands):

Net assets acquired.....	\$31,565
Goodwill.....	10,680

Total purchase price.....	\$42,245
	=====

Tejas Drilling Fluids, Inc. -- On September 17, 1998, the Company acquired 100% of the outstanding stock of Tejas Drilling Fluids, Inc. ("Tejas"), a privately-owned, non-affiliated company based in Corpus Christi, Texas for \$3.5 million cash and approximately \$74,000 of other direct costs incurred relative to the transaction. The fair market values of the assets acquired were estimated and the purchase price, as of the date of acquisition, was allocated as follows (in thousands):

Net assets acquired.....	\$ 263
Goodwill.....	2,061
Covenants not to compete.....	1,250

Total purchase price.....	\$3,574
	=====

1997 MERGER AND ACQUISITIONS

Wes-Tex Drilling Company -- On June 12, 1997, the Company consummated an acquisition to purchase 21 contract drilling rigs, related rolling stock, a shop and a yard from Wes-Tex Drilling Company ("Wes-Tex"), a privately-owned, non-affiliated contract drilling company based in Abilene, Texas. The purchase price of approximately \$35.4 million consisted of \$25.0 million in cash, 1.132 million shares of Patterson's common stock valued at \$7.875 per share, a three-year stock purchase warrant (valued at \$1.56 per share) to purchase 800,000 additional shares of Patterson common stock at an exercise price of \$8.00 per share and approximately \$190,000 of other direct costs incurred relative to the transaction. The acquisition was funded using \$19.0 million of cash on hand and \$6.0 million provided by the Company's credit facility maintained with Norwest Bank Texas, N.A. (the "Norwest Line") (see Note 7). The purchase price, as of the date of acquisition, was allocated based on estimated fair values as follows (in thousands):

Contract drilling assets.....	\$17,450
Goodwill.....	16,629
Covenants not to compete.....	1,273

Total purchase price.....	\$35,352
	=====

The Company's operating results since the date of this transaction include the operations of Wes-Tex. The following summary, prepared on a pro forma basis, combines the consolidated results of operations as if Wes-Tex had been acquired January 1, 1996, after including the impact of certain adjustments, such as restatement of depreciation using fair values instead of book values of the assets acquired, the increased

PATTERSON ENERGY, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

2. MERGER AND ACQUISITIONS -- (CONTINUED)

interest expense on the acquisition debt, increased amortization expense on intangible assets, conforming accounting treatment of wells in progress and the related income tax effects.

	YEAR ENDED DECEMBER 31,	
	1996	1997

	(UNAUDITED)	
	(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)	
Revenues.....	\$128,900	\$213,863
Net income.....	3,759	22,319
Net income per basic share.....	0.20	0.78
Net income per diluted share.....	0.19	0.76

The pro forma results have been prepared for comparative purposes only and do not purport to be indicative of what would have occurred had the acquisition been made as of the date indicated. In addition, they are not intended to be a projection of future results and do not reflect any synergies that might be achieved from combined operations.

Other 1997 asset acquisitions -- During 1997, in four separate transactions with non-affiliated entities, the Company acquired 17 contract drilling rigs, other related drilling equipment and rolling stock, five yards, two shops and an office. Total consideration paid for these assets was \$24.2 million, of which \$7.0 million was funded using cash on hand and \$17.3 million was provided by the Norwest Line. The related purchase prices as of the respective dates of acquisition were allocated based on estimated fair values as follows (in thousands):

Contract drilling assets.....	\$16,541
Goodwill.....	7,269
Covenants not to compete.....	400

Total purchase price.....	\$24,210
	=====

The aforementioned acquisitions completed during fiscal years 1997 and 1998 have been accounted for as purchases and the related results of operations and cash flows of the acquired entities have been included in the consolidated financial statements since their respective dates of acquisition.

1996 MERGER AND ACQUISITIONS

Tucker Drilling Company, Inc. -- On April 22, 1996, as amended on May 16, 1996, the Company executed the Agreement and Plan of Merger among Patterson Energy, Inc., Patterson Drilling Company ("Patterson Drilling") and Tucker Drilling Company, Inc. ("Tucker") (the "Merger Agreement") providing for the merger of Patterson Drilling with and into Tucker. The merger was consummated on July 30, 1996 after a required approval of the stockholders of both Patterson and Tucker, with Tucker as the surviving corporation, wholly-owned by Patterson and operating under the assumed name of Patterson Drilling Company.

Pursuant to the terms of the Merger Agreement, each share of Tucker common stock outstanding on July 30, 1996 was converted into 0.74 of a share ("Exchange Ratio") of Patterson common stock, par value \$0.01 per share, and all options to purchase shares of Tucker common stock outstanding on that date became options to purchase Patterson common stock, as adjusted by the Exchange Ratio, upon the terms of the governing stock option plans.

PATTERSON ENERGY, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

2. MERGER AND ACQUISITIONS -- (CONTINUED)

A total of 6.3 million shares of Patterson common stock was issued pursuant to the merger and an additional 298,368 shares of Patterson common stock were reserved for issuance under the outstanding Tucker stock options.

The merger was treated as a reorganization within the meaning of Section 368(a) of the Internal Revenue Code of 1986, as amended, and was accounted for as a pooling of interests for financial accounting purposes.

Certain adjustments were made in 1996 to conform the previous accounting policies and fiscal year end of Tucker with those of the Company. Consequently, the operations of Tucker for the three months ended March 31, 1996 (Tuckers' fiscal year end) are reflected in the consolidated financial statements of the Company for the year ended December 31, 1996.

A corresponding stockholders' equity adjustment has been recorded at December 31, 1996 as a result of including Tucker's operations for the three months ended March 31, 1996 with Patterson's operations for each of the years ended December 31, 1995 and 1996. Selected unaudited information related to the operations of Tucker for the three months ended March 31, 1996 is as follows (in thousands):

(UNAUDITED)

Revenues.....	\$3,972
Operating loss.....	(218)
Net income.....	759

Sledge Cattle Company, Inc. d/b/a Gene Sledge Drilling Corporation -- During October 1996, the Company executed a Stock Purchase Agreement (the "Purchase Agreement") with the owners of 100% of the outstanding stock of Sledge Cattle Company, Inc. d/b/a Gene Sledge Drilling Corporation ("Sledge"), a non-affiliated contract drilling company. The Purchase Agreement included, among other things, the acquisition of six oil and gas drilling rigs, related drilling equipment and inventory, three rig hauling trucks and one yard and shop facility for a purchase price of \$14.7 million. The acquisition was funded by a cash payment of \$4.3 million and proceeds of \$10.4 million provided by a credit facility maintained with The CIT Group/ Equipment Financing, Inc. (see Note 7). At the date of acquisition, Sledge had working capital of approximately \$4.3 million and immediately following consummation of the Purchase Agreement, certain assets, unrelated to the oil and natural gas industry, were sold back to the previous owners of Sledge for \$1.7 million.

The operating results of this acquisition are included in the Company's consolidated statements of income from the date of acquisition. The following unaudited pro forma summary as of December 31, 1996 presents the consolidated results of operations as if Sledge had been acquired as of January 1, 1996, after giving effect to certain adjustments, including the elimination of certain revenues and other income and expenses attributed to the assets not acquired from Sledge, and increased interest expense on the acquisition debt and related income tax effects (in thousands, except per share data).

(UNAUDITED)

Revenues.....	\$90,806
Net income.....	4,078
Net income per basic share.....	0.21
Net income per diluted share.....	0.20

The pro forma results have been prepared for comparative purposes only and do not purport to be indicative of what would have occurred had the acquisition been made as of the date indicated. In addition,

PATTERSON ENERGY, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

2. MERGER AND ACQUISITIONS -- (CONTINUED)

they are not intended to be a projection of future results and do not reflect any synergies that might be achieved from combined operations.

Other 1996 asset acquisitions -- During November and December 1996, in two separate transactions with non-affiliated entities, the Company acquired 15 contract drilling rigs and other related equipment. The total consideration paid for these assets was \$4.2 million consisting of \$2.4 million cash, a \$400,000 promissory note payable and the issuance of 208,000 shares of the Company's common stock, valued for purposes of the transaction at \$1.4 million (see Notes 7 and 9).

3. CASH

Included in cash as of December 31, 1997 and 1998 was approximately \$3.3 million and \$1.4 million respectively, of monthly oil and natural gas sales to be distributed to revenue owners subsequent to year-end.

4. PROPERTY AND EQUIPMENT

Property and equipment consisted of the following at December 31, 1997 and 1998 (in thousands):

	1997	1998
	----	----
Drilling rigs and related equipment.....	\$144,104	\$199,331
Producing oil and natural gas properties.....	24,024	27,856
Other equipment.....	917	2,135
Buildings.....	3,771	3,953
Land.....	984	1,534
	-----	-----
	173,800	234,809
Less accumulated depreciation and depletion.....	(73,395)	(98,132)
	-----	-----
	\$100,405	\$136,677
	=====	=====

5. INTANGIBLE ASSETS

Intangible assets consisted of the following at December 31, 1997 and 1998 (in thousands):

	1997	1998
	----	----
Goodwill.....	\$23,708	\$46,482
Covenants not to compete.....	1,673	2,673
Other.....	205	979
	-----	-----
	25,586	50,134
Less accumulated amortization.....	(942)	(4,259)
	-----	-----
	\$24,644	\$45,875
	=====	=====

PATTERSON ENERGY, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

6. ACCRUED EXPENSES

Accrued expenses consisted of the following at December 31, 1997 and 1998 (in thousands):

	1997	1998
	----	----
Salaries, wages and related payroll taxes.....	\$2,302	\$1,276
Workers' compensation liability.....	1,615	1,157
Sales tax.....	548	472
Employee benefit plan contributions.....	568	--
Other.....	109	265
	-----	-----
	\$5,142	\$3,170
	=====	=====

7. NOTE PAYABLE

Note payable consisted of the following at December 31, 1997 and 1998 (in thousands):

	1997	1998
	----	----
Line of credit agreement with Norwest Bank Texas, N.A. providing for an advancing, non-revolving credit facility of \$70.0 million, monthly payments of interest only at the London Interbank Offered Rate (LIBOR) plus 2.375% (7.921% at December 31, 1998) through May 1998 at which time the outstanding principal balance converted to a term loan with a maturity date of January 1, 2001 and a seven-year level principal amortization. The obligation is collateralized by certain accounts receivable, drilling rigs and other related drilling equipment.....	\$23,250	\$55,714
Less current maturities.....	(1,467)	(8,571)
	-----	-----
	\$21,783	\$47,143
	=====	=====

During February 1997, using proceeds provided by its equity offering completed during January and February of 1997 (see Note 9), the Company paid, prior to maturity, its notes payable and accrued interest amounts under loan agreements with The CIT Group/Equipment Financing, Inc. and Norwest Bank Texas, Wichita Falls, N.A. of approximately \$25.8 million. The Company expensed approximately \$191,000 of prepayment penalties and an additional \$74,000 in deferred financing costs with the early retirement of such notes payable. These amounts are included in interest expense at December 31, 1997 as management considers these amounts immaterial to treat as an extraordinary item.

During June 1997, the Company entered into a line of credit agreement with Norwest Bank Texas, N.A. (Norwest) providing for a credit facility of \$30.0 million. The terms of its Norwest credit included interest only payments at LIBOR plus 2.50% through December 31, 1997 at which time the outstanding principal amount would convert to a term note with a maturity date of January 1, 2000 maturity date and a seven-year level principal amortization. The Company borrowed \$23.25 million under the credit facility to partially fund its 1997 asset acquisitions (see Note 2).

During December 1997, the Company and Norwest Bank Texas, Wichita Falls, N.A. ("Norwest") renegotiated the terms of its existing credit agreement replacing it with a new agreement (the "Norwest Line") providing for an advancing, non-revolving credit facility of \$60.0 million. During February 1998, the existing credit facility was increased to \$70.0 million. The Norwest Line was payable interest only at LIBOR plus 2.375% through May 31, 1998, at which time the outstanding principal balance of \$60.0 million converted to a term loan with a January 1, 2001 maturity date and a seven-year level principal amortization. Using proceeds from the Norwest Line, the Company paid a \$75,000 origination fee and all amounts then

PATTERSON ENERGY, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

7. NOTE PAYABLE -- (CONTINUED)

outstanding under its previous Norwest credit facility, including principal of \$23.25 million and accrued interest of approximately \$94,000. During February 1998, the Company borrowed \$36.75 million under the Norwest Line to fund its acquisition of Robertson Onshore Drilling Company as described in Note 2.

Five-year maturities of note payable -- Scheduled maturities of the Norwest Line for the periods subsequent to December 31, 1998, are as follows (in thousands):

1999.....	\$ 8,571
2000.....	8,571
2001.....	38,572

Total.....	\$55,714
	=====

The Norwest Line contains a number of representations, warranties and covenants, the breach of which, at the election of Norwest, would accelerate the maturity date of the outstanding principal balance.

The more restrictive covenants include:

- Maintenance on a quarterly basis of a ratio of consolidated cash flow to current maturities of long-term debt of at least 2.0 to 1.0;
- Maintenance on a quarterly basis of a ratio of consolidated debt to tangible net worth not to exceed 1.10 to 1.0;
- Maintenance on a quarterly basis of a ratio of current assets to current liabilities of at least 1.4 to 1.0;
- Maintenance on a quarterly basis of positive net income;
- Without written consent of Norwest, the Company cannot conduct any business not currently being conducted by the Company, nor liquidate, dissolve or merge into any other entity; and
- The Company shall not pay, or authorize the payment of, any dividends on any stock, debenture or other security without the prior written consent of Norwest.

Other restrictive covenants under the terms of the Norwest Line require that the underlying collateral not be subjected to impairment, sold, conveyed, transferred, encumbered, mortgaged, pledged, assigned or hypothecated in any manner without the express written consent of Norwest. At December 31, 1998, the Company was in violation of the positive net income covenant provision. The Company has obtained an unconditional waiver of such violation from Norwest as of December 31, 1998. In addition, the Norwest Line was further amended to replace the positive net income covenant with an earnings before interest expense, income taxes, depreciation, depletion and amortization (EBITDA) to quarterly interest expense provision. The Company must maintain on a quarterly basis an EBITDA to interest expense of at least 2.25 to 1.0. In addition, the Company must provide a pledge of its oil and natural gas properties to Norwest.

The estimated fair value of the Company's long-term debt obligations approximates its related carrying value because the underlying debt agreement bears interest at current market rates.

A commercial bank has issued a letter of credit to the Company's workers' compensation insurance carrier on behalf of the Company in the amount of \$150,000 which is fully collateralized by a certificate of deposit. Additionally, the Company maintains letters of credit in the aggregate amount of \$340,289 with a bank for the benefit of an insurance company as collateral for retrospective premiums and retained losses which could become payable under the terms of the Company's insurance contract. These letters of credit

PATTERSON ENERGY, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

7. NOTE PAYABLE -- (CONTINUED)

expire in November 1999, but provide for an indefinite number of annual extensions of the expiration date and are fully collateralized by the Company's cash. No amounts have been drawn under the letters of credit.

8. COMMITMENTS AND CONTINGENCIES

Supplemental Executive Retirement Plan -- Effective April 1, 1991 the Tucker Drilling Company, Inc. Supplemental Executive Retirement Plan (the "Plan") was established for certain officers and key employees. Pursuant to agreements, as amended on April 22, 1996 and May 16, 1996 with related participants of the Plan, the Company was obligated to pay each participant, or the designated beneficiary, a lump sum at such participant's death, disability or retirement. The amount to be paid to each participant was equal to the participant's vested benefit at such date, limited, however, to related benefits received from underlying insurance policies as described below.

The Company, through a grantor trust of which it is beneficiary, owns life insurance policies on the participants and an annuity from which the premiums on the life insurance policies were paid. During 1998, the life insurance policies were cancelled and the respective cash values were distributed to the Plan participants.

Contingencies -- The Company's contract services and oil and natural gas exploration and production operations are subject to inherent risks, including blowouts, cratering, fire and explosions which could result in personal injury or death, suspended drilling operations, damage to, or destruction of equipment, damage to producing formations and pollution or other environmental hazards.

As a protection against these hazards, the Company maintains general liability insurance coverage of \$2.0 million per occurrence with \$2.0 million of aggregate coverage and excess liability and umbrella coverages up to \$50.0 million per occurrence with a \$50.0 million aggregate.

The Company believes it is adequately insured for public liability and property damage to others with respect to its operations. However, such insurance may not be sufficient to protect the Company against liability for all consequences of well disasters, extensive fire damage or damage to the environment. The Company also carries insurance to cover physical damage to, or loss of, its rigs; however, it does not carry insurance against loss of earnings resulting from such damage or loss. The Company's lender who has a security interest in the drilling rigs is named as loss payee on the physical damage insurance on such rigs. The Company has never been fined or incurred liability for pollution or other environmental damage in connection with its operations.

The Company is involved in various routine litigation incident to its business. In the Company's opinion, none of these proceedings will have a material adverse effect on the financial condition of the Company.

9. STOCKHOLDERS' EQUITY

During January 1998, the Company acquired the outstanding stock of Lone Star. The purchase price consisted of \$1.4 million in cash, 571,328 shares of the Company's common stock valued at \$17.41 per share, the assumption of \$1.6 million of debt and approximately \$3,300 of other direct costs (see Note 2).

On July 1, 1997, the stockholders of Patterson approved an amendment to Patterson's Certificate of Incorporation increasing the number of authorized shares of common stock from 9 million shares to 18 million shares. During December 1997, the stockholders of Patterson approved a second amendment to Patterson's Certificate of Incorporation further increasing the number of authorized shares of common stock to 50 million shares.

PATTERSON ENERGY, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

9. STOCKHOLDERS' EQUITY -- (CONTINUED)

During July and December 1997, the Company's Board of Directors authorized two-for-one stock splits in the form of 100% stock dividends payable on July 25, 1997 and January 23, 1998, respectively. Par value of the Company's common stock remained at \$0.01 per share. Earnings per share and weighted average number of common shares outstanding have been restated for all periods presented to reflect the stock splits. As such, the Consolidated Statements of Stockholders' Equity and pertinent footnote disclosures contained herein have been restated to retroactively apply the effects of the stock splits.

During June 1997, the Company issued 1.1 million shares of common stock valued at \$7.875 per share as partial consideration for its acquisition of 21 contract drilling rigs and other related drilling equipment (see Note 2).

During January 1997, the Company completed a public offering of 7.1 million shares of common stock at a price of \$7.6875 per share. During February 1997, the underwriters of the Company's public offering exercised their over-allotment option to purchase 1.2 million additional shares of common stock. Net proceeds from the offering totaled approximately \$59.4 million to the Company.

In December 1996, the Company acquired three drilling rigs from a non-affiliated party. The purchase price for the rigs consisted of \$100,000 cash, a \$400,000 promissory note and the issuance of 208,000 shares of the Company's common stock valued at \$1.4 million (see Note 2).

In July 1996, the stockholders of the Company approved an amendment to the Company's Certificate of Incorporation providing for an increase of 4,000,000 shares in the total number of authorized shares of the Company's common stock and the issuance of 6.3 million shares in connection with the Company's merger with Tucker (see Note 2).

In July 1996, pursuant to the terms of the Underwriters' Warrant Agreement dated November 2, 1993 as amended on November 15, 1994 and June 18, 1996, the Company issued 152,896 shares of common stock upon the conversion of 301,260 warrants. In lieu of a cash payment for the exercise of such warrants, the respective warrant holders elected to forfeit 148,364 shares of common stock back to the Company.

10. STOCK OPTIONS AND WARRANTS

Employee Stock Incentive Plans -- In August 1993, the Company adopted the Patterson Energy, Inc. 1993 Stock Incentive Plan (the "Stock Incentive Plan"). The purpose of the Stock Incentive Plan is to provide continuing incentives to the Company's key employees, which may include, but shall not necessarily be limited to, members of the Board of Directors (excluding members of the Compensation Committee) and officers of the Company. The Stock Incentive Plan provides for an authorization of 2.8 million shares of common stock for issuance thereunder. Under the Stock Incentive Plan, the Company may grant to key employees awards of stock options and restricted stock or any combination thereof. The Company may grant both incentive stock options ("incentive stock options") intended to qualify under Section 422 of the Internal Revenue Code of 1986, as amended, and options which are not qualified as incentive stock options. The options become immediately exercisable in the event of a change in control (as defined in the Stock Incentive Plan) of the Company.

Under the Stock Incentive Plan, the exercise price of incentive stock options must be at least equal to the fair market value of the stock on date of grant and the exercise price of non-incentive stock options may not be less than 80% of the fair market value on date of grant.

Stock options covering a total of 1.6 million shares of common stock have been granted to date under the Stock Incentive Plan to five executive officers and various other employees of the Company, including Mr. Patterson (options covering 455,000 shares or approximately 25% of the total options granted). The outstanding options were variously granted since 1995. Each of the options has a 10-year term and the exercise

PATTERSON ENERGY, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

10. STOCK OPTIONS AND WARRANTS -- (CONTINUED)

prices were equal to the fair market value of the Company's common stock on the respective grant dates. The options granted to the employees vest either (i) 20% a year, beginning on the grant date and 20% for the next four anniversaries of the date of grant, or (ii) 11.2% for the first five years, beginning on the grant date, and 22% on each of the next two anniversaries of the grant date. A total of 354,520 options granted under the Stock Incentive Plan have been exercised, 29,216 have been forfeited and 11,984 have expired as of December 31, 1998.

In March 1983, the Board of Directors of Tucker approved and implemented an Incentive Stock Option Plan which was amended in 1988 to allow for the granting of nonqualified stock options and in 1991 was further amended to eliminate stock appreciation rights. The purpose of the plan was to attract and retain key employees and directors and to provide such persons with a proprietary interest in Tucker through the granting and exercise of stock options. The maximum number of shares of common stock available for issuance under the plan was 507,640 shares.

In June 1994, the Board of Directors of Tucker adopted the Tucker Drilling Company, Inc. 1994 Non-Qualified Stock Option Plan. Officers and directors were not eligible to receive options from this plan. The maximum number of shares available for issuance under the plan was 82,880 shares.

Each of the plans provide that options may be granted to purchase shares at prices not less than the fair market value at date of grant. The exercise period is governed by option agreements, but in no event may the exercise period extend beyond ten years from the date of grant. As discussed in Note 2, existing stock options and other employee incentive plans of Tucker became plans to purchase or receive common stock of the Company upon consummation of the merger of the Company and Tucker. At December 31, 1998, 8,288 options granted under the above mentioned plans were outstanding to purchase common stock of the Company, 1,184 options have been forfeited and 1,184 options have expired as of December 31, 1998.

Non-Employee Directors' Stock Option Plan -- In June 1995, Patterson adopted the Non-Employee Directors' Stock Option Plan (the "Outside Directors' Plan"). The purpose of the Outside Directors' Plan is to encourage and provide incentive for high level performance by non-employee directors of the Company. An aggregate of 120,000 shares of Common Stock are reserved for issuance under the Outside Directors' Plan to directors who are not employees of the Company.

As directed by the Outside Directors' Plan, the exercise price of the options will be equal to the fair market value of the Company's common stock on the date of grant. Outside directors are automatically granted options to purchase 20,000 shares and an additional 4,000 shares for each subsequent year that they serve up to a maximum of 40,000 shares per director. Each option is exercisable one year after the date of grant and expires five years from the date of grant. The options become immediately exercisable in the event of a change of control (as defined in the Outside Directors' Plan) of the Company.

PATTERSON ENERGY, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

10. STOCK OPTIONS AND WARRANTS -- (CONTINUED)

The table below sets forth information regarding options granted under the Outside Directors' Plan. Each of the options are granted with an exercise price per share equal to fair market value on the grant date.

DATE GRANTED -----	OPTIONS GRANTED -----	EXERCISE PRICE/SHARE -----
June 6, 1995.....	40,000	\$ 2.25
June 6, 1996.....	8,000	4.31
July 30, 1996.....	20,000	4.38
June 6, 1997.....	8,000	10.00
July 30, 1997.....	4,000	15.81
June 6, 1998.....	8,000	11.06
July 30, 1998.....	4,000	7.38

Total options granted.....	92,000	
	=====	

A summary of the status of the Company's stock options issued under the Stock Incentive Plan and the Outside Directors' Plan as of December 31, 1996, 1997 and 1998 and the changes during each of the three years then ended are presented below (in thousands):

	1996		1997		1998	
	NO. OF SHARES OF UNDERLYING OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE	NO. OF SHARES OF UNDERLYING OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE	NO. OF SHARES OF UNDERLYING OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE
Outstanding at beginning of the year.....	760	\$2.64	\$ 788	\$ 2.70	1,145	\$ 9.39
Granted at the money.....	28	4.36	648	14.76	515	9.79
	-----	-----	-----	-----	-----	-----
Total granted.....	788	2.70	1,436	8.14	1,660	9.51
	-----	-----	-----	-----	-----	-----
Exercised.....	--	--	291	2.88	133	2.31
Forfeited.....	--	--	--	--	30	12.47
Expired.....	--	--	--	--	13	11.62
	-----	-----	-----	-----	-----	-----
Outstanding at end of year.....	788	\$2.70	\$1,145	\$ 9.39	1,484	\$10.08
	=====	=====	=====	=====	=====	=====
Exercisable at end of year.....	374	\$2.81	\$ 361	\$ 6.70	574	\$ 8.96
	=====	=====	=====	=====	=====	=====
Weighted average fair value of options granted during the year.....	N/A	\$1.93	N/A	\$ 6.15	N/A	\$ 4.99
	=====	=====	=====	=====	=====	=====

The following table summarizes information about stock options outstanding at December 31, 1998:

RANGE OF EXERCISE PRICES -----	OPTIONS OUTSTANDING			OPTIONS EXERCISABLE	
	NUMBER OUTSTANDING	WEIGHTED AVERAGE REMAINING CONTRACTED LIFE	WEIGHTED AVERAGE EXERCISE PRICE	NUMBER EXERCISABLE	WEIGHTED AVERAGE EXERCISE PRICES
\$1.81 to \$5.00	378,768	6.71	\$ 2.89	245,136	\$ 3.05
\$5.01 to \$15.81	1,104,800	8.85	\$12.56	328,800	\$13.36
	-----	-----	-----	-----	-----
	1,483,568	8.30	\$10.08	573,936	\$ 8.96
	=====	=====	=====	=====	=====

The fair value of each stock option granted is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions for grants in 1995, 1996, 1997 and

PATTERSON ENERGY, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

10. STOCK OPTIONS AND WARRANTS -- (CONTINUED)

1998 respectively; dividend yield of 0.00%; risk-free interest rates are different for each grant and range from 5.61% to 6.60%; the expected term is 5 years; and a volatility of 38.68% for all 1995 and 1996 grants, 35.97% for all 1997 grants and 51.08% for all 1998 grants.

Public Relations Services Stock Options -- During November 1994, February 1995 and July 1995, the Company issued options covering a total of 500,000 shares of common stock to two consultants as partial compensation for public relations services rendered to the Company. All options granted to the consultants have an exercise price no less than the fair market value of the stock at date of grant. The respective options were fully exercisable upon grant date. In November 1994, 130,000 options were granted at \$1.88 per share and 50,000 options were granted at \$2.13 per share. In February 1995, 80,000 options were granted at \$2.19 per share which had a fair value of \$0.56 per option and in July 1995, 240,000 options were granted at \$2.41 per share which had a fair value of \$1.04 per option. At December 31, 1996, 80,000 options with an exercise price of \$2.41 per share have been exercised. The remaining 420,000 options were exercised during 1997.

The fair values of these options were determined using the following assumptions: dividend yield of 0.00%; risk-free interest rates of 7.74% and 5.92%, for January 1 and July 1, respectively; expected lives of 5 years; and volatility of 38.68%.

Pro Forma Stock-Based Compensation Disclosure -- Had the compensation cost for the Company's stock-based compensation plan been determined consistent with SFAS No. 123, the Company's net income (loss) and net income (loss) per common share for 1996, 1997 and 1998 would approximate the pro forma amounts below:

	DECEMBER 31, 1996		DECEMBER 31, 1997		DECEMBER 31, 1998	
	AS REPORTED	PRO FORMA	AS REPORTED	PRO FORMA	AS REPORTED	PRO FORMA
SFAS No. 123 charge net of income tax...	\$ --	\$ 162	\$ --	\$ 1,329	\$ --	\$ 1,817
APB 25 charge.....	\$ --	\$ --	\$ --	\$ --	\$ --	\$ --
Net income (loss).....	\$4,271	\$4,109	\$22,242	\$20,913	\$ (325)	\$ (2,142)
Net income (loss) per common share:						
Basic.....	\$ 0.22	\$ 0.21	\$ 0.78	\$ 0.73	\$ (0.01)	\$ (0.07)
Diluted.....	\$ 0.21	\$ 0.20	\$ 0.75	\$ 0.71	\$ (0.01)	\$ (0.07)

The effects of applying SFAS No. 123 in this pro forma disclosure are not indicative of future amounts. SFAS No. 123 does not apply to awards prior to 1995.

Underwriters' Warrants -- In November 1993, the underwriters of the Company's initial public offering were issued warrants as partial consideration for their underwriting services for the initial public offering. The warrants gave the underwriters the right to purchase 301,260 shares of the Company's common stock at a price of \$2.17 per share and 301,260 redeemable warrants at \$0.09 per warrant. In November 1995, 301,260 redeemable warrants were issued to the underwriters due to a partial exercise of the warrants. These redeemable warrants were immediately exercised by the underwriters at a price of \$1.88 per share resulting in the issuance of 142,308 shares of the Company's common stock. In July 1996 the remaining 301,260 warrants were exercised in which 152,896 shares of the Company's common stock were issued (see Note 9).

Stock Purchase Warrants -- In May 1995, the Company issued 300,000 warrants exercisable at \$2.25 per share as partial consideration for the purchase of three drilling rigs and related equipment (see Note 9). The warrants were exercisable upon issuance and would have expired on December 31, 1997. During

PATTERSON ENERGY, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

10. STOCK OPTIONS AND WARRANTS -- (CONTINUED)

November 1997, the Company registered certain securities with the Commission on a Form S-3 Registration Statement which included the aforementioned 300,000 shares upon exercise of the underlying warrants.

Tabular Summary -- The following table summarizes information regarding the Company's stock options and warrants granted under the provisions of the aforementioned plans as well as stock options and warrants issued pursuant to certain transactions described in Notes 2 and 9:

GRANTED -----	SHARES -----	WEIGHTED AVERAGE EXERCISE PRICE -----
1996.....	28,000	\$ 4.36
1997.....	1,448,000	11.02
1998.....	515,000	9.79
EXERCISED		
1996.....	578,032	\$ 2.10
1997.....	1,808,720	4.88
1998.....	132,720	2.31
SURRENDERED		
1996.....	148,364	\$ 2.17
1997.....	1,184	2.07
1998.....	43,568	12.10
OUTSTANDING AT YEAR END		
1996.....	1,506,760	\$ 2.39
1997.....	1,144,856	9.37
1998.....	1,483,568	10.08
EXERCISABLE AT YEAR END		
1996.....	1,080,360	\$ 2.30
1997.....	347,800	6.78
1998.....	573,936	8.96

11. LEASES

The Company incurred rent expense, consisting primarily of daily rental charges for the use of drilling equipment, of \$1.8 million, \$5.0 million and \$4.3 million, for the periods ended December 31, 1996, 1997 and 1998, respectively. The Company's obligations under non-cancelable operating lease agreements are not material to the Company's operations.

PATTERSON ENERGY, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

12. INCOME TAXES

The provision for income taxes for the years ended December 31, 1996, 1997 and 1998 consists of the following (in thousands):

	1996 ----	1997 ----	1998 ----
Federal income tax expense (benefit):			
Current.....	\$ 52	\$ 9,444	\$ (6,358)
Deferred.....	(2,428)	2,420	6,451
	-----	-----	-----
	(2,376)	11,864	93
State income tax expense:			
Current.....	122	909	--
Deferred.....	--	93	--
	-----	-----	-----
Total income tax expense (benefit).....	\$ (2,254)	\$12,866	\$ 93
	=====	=====	=====

The effective income tax rate varies from the Federal statutory rate as follows for the years ended December 31, 1996, 1997 and 1998:

	1996 ----	1997 ----	1998 ----
Statutory tax rate.....	34.0%	35.0%	34.0%
Reduction of valuation allowance.....	(151.8)	--	--
Nondeductible amortization.....	--	--	(102.75)
Statutory depletion in excess of basis.....	--	(1.1)	44.29
State income taxes.....	6.1	2.9	--
Non-deductible expenses.....	--	--	(12.83)
Other, net.....	--	(0.2)	(2.8)
	-----	-----	-----
Effective tax rate.....	(111.7)%	36.6%	(40.09)%
	=====	=====	=====

There is approximately \$8.4 million of Federal income taxes receivable in current assets at December 31, 1998 and approximately \$6.0 million of Federal income taxes payable was accrued at December 31, 1997. The Company reduced its accrued Federal and state income tax payable in 1997 by approximately \$2.9 million due to a tax benefit received from the exercise of certain stock options. There was \$920,600 of accrued state income taxes accrued at December 31, 1997.

As of January 1, 1994, a deferred tax asset valuation allowance of approximately \$6.0 million was due primarily to net operating loss ("NOL") carryforwards which were not expected to be utilized before their respective expiration dates or which benefits the Company was unable to predict would more likely than not be realized. During each of the years ended December 31, 1995 and 1996, the Company changed its estimate with respect to its net deferred tax assets and, accordingly, reduced the related valuation allowance by approximately \$1.7 million and \$2.1 million, respectively. To the extent the valuation allowance was reduced, the related tax benefit was credited to income tax expense.

PATTERSON ENERGY, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

12. INCOME TAXES -- (CONTINUED)

The tax effect of significant temporary differences representing deferred tax assets and liabilities and changes therein were as follows (in thousands):

	JANUARY 1, 1996	NET CHANGE	DECEMBER 31, 1996	NET CHANGE	DECEMBER 31, 1997	NET CHANGE	DECEMBER 31, 1998
	-----	-----	-----	-----	-----	-----	-----
Deferred tax assets:							
Net operating loss							
carryforwards.....	\$ 2,669	\$ (258)	\$2,411	\$ (1,195)	\$ 1,216	\$ 218	\$ 1,434
Investment tax credit							
carryforwards.....	469	(94)	375	--	375	--	375
AMT credit carryforwards.....	282	--	282	--	282	--	282
Depletion carryforwards.....	612	(218)	394	(394)	--	--	--
Property and equipment.....	--	--	--	--	--	--	--
Other.....	272	(18)	254	796	1,050	78	1,128
	-----	-----	-----	-----	-----	-----	-----
	4,304	(588)	3,716	(793)	2,923	296	3,219
Valuation allowance.....	(2,095)	2,095	--	--	--	--	--
	-----	-----	-----	-----	-----	-----	-----
Deferred tax assets.....	2,209	1,507	3,716	(793)	2,923	296	3,219
Deferred tax liabilities:							
Property and equipment basis							
difference.....	(802)	(1,527)	(2,329)	(1,553)	(3,882)	(7,335)	(11,217)
	-----	-----	-----	-----	-----	-----	-----
Net deferred tax asset							
(liability).....	\$ 1,407	\$ (20)	\$1,387	\$ (2,346)	\$ (959)	\$ (7,039)	\$ (7,998)
	=====	=====	=====	=====	=====	=====	=====

For tax return purposes, the Company had tax NOL carryforwards of approximately \$4.2 million at December 31, 1998. If unused, the aforementioned tax NOL carryforwards will expire in various amounts in years 1999 to 2012. During the years ended December 31, 1996 and 1997, the Company utilized approximately \$2.2 million and \$3.6 million, respectively, of NOL carryforwards.

During 1995, the Company's NOL carryforwards became subject to an annual limitation due to a change of over 50% in the stock ownership of the Company as defined in Internal Revenue Service Code Section 382(g). The NOL carryforwards that can be utilized to offset net income in any year will be equal to approximately \$3.3 million plus any unused benefit from the prior year. The NOL limitation is determined by the value of Patterson's equity on August 2, 1995, the day prior to the ownership change, times 5.88%, the Federal long-term exempt rate on that date as published by the U.S. Treasury Department, or \$1.8 million, and approximately \$1.5 million which is determined by the value of Tucker's equity on July 29, 1996, the day prior to consummation of the Merger, times 5.78%, the Federal long-term exempt rate on that date.

During the year ended December 31, 1996, the Company began recording non-cash Federal deferred income taxes based primarily on the relationship between the amount of the Company's unused Federal NOL carryforwards and the temporary differences between the book basis and tax basis in the Company's assets.

13. EMPLOYEE BENEFITS

Effective January 1, 1992, the Company established a 401(k) profit sharing plan for all eligible employees. Company contributions are discretionary. In March 1998, the Company contributed \$519,559 to the plan. The amount of the contribution was included in accrued expenses at December 31, 1997. No matching contribution was accrued or paid by the Company for the 1998 fiscal year.

14. BUSINESS SEGMENTS

The Company conducts its business through three distinct operating activities: contract drilling of oil and natural gas wells, oil and natural gas exploration, development, acquisition and production and, to a lesser degree, providing drilling fluid services to operators in the oil and natural gas industry. Although the drilling

PATTERSON ENERGY, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

14. BUSINESS SEGMENTS -- (CONTINUED)

fluid operations do not meet the quantitative thresholds to warrant disclosure as a business segment, management of the Company considers its drilling fluid operations an integral part of its business.

Contract Drilling Services. The Company markets its contract drilling services to major oil companies and independent oil and natural gas producers. The Company owns 119 drilling rigs, 114 of which are currently operable. Currently, 99 of the operable drilling rigs are based in Texas (60 in west Texas, 22 in south Texas, 12 in east Texas and five in north Texas), nine are based in southeast New Mexico, five in Mississippi and one in Utah. The drilling rigs have rated maximum depth capabilities ranging from 7,000 feet to 25,000 feet.

Oil and Natural Gas Operations. The Company has been engaged in the development, exploration, acquisition and production of oil and natural gas since 1982. The Company's oil and natural gas activities are designed to complement its land drilling operations and diversify the Company's overall business strategy. These activities are primarily focused in mature producing regions in the Austin Chalk Trend, the Permian Basin and South Texas. Oil and natural gas operations comprised approximately 4% of the Company's consolidated operating revenues for the year ended December 31, 1998. The Company's business strategy for its oil and natural gas operations is to increase its oil and natural gas reserves primarily through developmental and exploratory drilling in producing areas. At December 31, 1998, the Company's proved developed reserves were approximately 1.5 million BOE and had a present value (discounted at 10% before income taxes) of estimated future net revenues of approximately \$6.8 million. The industry's significantly reduced commodity prices, primarily the price of crude oil, have had a negative impact on the valuation of the Company's oil and natural gas reserves. For each of the years ended December 31, 1996, 1997 and 1998, the Company incurred \$549,000, \$355,000 and \$3.8 million, respectively, of impairment charge to its oil and natural gas properties.

Drilling Fluid Services. The Company provides contract drilling fluid services to numerous operators in the oil and natural gas industry. Operating revenues derived from these activities constitute approximately 7% of the Company's consolidated operating revenues. Patterson believes that these contract services integrate well with its other core operating activities. The drilling fluid operations were added by the Company during the current fiscal year with its acquisitions of Lone Star Mud, Inc. during January 1998 and Tejas Drilling Fluids, Inc. in September 1998 and have operations throughout Texas, New Mexico, Oklahoma and Colorado.

	DECEMBER 31,		
	1996	1997	1998
	----	----	----
Revenues:			
Contract drilling.....	\$73,590	\$178,332	\$165,997
Oil and natural gas.....	10,118	12,445	7,170
Drilling fluids.....	--	--	13,397
	-----	-----	-----
Total revenues.....	\$83,708	\$190,777	\$186,564
	=====	=====	=====
Income (loss) from operations:			
Contract drilling.....	\$ 3,869	\$ 32,745	\$ 9,329
Oil and natural gas.....	1,550	2,352	(6,217)
Drilling fluids.....	--	--	360
	-----	-----	-----
General corporate expense(a).....	5,419	35,097	3,472
Interest income.....	(2,268)	--	--
Interest expense.....	478	1,056	767
	-----	-----	-----
Income (loss) before income taxes.....	(1,612)	(1,045)	(4,471)
	-----	-----	-----
	\$ 2,017	\$ 35,108	\$ (232)
	=====	=====	=====

PATTERSON ENERGY, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

14. BUSINESS SEGMENTS -- (CONTINUED)

	DECEMBER 31,		
	1996	1997	1998
	----	----	----
Identifiable assets:			
Contract drilling.....	\$63,506	\$162,726	\$185,237
Oil and natural gas.....	24,407	23,777	15,411
Drilling fluids.....	--	--	20,063
Corporate(b).....	--	16,697	15,894
	-----	-----	-----
Total assets.....	\$87,913	\$203,200	\$236,605
	=====	=====	=====
Depreciation, depletion and amortization:			
Contract drilling.....	\$ 6,837	\$ 12,541	\$ 22,416
Oil and natural gas.....	3,123	4,956	4,780
Drilling fluids.....	--	--	895
	-----	-----	-----
Total depreciation, depletion and amortization.....	\$ 9,960	\$ 17,497	\$ 28,091
	=====	=====	=====
Capital expenditures:			
Contract drilling.....	\$19,867	\$ 74,495	\$ 67,471
Oil and natural gas.....	4,106	9,766	7,734
Drilling fluids.....	--	--	4,396
	-----	-----	-----
Total capital expenditures.....	\$23,973	\$ 84,261	\$ 79,601
	=====	=====	=====

(a) The general corporate expense for 1996 is comprised entirely of non-recurring acquisition costs. All other general corporate revenues and expenses, except for interest income and interest expense, have been allocated to the business segments of the Company.

(b) Corporate assets primarily include cash on hand managed by the parent corporation and certain deferred Federal income tax assets.

15. OIL AND NATURAL GAS EXPENDITURES

Gross oil and natural gas expenditures by the Company for the years ended December 31, 1996, 1997 and 1998 are summarized below (in thousands):

	DECEMBER 31,		
	1996	1997	1998
	----	----	----
Property acquisition costs.....	\$ 666	\$ 2,577	\$1,585
Exploration costs.....	3,684	7,680	6,510
Development costs.....	2,174	2,412	1,126
	-----	-----	-----
	\$6,524	\$12,669	\$9,221
	=====	=====	=====

The aggregate amount of capitalized costs of oil and natural gas properties as of December 31, 1997 and 1998 is comprised of the following (in thousands):

	DECEMBER 31,	
	1997	1998
	----	----
Proved properties.....	\$ 24,024	\$ 27,856
Accumulated depreciation, depletion and amortization.....	(15,696)	(21,809)
	-----	-----
Net proved properties.....	\$ 8,328	\$ 6,047
	=====	=====

PATTERSON ENERGY, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

16. SUPPLEMENTARY OIL AND NATURAL GAS RESERVE INFORMATION AND RELATED DATA (UNAUDITED)

The following table sets forth information with respect to quantities of net proved developed oil and natural gas reserves and changes in those reserves for the years ended December 31, 1996, 1997 and 1998. The quantities were estimated by an independent petroleum engineer. The Company's proved developed oil and natural gas reserves are located entirely within the United States.

ESTIMATES OF RESERVES AND PRODUCTION PERFORMANCE ARE SUBJECTIVE AND MAY CHANGE MATERIALLY AS ACTUAL PRODUCTION INFORMATION BECOMES AVAILABLE.

OIL AND NATURAL GAS RESERVE QUANTITIES

	OIL (BBLs)	GAS (MCF)
	-----	-----
	(IN THOUSANDS)	
Estimated quantity, January 1, 1996.....	757	5,270
Revision in previous estimates.....	39	464
Extensions, discoveries and other additions.....	215	1,972
Purchases.....	289	1,687
Sales of reserves-in-place.....	(3)	(87)
Production.....	(235)	(1,679)
	-----	-----
Estimated quantity, January 1, 1997.....	1,062	7,627
Revision in previous estimates.....	193	(973)
Extensions, discoveries and other additions.....	411	294
Purchases.....	--	--
Sales of reserves-in-place.....	(336)	(2,003)
Production.....	(385)	(1,157)
	-----	-----
Estimated quantity, January 1, 1998.....	945	3,788
Revision in previous estimates.....	140	(596)
Extensions, discoveries and other additions.....	146	1,100
Purchases.....	--	--
Sales of reserves-in-place.....	(1)	(7)
Production.....	(284)	(795)
	-----	-----
Estimated quantity, January 1, 1999.....	946	3,490
	=====	=====

PATTERSON ENERGY, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

16. SUPPLEMENTARY OIL AND NATURAL GAS RESERVE INFORMATION AND RELATED
DATA (UNAUDITED) -- (CONTINUED)
RESULTS OF OPERATIONS FOR OIL AND NATURAL GAS PRODUCING ACTIVITIES

	YEAR ENDED DECEMBER 31,		
	1996	1997	1998
	(IN THOUSANDS)		
Oil and natural gas sales.....	\$8,299	\$10,773	\$ 5,641
Gain (loss) on sale of oil and natural gas properties.....	(101)	803	68
	-----	-----	-----
	8,198	11,576	5,709
	-----	-----	-----
Costs and expenses:			
Production costs.....	2,012	2,274	1,924
Exploration expenses.....	1,453	2,128	1,752
Depreciation, depletion and amortization.....	3,123	4,956	4,780
Impairment of oil and natural gas properties.....	549	355	3,816
Income tax expense (benefit).....	362	633	(2,231)
	-----	-----	-----
	7,499	10,346	10,041
	-----	-----	-----
Results of operations for oil and natural gas producing activities.....	\$ 699	\$ 1,230	\$ (4,332)
	=====	=====	=====

STANDARDIZED MEASURE OF FUTURE NET CASH FLOWS OF PROVED DEVELOPED OIL AND
NATURAL GAS RESERVES, DISCOUNTED AT 10% PER ANNUM

	YEAR ENDED DECEMBER 31,		
	1996	1997	1998
	(IN THOUSANDS)		
Future gross revenues.....	\$42,930	\$23,933	\$16,451
Future development and production costs.....	(17,293)	(8,921)	(7,219)
Future income tax expense(a).....	(6,581)	(3,679)	(1,929)
	-----	-----	-----
Future net cash flows.....	19,056	11,333	7,303
Discount at 10% per annum.....	(5,756)	(2,710)	(1,953)
	-----	-----	-----
Standardized measure of discounted future net cash flows.....	\$13,300	\$ 8,623	\$ 5,350
	=====	=====	=====

(a) Future income taxes are computed by applying the statutory tax rate to future net cash flows less the tax basis of the properties and net operating loss attributable to oil and gas operations and investment tax credit carryforwards as of year-end; statutory depletion and tax credits applicable to future oil and gas-producing activities are also considered in the income tax computation.

PATTERSON ENERGY, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

16. SUPPLEMENTARY OIL AND NATURAL GAS RESERVE INFORMATION AND RELATED DATA (UNAUDITED) -- (CONTINUED)
CHANGES IN THE STANDARDIZED MEASURE OF NET CASH FLOWS OF PROVED DEVELOPED OIL AND GAS RESERVES DISCOUNTED AT 10% PER ANNUM

	YEAR ENDED DECEMBER 31,		
	1996	1997	1998
	(IN THOUSANDS)		
Standardized measure at beginning of year.....	\$ 8,668	\$ 13,300	\$ 8,623
Sales and transfers of oil and gas produced, net of production costs.....	(6,288)	(5,195)	(2,773)
Net changes in sales price and future production and development costs.....	2,015	1,347	(5,056)
Extensions, discoveries and improved recovery, less related costs.....	9,505	5,061	3,018
Sales of minerals-in-place.....	--	(4,775)	(9)
Revision of previous quantity estimates.....	1,249	(1,024)	(804)
Accretion of discount.....	631	1,922	1,193
Changes in production rates and other.....	1,943	231	(224)
Net change in income taxes.....	(4,423)	(2,244)	1,382
	-----	-----	-----
Standardized measure at end of year.....	\$13,300	\$ 8,623	\$ 5,350
	=====	=====	=====

17. CONCENTRATIONS OF CREDIT RISK

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist primarily of demand deposits, temporary cash investments and trade receivables.

The Company believes that it places its demand deposits and temporary cash investments with high credit quality financial institutions. At December 31, 1997 and 1998, the Company's demand deposits and temporary cash investments consisted of the following (in thousands):

	1997	1998
	----	----
Deposit in FDIC and SIPC-insured institutions under \$100,000 and cash on hand.....	\$ 1,490	\$ 1,755
Deposit in FDIC and SIPC-insured institutions over \$100,000 and cash on hand.....	28,792	11,097
	-----	-----
Less outstanding checks and other reconciling items.....	30,282	12,852
	(6,944)	(3,866)
	-----	-----
Cash and cash equivalents.....	23,338	8,986
Investment in U.S. Treasury securities.....	566	--
	-----	-----
	\$23,904	\$ 8,986
	=====	=====

Concentrations of credit risk with respect to trade receivables are primarily focused on contract drilling receivables. The concentration is mitigated by the diversification of customers for which the Company provides drilling services. No significant losses from individual contracts were experienced during the years ended December 31, 1996, 1997 and 1998. Included in general and administrative expense for the periods ended December 31, 1996, 1997 and 1998 are provisions for doubtful receivables of \$126,596, \$122,069 and \$90,000, respectively.

The carrying values of cash and cash equivalents, marketable securities and trade receivables approximate fair value due to the short-term maturity of these assets.

18. RELATED PARTY TRANSACTIONS

Use of Assets -- The Company leases a 1981 Beech King-Air 90 airplane owned by an affiliate of the Company's Chairman of the Board/Chief Executive Officer. Under the terms of the lease, the Company pays a monthly rental of \$9,200 and its proportionate share of the costs of fuel, insurance, taxes and maintenance of the aircraft. The Company paid approximately \$267,001, \$171,803 and \$211,495 for the lease of the airplane during 1996, 1997 and 1998, respectively.

Contract Drilling Services -- A company owned in part by a relative of the Chairman of the Board/Chief Executive Officer, contracted drilling services from the Company during 1996 and 1997. Revenues for 1996 and 1997 were approximately \$919,743 and \$1.382 million respectively, for these services.

Sales of Oil -- A company owned in part by a relative of the Chairman of the Board/Chief Executive Officer, acted as the first purchaser of oil produced from leases operated by the Company during 1996, 1997 and 1998. Sales of oil to that entity, both royalty and working interest (including the Company) were approximately \$19.6 million, \$12.9 million and \$8.1 million for 1996, 1997 and 1998, respectively.

Joint Operation of Oil and Natural Gas Properties -- The Company operates certain oil and natural gas properties in which the Chairman of the Board/Chief Executive Officer, the President/Chief Operating Officer and other persons or entities related to the Company purchased a joint interest ownership with the Company and other industry partners. The Company made oil and natural gas production payments (net of royalty) of \$6.3 million, \$10.5 million and \$6.9 million from these properties in 1996, 1997 and 1998, respectively, to the aforementioned persons or entities. These persons or entities reimbursed the Company for joint operating costs of \$5.3 million, \$12.8 million and \$7.4 million in 1996, 1997 and 1998, respectively.

19. SUBSEQUENT EVENT

On January 27, 1999, the Company completed the acquisition of five drilling rigs and other related equipment from Padre Industries, Inc., a privately-held, non-affiliated entity based in Corpus Christi, Texas. The purchase price of approximately \$4.0 million consisted of 800,000 unregistered shares of the Company's common stock valued at \$4.00 per share and a contingent payment based on a guarantee that the Company's common stock will be trading at \$5.00 per share one year from the acquisition date. The contingent cash payment will be calculated by multiplying the 800,000 shares by the difference of the closing sales price of the Company's common stock one year from the closing date and \$5.00. The maximum cash payment will be \$800,000 [$(\$5.00 - \$4.00) \times 800,000$] plus \$80,000 of interest. The cash payment and interest thereon will be ratably reduced if the price of the Company's common stock, one year from the acquisition date exceeds \$5.00. No cash payment will be required if the Company's common stock is at least \$5.50 per share one year from the acquisition date.

INDEX TO EXHIBITS

EXHIBIT
NO.

- 2.1 Plan and Agreement of Merger dated October 14, 1993, between Patterson Energy, Inc., a Texas corporation, and Patterson Energy, Inc., a Delaware corporation, together with related Certificates of Merger.(1)
- 2.2 Agreement and Plan of Merger, dated April 22, 1996 among Patterson Energy, Inc., Patterson Drilling Company and Tucker Drilling Company, Inc.(2)
- 2.2.1 Amendment to Agreement and Plan of Merger, dated May 16, 1996 among Patterson Energy, Inc., Patterson Drilling Company and Tucker Drilling Company, Inc.(3)
- 2.3 Asset Purchase Agreement, dated April 22, 1997, among and between Patterson Drilling Company and Ziadril, Inc.(4)
- 2.4 Asset Purchase Agreement, dated June 4, 1997, among Patterson Energy Inc., Patterson Drilling Company and Wes-Tex Drilling Company.(3)
- 2.4.1 Amendment to Asset Purchase Agreement, dated June 4, 1997, among Patterson Energy Inc., Patterson Drilling Company and Wes-Tex Drilling Company.(5)
- 2.5 Agreement, dated June 4, 1997, among Patterson Energy Inc., Patterson Drilling Company, Greathouse Foundation and Myrle Greathouse, Trustee under Agreement dated June 2, 1997.(5)
- 2.6 Asset Purchase Agreement, dated September 4, 1997, among Patterson Energy Inc., Patterson Drilling Company and McGee Drilling Company.(4)
- 2.7 Agreement and Plan of Merger, dated January 20, 1998, among Patterson Energy, Inc., Patterson Onshore Drilling Company and Robertson Onshore Drilling Company.(7)
- 2.8 Stock Purchase Agreement, dated January 5, 1998, among Patterson Energy, Inc., Spencer D. Armour, III. And Richard G. Price.(19)
- 2.9 Stock Purchase Agreement, dated September 17, 1998, among Lone Star Mud, Inc. and Mark Campbell (shareholder of Tejas Drilling Fluids, Inc.).
- 2.10 Asset Purchase Agreement, dated January 27, 1999, among Patterson Energy, Inc., Patterson Drilling Company and Padre Industries, Inc.
- 3.1 Restated Certificate of Incorporation.(8)
- 3.1.1 Certificate of Amendment to the Certificate of Incorporation.(9)
- 3.2 Bylaws.(1)
- 4.1 Excerpt from Restated Certificate of Incorporation of Patterson Energy, Inc. regarding authorized Common Stock and Preferred Stock.(10)
- 4.2 Registration Rights Agreement, dated June 12, 1997, among Patterson Energy Inc. and Wes-Tex Drilling Company, Greathouse Foundation and Myrle Greathouse, Trustee under Agreement dated June 2, 1997.(11)
- 4.3 Stock Purchase Warrant of Patterson Energy, Inc., dated June 12, 1997.(11)
- 10.1 Credit Agreement dated December 9, 1997 among Patterson Energy, Inc., Patterson Drilling Company, Patterson Petroleum, Inc., Patterson Trading Company, Inc. and Norwest Bank Texas, N.A.(6)
- 10.1.1 Promissory Note dated December 9, 1997 among Patterson Energy, Inc. and Norwest Bank Texas, N.A.(6)
- 10.1.2 Security Agreement dated December 9, 1997 between Patterson Drilling Company and Norwest Bank Texas, N.A.(6)
- 10.1.3 Corporate Guarantees of Patterson Drilling Company, Patterson Petroleum, Inc. and Patterson Petroleum Trading Company, Inc.(6)

EXHIBIT

NO.

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- 10.1.4 Amendment to Credit Agreement dated March 4, 1999 among Patterson Energy, Inc., Patterson Drilling Company, Patterson Petroleum, Inc., Patterson Trading Company, Inc. and Norwest Bank Texas, N.A.
- 10.2 Aircraft Lease, dated December 20, 1998, (effective January 1, 1999) between Talbott Aviation, Inc. and Patterson Energy, Inc.
- 10.3 Participation Agreement, dated October 19, 1994, between Patterson Petroleum Trading Company, Inc. and BHT Marketing, Inc.(12)
- 10.3.1 Participation Agreement dated October 24, 1995, between Patterson Petroleum Trading Company, Inc. and BHT Marketing, Inc.(13)
- 10.4 Crude Oil Purchase Contract, dated October 19, 1994, between Patterson Petroleum, Inc. and BHT Marketing, Inc.(14)
- 10.4.1 Crude Oil Purchase Contract, dated October 24, 1995, between Patterson Petroleum, Inc. and BHT Marketing, Inc.(13)
- 10.5 Patterson Energy, Inc. 1993 Stock Incentive Plan, as amended.(15)
- 10.6 Patterson Energy, Inc. Non-Employee Directors' Stock Option Plan, as amended.(16)
- 10.7 Model Form Operating Agreement.(17)
- 10.8 Form of Drilling Bid Proposal and Footage Drilling Contract.(17)
- 10.9 Form of Turnkey Drilling Agreement.(17)
- 21.1 Subsidiaries of the registrant.(18)
- 23.1 Consent of Independent Accountants -- PricewaterhouseCoopers LLP.
- 27.1 Financial Data Schedule as of December 31, 1998 and for the year then ended.

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- (1) Incorporated herein by reference to Item 27, "Exhibits" to Amendment No. 2 to Registration Statement on Form SB-2 (File No. 33-68058-FW); filed October 28, 1993.
- (2) Incorporated by reference to Item 7, "Financial Statements and Exhibits" to Form 8-K dated April 22, 1996 and filed on April 30, 1996.
- (3) Incorporated by reference to Item 7, "Financial Statements and Exhibits" to Form 8-K dated May 16, 1996 and filed on May 22, 1996.
- (4) Incorporated herein by reference to Item 16, "Exhibits" to Amendment No. 1 to Registration Statement on Form S-3 (File No. 333-29035); filed August 5, 1997.
- (5) Incorporated herein by reference to Item 7, "Financial Statements and Exhibits", to Form 8-K dated September 3, 1997; filed September 11, 1997.
- (6) Incorporated herein by reference to Item 7, "Financial Statements and Exhibits" to Form 8-K dated November 14, 1997 and filed December 24, 1997.
- (7) Incorporated herein by reference to Item 7, "Financial Statements and Exhibits," to Form 8-K dated January 23, 1998; filed February 3, 1998.
- (8) Incorporated herein by reference to Item 6, "Exhibits and Reports on Form 8-K" to Form 10-Q for the quarterly period ended September 30, 1996; filed August 12, 1996.
- (9) Incorporated herein by reference to Item 6. "Exhibits and Reports on Form 8-K" to Form 10-Q for the quarterly period ended June 30, 1997; filed August 14, 1997.
- (10) Incorporated herein by reference to Item 16, "Exhibits" to Registration Statement on Form S-3 filed with the Securities Exchange Commission on December 18, 1996.
- (11) Incorporated herein by reference to Item 7, "Financial Statements and Exhibits", to Form 8-K dated September 12, 1997; filed September 19, 1997.

- (12) Incorporated herein by reference to Item 27, "Exhibits" to Post Effective Amendment No. 1 to Registration Statement on Form SB-2 (File No. 33-68058-FW).
- (13) Incorporated by reference to Item 7, "Financial Statements and Exhibits" to Form 10-KSB for the year ended December 31, 1995.
- (14) Incorporated by reference to Item 5, "Other Items" to Form 8-K dated December 1, 1995 and filed on January 16, 1996.
- (15) Incorporated herein by reference to Item 8, "Exhibits" to Registration Statement on Form S-8 (File No. 333-47917); filed March 13, 1998.
- (16) Incorporated herein by reference to Item 8, "Exhibits" to Registration Statement on Form S-8 (File No. 33-39471); filed November 4, 1997.
- (17) Incorporated by reference to Item 27, "Exhibits" to Registration Statement filed with the Securities and Exchange Commission on August 30, 1993.
- (18) Incorporated by reference to Item 14, "Exhibits, Financial Statement Schedules and Reports on Form 8-K" to Form 10-K dated December 31, 1997.
- (19) Incorporated herein by reference to Item 16, "Exhibits" to Registration Statement on Form S-3 filed with the Securities Exchange Commission on January 5, 1998.

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STOCK PURCHASE AGREEMENT
AMONG
LONE STAR MUD, INC.
AND
MARK CAMPBELL

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STOCK PURCHASE AGREEMENT

STOCK PURCHASE AGREEMENT, dated as of September ____, 1998 (this "Agreement"), among LONE STAR MUD, INC., a Texas corporation ("Lone Star") wholly-owned by Patterson Energy, Inc., a Delaware corporation ("PEC"), and Mark Campbell (referred to herein as "M Campbell" or "Shareholder").

WITNESSETH:

WHEREAS, M Campbell owns (beneficially and of record) all of the outstanding common stock, par value \$1.00 per share ("TFI Common Stock") of TEJAS FLUIDS, INC., a Texas corporation ("TFI"); and

WHEREAS, Lone Star desires to purchase, and Shareholder desires to sell, all of the outstanding TFI Common Stock (the "Stock Purchase") for the consideration set forth and provided for herein; and

WHEREAS, Lone Star, on the one hand, and Shareholder, on the other, desire to make certain representations, warranties and agreements in connection with the Stock Purchase.

NOW, THEREFORE, in consideration of the premises and the representations, warranties and agreements herein contained, the parties agree as follows:

ARTICLE I

THE STOCK PURCHASE

SECTION 1.1 The Stock Purchase. Upon the terms and subject to the conditions of this Agreement, at the Closing (as defined below) provided herein, Lone Star shall purchase from Shareholder, and Shareholder shall sell to Lone Star, all of the outstanding shares of TFI Common Stock.

SECTION 1.2 Stock Purchase Consideration. Lone Star agrees to pay a total of \$3.5 million in cash, subject to possible post-closing adjustment, if any, pursuant to Section 1.6 (the "Stock Purchase Consideration"), to Shareholder as consideration for the Stock Purchase.

SECTION 1.3 No Further Ownership Rights in TFI Common Stock. The Stock Purchase Consideration, when paid at Closing in accordance with the terms hereof, shall be deemed to have been paid in full satisfaction of all ownership rights pertaining to the outstanding shares of TFI Common Stock.

SECTION 1.4 Closing. The closing of the transaction contemplated by this Agreement (the "Closing") shall take place at the offices of Lone Star in Midland, Texas at 10:00 a.m. local time, on the date of this Agreement or at such other time and place as Lone Star and Shareholder shall agree.

SECTION 1.5 Calculation of Working Capital. Within 60 days after the Closing, Lone Star will prepare and present to Shareholder a calculation of the Net Working Capital (defined below) of TFI as of the Closing (the "Working Capital Calculation"). The parties agree that the Working Capital Calculation shall be prepared so that it presents fairly the Net Working Capital of TFI as of the Closing using practices and procedures consistent with the preparation of the TFI Financial Statements (defined below). Shareholder and an independent certified public accountant selected and retained by Shareholder (the "Shareholder's Auditor") shall have the right to review and copy, promptly upon request, the work papers of Lone Star and/or its accountants utilized in preparing the Working Capital Calculation for purposes of verifying the accuracy thereof. The Working Capital Calculation shall be binding upon the parties unless shareholder gives written notice of disagreement with any of the values or amounts contained therein to Lone Star within 15 business days after receipt of the working Capital Calculation and the work papers, specifying in reasonable detail the nature and extent of such disagreement. If Lone Star and Shareholder are unable to resolve any such disagreement within such period, the disagreement shall be referred for

final determination to an independent accounting firm of national reputation mutually selected by Shareholder and Lone Star (the "Selected Firm"), and the resolution of that disagreement (the "Disagreement") shall be final and binding upon the parties for purposes of this Agreement. The working Capital Calculation as finally agreed to or determined by the Selected Firm is referred to herein as the "Final Working Capital Calculation." The fees and disbursements incurred in the preparation of the Working capital Calculation, other than the expense of Shareholder's Auditor and of the Selected Firm, shall be paid by Lone Star. Shareholder shall pay the fees and disbursements of Shareholder's auditor, while the fees and disbursements of the Selected firm, if any, shall be paid by the non-prevailing party in the Disagreement. For purposes of this Agreement, "Net Working capital" means, as of the Closing, the amount by which (a) the current assets of TFI (exclusive of the \$300,000 to be used to fund annuities for, and to pay bonuses to, certain TFI employees) on the close of business on the last business day immediately preceding the Closing (the "Determination Date") exceed 9b) the current liabilities of TFI on the Determination Date, with the current assets and current liabilities to be as determined in accordance with accrual tax basis accounting consistently applied.

SECTION 1.6 Post Closing Stock Purchase Adjustment. If the Net Working Capital of TFI as of the Determination Date as set forth in the Final Working capital Calculation is less than \$500,000, then within five business days after the determination of the Final Working Capital Calculation, Shareholder shall reimburse to Lone Star the amount of such shortfall in cash in immediately available funds by wire transfer to a bank account designated in writing by Lone Star prior to the due date thereof.

ARTICLE II

REPRESENTATIONS AND WARRANTIES OF LONE STAR

Lone Star represents and warrants to Shareholder as follows:

SECTION 2.1 Organization, Standing and Power. Lone Star (i) is a corporation duly incorporated, validly existing and in good standing under the laws of the State of Texas and has the requisite corporate power and authority to carry on its business as now being conducted, and (ii) is in good standing in each jurisdiction where the character of its business owned or held under lease or the nature of its activities makes such qualification necessary, except where the failure to be so qualified would not individually or in the aggregate, have a Material Adverse Effect on Lone Star. "Material Adverse Change" or "Material Adverse Effect" means, when used with respect to Lone Star or TFI, any change or effect that is or, so far as can reasonably be determined, is likely to be materially adverse to the assets, properties, condition (financial or otherwise), business or results of operations of Lone Star or TFI, as the case may be.

SECTION 2.2 Authority; Non-Contravention. Lone Star has all requisite power and authority to enter into this Agreement and to consummate the Stock Purchase. The execution and delivery by Lone Star of this Agreement and the consummation by Lone Star of the Stock Purchase have been duly authorized by all necessary corporate action on the part of Lone Star. This Agreement has been duly executed and delivered by Lone Star and (assuming the valid authorization, execution and delivery of this Agreement by Shareholder) constitutes a valid and binding obligation of Lone Star enforceable against Lone Star in accordance with its terms, except to the extent enforceability may be limited by bankruptcy, insolvency, reorganization, moratorium, fraudulent transfer or other similar laws of general applicability relating to or affecting the enforcement of creditors' rights and by the effect of general principles of equity (regardless of whether enforceability is considered in a proceeding in equity or at law). The execution and delivery of this Agreement do not or will not, as the case may be, and the consummation of the transactions contemplated hereby and compliance with the provisions hereof will not, conflict with, or result in any violation of, or default (with or without notice or lapse of time, or both) under, or give rise to a right of termination, cancellation or acceleration of any obligation or to the loss of a material benefit under, or result in the creation of any lien, security interest, charge or encumbrance upon any of the properties or assets of Lone Star under, any provision of (i) the Articles of Incorporation or Bylaws of Lone Star, (ii) any loan or credit agreement, note, bond, mortgage, indenture, lease or other agreement, instrument, permit, concession, franchise or license applicable to Lone Star, or (iii) any judgment, order, decree, statute, law, ordinance, rule or regulation applicable to Lone Star or any of its properties or assets, other than, in the case of clauses (ii) or (iii), any such conflicts, violations, defaults, losses, liens, security interests, charges or encumbrances that, individually or in the aggregate,

would not have a Material Adverse Effect on Lone Star, materially impair the ability of Lone Star to perform its obligations hereunder or prevent consummation of the transaction contemplated hereby. No filing or registration with, or authorization, consent or approval of, any domestic (federal and state), foreign or supranational court, commission, governmental body, regulatory agency, authority or tribunal (a "Governmental Entity") is required by or with respect to Lone Star in connection with the exercise and delivery of this Agreement by Lone Star or is necessary for the consummation by Lone Star of the Stock Purchase or any other transaction contemplated by this Agreement.

SECTION 2.3 Investment Representation. Lone Star is acquiring the TFI Common Stock for investment solely for its own account and not with a view to, or for resale in connection with, any distribution thereof and acknowledges that Shareholder is relying upon the bona fide nature of the investment intent of Lone Star as set forth herein. Lone Star further acknowledges that the TFI Common Stock has not been registered under the Securities Act of 1933, as amended (the "Securities Act"), and has not been qualified under applicable state securities laws and that any subsequent disposition thereof must be registered under the Securities Act and qualified under applicable state securities laws or be exempt from such registration and qualification. Lone Star is aware that no trading market exists for the TFI Common Stock. Lone Star has the ability to bear the economic risk of investment in the TFI Common Stock, including a complete loss of the investment.

SECTION 2.4 Brokers. No broker, investment banker or other person is entitled to any broker's, finder's or similar fee or commission in connection with the transactions contemplated by this Agreement based upon arrangements made by or on behalf of Lone Star.

ARTICLE III

REPRESENTATIONS AND WARRANTIES OF M CAMPBELL

M Campbell represents and warrants to Lone Star as follows:

SECTION 3.1 Organization, Standing and Power. TFI (i) is a corporation duly incorporated, validly existing and in good standing under the laws of the State of Texas and has the requisite corporate power and authority to carry on its business as now being conducted, (ii) is duly qualified to do business, and is in good standing, in each jurisdiction where the character of its properties owned or held under lease or the nature of its activities makes such qualification necessary, except where the failure to be so qualified would not individually, or in the aggregate, have a Material Adverse Effect on TFI. TFI has no subsidiaries.

SECTION 3.2 Capital Structure of TFI. The authorized capital stock of TFI consists of 100,000 shares of common stock with a par value of \$1.00 per share, of which 1,000 shares are issued and outstanding. All of the TFI Common Stock are validly issued, fully paid and nonassessable and have not been issued in violation of any preemptive rights. There are no options, warrants, rights, commitments, agreements, arrangements or undertakings of any kind to which TFI is a party or by which it is bound obligating TFI to issue, deliver or sell, or cause to be issued, delivered or sold, additional shares of capital stock of TFI.

SECTION 3.3 Ownership of TFI Common Stock. All of the issued and outstanding shares of capital stock of TFI are owned of record and beneficially by M Campbell, free and clear of any restrictions on transfer (other than restrictions under the Securities Act and state securities laws), taxes, Liens (as defined below in this Section), options, warrants, purchase rights, contracts, commitments, equities, claims and demands. M Campbell is not party to (i) any option, warrant, purchase right, or other contract or commitment that could require him to sell, transfer, or otherwise dispose of any TFI Common Stock (other than pursuant to this Agreement) or (ii) any voting trust, proxy, or other agreement or understanding with respect to the TFI Common Stock. For purposes of this Agreement "Liens" means liens, mortgages, pledges, security interests and encumbrances.

SECTION 3.4 Authority; Non-Contravention. Shareholder has all requisite power and authority to enter into this Agreement and to consummate the Stock Purchase. This Agreement has been duly executed and delivered by Shareholder and (assuming the valid authorization, execution and delivery of this Agreement by Lone Star) constitutes a valid and binding obligation of Shareholder enforceable against him in

accordance with its terms, except to the extent enforceability may be limited by bankruptcy, insolvency, reorganization, moratorium, fraudulent transfer or other similar laws of general applicability relating to or affecting the enforcement of creditors' rights and by the effect of general principles of equity (regardless of whether enforceability is considered in a proceeding or at law). The execution and delivery of this Agreement do not, and the consummation of the Stock Purchase and compliance with the provisions hereof will not, conflict with, or result in any violation of, or default (with or without notice of lapse of time, or both) under, or give rise to a right of termination, cancellation or acceleration of any obligation or to the loss of a material benefit under, or result in the creation of any Lien upon any of the properties or assets of TFI under, any provision of (i) the Articles of Incorporation or Bylaws of TFI (true and complete copies of which as of the date hereof have been delivered to Lone Star), (ii) any loan or credit agreement, note, bond, mortgage, indenture, lease or other agreement, instrument, permit, concession, franchise or license applicable to Shareholder or TFI, or (iii) any judgment, order, decree, statute, law, ordinance, rule or regulation applicable to Shareholder or TFI or any of the respective properties or assets of Shareholder or TFI, other than, in the case of clauses (ii) or (iii), any such conflicts, violations, defaults, rights, Liens or losses that, individually or in the aggregate, would not have a Material Adverse Effect on TFI, materially impair the ability of Shareholder to perform his obligations hereunder or prevent the consummation of the Stock Purchase. No filing or registration with, or authorization, consent or approval of, any Governmental Entity is required by or with respect to Shareholder or TFI in connection with the execution and delivery of this Agreement by Shareholder or is necessary for the consummation by Shareholder of the Stock Purchase or any other transaction contemplated by this Agreement.

SECTION 3.5 Financial Statements. Included in Section 3.5 of the disclosure schedules attached to this Agreement (the "M Campbell Disclosure Schedule") are the following unaudited financial statements (collectively, the "TFI Financial Statements") of TFI: (i) balance sheet as of September 15, 1998; and (ii) statement of income for the six and one-half month period ended September 15, 1998.

Except as may be set forth in Section 3.5 of the M Campbell Disclosure Schedule, the TFI Financial Statements (a) are complete and correct in all material respects, (b) have been prepared in conformity with accrual tax basis accounting consistently applied, and (c) present fairly the financial condition of TFI at the date presented and the results of operations of TFI for the period then ended. There does not, and there will not be at Closing, exist any fact, event, condition or claim known to Shareholder which would cause a Material Adverse Change in the TFI Financial Statements as presented other than as set forth therein.

SECTION 3.6 Absence of Material Adverse Change. Except as otherwise set forth in Section 3.6 of the M Campbell Disclosure Schedule, there has not been any Material Adverse Change with respect to TFI since September 15, 1998.

SECTION 3.7 Taxes. Except as otherwise set forth in Section 3.7 of the M Campbell Disclosure Schedule: (i) all Tax Returns required to be filed by TFI have been filed or extensions have been validly obtained; (ii) Tax Returns referred to in clause (i) are true and correct in all material respects and have been completed in all material respects in accordance with applicable law; (iii) all Taxes shown to be due on the Tax Returns referred to in clause (i) have been timely paid or extensions have been duly obtained or such taxes have been adequately provided for on TFI's balance sheet or are being timely and properly contested; (iv) TFI has not waived any statute of limitations in respect of Taxes of TFI; (v) neither M Campbell nor TFI has received notice that the Internal Revenue Service or any other taxing authority has asserted against TFI any deficiency in Taxes or claims for additional Taxes in connection with any tax period; (vi) all deficiencies asserted or assessments made as a result of any examination of the Tax Returns referred to in clause (i) by a taxing authority have been paid in full or adequately provided for on TFI's balance sheet or are being timely and properly contested; and (vii) TFI has made available to Lone Star correct and complete copies of all federal and state income Tax Returns, examination reports, and statements of deficiencies assessed against or agreed to by TFI for the prior six years. For purposes of this Agreement, (a) "Tax" (and, with correlative meaning, "Taxes" and "Taxable") means any federal, state, local or foreign income, gross receipts, property, sales, use, license, excise, franchise, employment, payroll, withholding, alternative or added minimum, ad valorem, transfer, severance or excise tax, or any other tax, custom, duty, governmental fee or other like assessment or charge of any kind whatsoever, together with any interest or penalty, imposed by any governmental authority, and (b) "Tax Return" means any return, report or similar statement required to be filed with respect to any Tax (including any attached schedules), including, without limitation, any information return, claim for refund, amended return or declaration of estimated Tax.

SECTION 3.8 Real and Personal Property; Title Thereto. Set forth in Section 3.8 of the M Campbell Disclosure Schedule is a complete and accurate schedule of (a) all real and personal property owned by TFI having an individual fair market value in excess of \$5,000, and (b) any real or personal property held by TFI under lease. Except as set forth in Section 3.8 of the M Campbell Disclosure Schedule, TFI has good and, with respect to real property, indefeasible title to all of such real property and personal property, subject to no Liens except for (i) Liens for taxes not yet delinquent or the validity of which is being contested in good faith, and (ii) any Liens arising by operation of law securing obligations not yet overdue. Any real or personal property held by TFI under lease is held under valid and enforceable leases which will continue in full force and effect immediately after the Closing Date; TFI is not in default with respect to any such lease.

SECTION 3.9 Accounts Receivable. Set forth in Section 3.9 of the M Campbell Disclosure Schedule is a complete and accurate schedule of the accounts receivable of TFI as of September 15, 1998, as reflected in the balance sheet as of that date included in the TFI Financial Statements, together with an accurate aging of those accounts. To the knowledge of Shareholder, the accounts described in Section 3.9 have been collected in full or are valid obligations owing to TFI. Except as set forth in Section 3.9 of the M Campbell Disclosure Schedule, Shareholder has no knowledge of any notice from any account debtor on such accounts indicating such account debtor will not pay such accounts (to the extent not yet collected).

SECTION 3.10 Liabilities. There are no liabilities of TFI of any kind, whether contingent or fixed, other than (i) liabilities disclosed or provided for in the balance sheet of TFI as of September 15, 1998, included in the Lone Star Financial Statements or disclosed in Section 3.10 of the M Campbell Disclosure Schedule, or (ii) liabilities incurred in the ordinary course of business since September 15, 1998, none of which, either individually or in the aggregate, may be reasonably expected to be materially adverse to the business, assets, condition (financial or otherwise) or results of operations of TFI.

SECTION 3.11 Insurance. Set forth in Section 3.11 of the M Campbell Disclosure Schedule is a complete list of all policies of fire and extended coverage, liability, worker compensation and other forms of similar insurance or indemnity bonds held by TFI for which all premiums have been paid. There are no claims pending under any of such policies. To the knowledge of TFI, TFI is not in default in any material respect with respect to any provisions of any such policy or indemnity bond and has not failed to give any notice or present any claim thereunder in due and timely fashion, which failure would materially adversely affect the condition (financial or otherwise), results of operations, assets, liabilities or business of TFI.

SECTION 3.12 Contracts and Other Agreements. Except as disclosed on Section 3.12 of the M Campbell Disclosure Schedule, TFI is not a party to or bound by any written or oral (i) employment, agency, consulting or similar contract which cannot be terminated upon 30 days' notice without liability to TFI, as the case may be, (ii) lease, whether as lessor or lessee, with respect to any real or personal property, (iii) contract or commitment involving more than \$5,000 a year, other than contracts with TFI's drilling fluids customers in the ordinary course of business; (iv) credit agreements; (v) guarantee, suretyship, indemnification or contribution agreement, or (vi) other contracts not made in the ordinary course of business.

SECTION 3.13 Records. The minute books of TFI contain true and complete records in all material respects of all actions taken at any meetings of TFI's shareholders or Board of Directors and of all written consents executed in lieu of holding of any such meeting.

SECTION 3.14 Transactions with Affiliates. Except as otherwise set forth in 3.14 of the M Campbell Disclosure Schedule, no Affiliate (as hereinafter defined) has any direct or indirect interest in or owns directly or indirectly any asset or right used in the conduct of the business of TFI or is party to any contract, lease, agreement, arrangement or commitment used in such business.

"Affiliate" as used in this Section 3.14 means a person which directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with, TFI. For purposes of this definition, the officers, directors and stockholders of TFI shall be deemed Affiliates.

SECTION 3.15 Employee Benefit Plans; Employment Agreements. With respect to all the employee benefit plans, programs and arrangements of TFI maintained for the benefit of any current or former

employee, officer or director of TFI (collectively, the "TFI Plans"), except as would not, individually or in the aggregate, have a Material Adverse Effect on TFI: (i) none of the TFI Plans is a multi-employer plan within the meaning of ERISA; (ii) none of the TFI Plans promises or provides retiree medical or life insurance benefits to any person, except as otherwise required by law; (iii) each TFI Plan intended to be qualified under Section 401(k) of the Code has received a favorable determination letter from the Internal Revenue Service that it is so qualified and nothing has occurred since the date of such letter that could reasonably be expected to affect the qualified status of such TFI Plan; (iv) each TFI Plan has been operated in all material respects in accordance with its terms and the requirements of applicable law; and (v) TFI has not incurred any direct or indirect liability under, arising out of or by operation of Title IV of ERISA in connection with the termination of, or withdrawal from, any TFI Plan or other retirement plan or arrangement, and no fact or event exists that could reasonably be expected to give rise to any such liability. The aggregate accumulated benefit obligations of any TFI Plan subject to Title IV of ERISA do not exceed the fair market value of the assets of such TFI Plan. Except as set forth in Section 3.15 of the M Campbell Disclosure Schedule, TFI has no TFI Plans or any employment or severance agreements with any of its employees.

SECTION 3.16 Labor Matters. (i) TFI is not a party to any collective bargaining agreement or other material contract or agreement with any labor organization or other representative of employees nor is any such contract being negotiated; (ii) there is no material unfair labor practice charge or complaint pending nor, to the knowledge of M Campbell, threatened, with regard to employees of TFI; (iii) there is no labor strike, material slowdown, material work stoppage or other material labor controversy in effect, or, to the knowledge of M Campbell, threatened against TFI; (iv) there are no campaigns being conducted by and/or to the employees of TFI to authorize representation by a labor organization; (v) TFI is not party to, or is not otherwise bound by, any consent decree with any governmental authority relating to employees or employment practices of TFI; (vi) TFI has not incurred any liability under, and has complied in all respects with, the Worker Adjustment Retraining Notification Act, and no fact or event exists that could give rise to liability under such Act; (vii) except as disclosed in Section 3.16 of the M Campbell Disclosure Schedule, TFI is in compliance with all applicable agreements, contracts and policies relating to employment, employment practices, wages, hours and terms and conditions of employment of the employees and all applicable laws respecting employment practice, except where the failure to be in compliance with each such agreement, contract and policy would not, either singly or in the aggregate, have a Material Adverse Effect on TFI; and (viii) no charges with respect to, or relating to TFI are pending before the Equal Employment Opportunity Commission, or any corresponding state agency.

SECTION 3.17 Environmental Matters.

(a) Except to the extent that the inaccuracy of any of the following, individually or in the aggregate, would not have a Material Adverse Effect on TFI, to the knowledge of M Campbell:

(i) TFI holds, and is in compliance with and has been in compliance with for the last three years, all Environmental Permits, and is otherwise in substantial compliance and has been in substantial compliance for the last three years with, all applicable Environmental Laws and there is no condition that is reasonably likely to prevent or materially interfere prior to the Closing with compliance by TFI with Environmental Laws;

(ii) no modification, revocation, reissuance, alteration, transfer or amendment of any Environmental Permit, or any review by, or approval of, any third party of any Environmental Permit is required in connection with the execution or delivery of this Agreement or the consummation by Shareholder of the transactions contemplated hereby or the operation of the business of TFI on the date of the Closing;

(iii) TFI has not received any Environmental Claim, nor has any Environmental Claim been threatened against TFI;

(iv) TFI has not entered into, agreed to or is not subject to any outstanding judgment, decree, order or consent arrangement with any governmental authority under any Environmental Laws, including, without limitation, those relating to compliance with

any Environmental Laws or to the investigation, cleanup, remediation or removal of Hazardous Materials;

(v) there are no circumstances that are reasonably likely to give rise to liability under any agreements with any person pursuant to which TFI would be required to defend, indemnify, hold harmless, or otherwise be responsible for any violation by or other liability or expense of such person, or alleged violation by or other liability or expense of such person, arising out of any Environmental Law; and

(vi) there are no existing conditions that are reasonably likely to give rise to liability of TFI under any Environmental Laws.

(b) For purposes of this Agreement, the terms below shall have the following meanings:

"Environmental Claim" means any written complaint, notice, claim, demand, action, suit or judicial, administrative or arbitral proceeding by any person to TFI or any of its subsidiaries asserting liability or potential liability (including, without limitation, liability or potential liability for investigatory costs, cleanup costs, governmental response costs, natural resource damages, property damage, personal injury, fines or penalties) arising out of, relating to, based on or resulting from (i) the presence, discharge, emission, release or threatened release of any Hazardous Materials at any location, (ii) circumstances forming the basis of any violation or alleged violation of any Environmental Laws or Environmental Permits, or (iii) otherwise relating to obligations or liabilities of TFI under any Environmental Law.

"Environmental Permits" means all permits, licenses, registrations, exemptions and other governmental authorizations required under Environmental Laws for TFI to conduct its operations as presently conducted.

"Environmental Laws" means all applicable foreign, federal, state and local statutes, rules, regulations, ordinances, orders, decrees and common law relating in any manner to pollution or protection of the environment, to the extent and in the form that such exist at the date hereof.

"Hazardous Materials" means all hazardous or toxic substances, wastes, materials or chemicals, petroleum (including crude oil or any fraction thereof) and petroleum products, asbestos and asbestos-containing materials, pollutants, contaminants and all other materials and substances, including but not limited to radioactive materials, regulated pursuant to any Environmental Laws.

SECTION 3.18 Litigation. Except as set forth in Section 3.18 of the M Campbell Disclosure Schedule, there is no suit, action, investigation or proceeding pending or, to the knowledge of Shareholder, threatened against TFI at law or in equity before or by any federal, state, municipal or other governmental department, commission, board, bureau, agency or instrumentality, domestic or foreign, or before any arbitrator of any kind, that would have a Material Adverse Effect on either TFI or, with respect to such matters that are pending or threatened as of the date hereof, materially impair the ability of Shareholder to perform his obligations hereunder or to consummate the Stock Purchase, and there is no judgment, decree, injunction, rule or order of any court, governmental department, commission, board, bureau, agency, instrumentality or arbitrator to which Shareholder is subject that would have a Material Adverse Effect on TFI or, with respect to such items that are outstanding and applicable as of the date hereof, materially impair the ability of Shareholder to perform his obligations hereunder or to consummate the Stock Purchase.

SECTION 3.19 Governmental Licenses and Permits; Compliance with Law. TFI has not received notice of any revocation or modification of any federal, state, local or foreign governmental license, certification, tariff, permit, authorization or approval, the revocation or modification of which would have a Material

Adverse Effect on TFI. To the knowledge of Shareholder, the conduct of the business of TFI complies with all statutes, laws, regulations, ordinances, rules, judgments, orders, decrees or arbitration awards applicable thereto, except for violations or failures to comply, if any, that, individually or in the aggregate, would not have a Material Adverse Effect on TFI.

SECTION 3.20 Brokers. No broker, investment banker or other person is entitled to any broker's, finder's or other similar fee or commission in connection with the transactions contemplated by this Agreement based upon arrangements made by or on behalf of Shareholder or TFI.

SECTION 3.21 Bank Accounts. A complete list of each bank account maintained by TFI, including safe deposit boxes maintained by TFI, the account balances and the names of the persons authorized to draw down upon or have access thereto is set forth in Section 3.21 of the M Campbell Disclosure Schedule.

SECTION 3.22 Distributions to Stockholders of TFI. Except as set forth in Section 3.23 of the M Campbell Disclosure Schedule, TFI, since December 31, 1997, has not declared, set aside or paid any dividends on, or made any other actual, constructive or deemed distributions in respect of, any of its capital stock, or otherwise made any payments to any of the stockholders of TFI other than salaries in the ordinary course of business and bonuses accrued on the December 31, 1997 balance sheet of TFI.

SECTION 3.23 Workers' Compensation Claims. Except as set forth in Section 3.23 of the M Campbell Disclosure Schedule, there are no workers' compensation claims pending or, to the knowledge of Shareholder, threatened against TFI.

ARTICLE IV

ADDITIONAL AGREEMENTS

SECTION 4.1 Fees and Expenses. All costs and expenses incurred by Lone Star in connection with this Agreement and the transactions contemplated hereby shall be paid by Lone Star; such costs and expenses incurred by TFI up to a maximum of \$15,000 shall be paid by Lone Star and the balance, if any, shall be paid by Shareholder.

SECTION 4.2 Reasonable Best Efforts. Upon the terms and subject to the conditions set forth in this Agreement, each of the parties agrees to use all reasonable best efforts to take, or cause to be taken, all actions, and to do, or cause to be done, and to assist and cooperate with the other parties in doing, all things necessary, proper or advisable to consummate and make effective, in the most expeditious manner practicable, the Stock Purchase and the other transactions contemplated by this Agreement and the prompt satisfaction of the conditions hereto.

SECTION 4.3 M Campbell Indemnification. On and after the date of Closing, Shareholder shall jointly and severally indemnify and hold Lone Star harmless against and in respect of all actions, suits, demands, judgments, costs and expenses (including reasonable attorneys' fees of Lone Star), arising out of any breach of any representation, warranty, covenant or agreement on the part of Shareholder contained in this Agreement. The indemnification provided for in this Section 4.3 shall terminate and be of no further force and effect two years from the date of Closing, except as to any representation or warranty as to which a written notice of claim for indemnification has been given to M Campbell prior to the expiration of such two-year period.

SECTION 4.4 Lone Star Indemnification.. On and after the date of Closing, Lone Star shall indemnify and hold Shareholder harmless against and in respect of all actions, suits, demands, judgments, costs and expenses (including reasonable attorneys fees of Shareholder) arising out of any breach of any representation, warranty, covenant or agreement on the part of Lone Star contained in this Agreement and any and all liabilities arising out of or related to the business or the operations of TFI, Lone Star or any successor thereof to the extent the liabilities arise out of, or are based upon, facts or events occurring after the Closing. The indemnification provided for in this Section 4.4 shall terminate and be of no further force and effect two years from the date of Closing, except

as to any representation or warranty as to which a written notice of claim for indemnification has been given to Lone Star prior to expiration of such two-year period.

SECTION 4.5 Limitation on Indemnification Obligations. The parties shall have no liability for indemnification under this Article IV unless the total of the alleged costs, expenses or damages with respect to any individual matter exceeds \$5,000 or the costs, expenses or damages arising out of multiple claims of less than \$5,000 exceed \$20,000 in the aggregate (the "Basket Amount"). The indemnification obligations of the parties pursuant to this Article IV shall (a) in no event exceed the amount of the Stock Purchase Consideration (the "Maximum Indemnification Limitation"), and (b) except as set forth in Section 6.8 below, be the sole and exclusive remedy of the parties with respect to this Agreement. Notwithstanding the foregoing, neither the Basket Amount nor the Maximum Indemnification Limitation shall be applicable in respect of any actions, suits, demands, judgments, costs and expenses (including reasonable attorney's fees), arising out of, or based upon, a fraudulent representation by M Campbell or Lone Star in this Agreement or any claims for indemnification relating to unpaid or undisclosed Tax liabilities of TFI.

SECTION 4.6 Employee Benefits. At Closing, all employee benefit plans and programs of TFI shall terminate, and, subject to all applicable laws, all vested rights and benefits of such benefit plans and programs shall be distributed to the eligible recipients in accordance with the terms of such plans.

ARTICLE V

CONDITIONS PRECEDENT TO THE STOCK PURCHASE

SECTION 5.1 Conditions to Each Party's Obligation to Effect the Stock Purchase. The respective obligations of each party to effect the Stock Purchase shall be subject to the fulfillment or waiver (where permissible) at or prior to the date of Closing of each of the following conditions:

(a) No Order. No Governmental Entity or court of competent jurisdiction shall have enacted, issued, promulgated, enforced or entered any law, rule, regulation, executive order, decree, injunction or other order (whether temporary, preliminary or permanent) which is then in effect and has the effect of prohibiting the Stock Purchase or any of the other transactions contemplated hereby; provided that, in the case of any such decree, injunction or other order, each of the parties shall have used reasonable best efforts to prevent the entry of any such injunction or other order and to appeal as promptly as practicable any decree, injunction or other order that may be entered.

(b) Non-Competition Agreement. A Non-Competition Agreement in the form attached hereto as Exhibit A shall have been executed and delivered by PEC, Lone Star, and M Campbell.

(c) Employment Agreement. An Employment Agreement in the form attached hereto as Exhibit B shall have been executed and delivered by Lone Star and M Campbell.

(d) Bonus Payment. Prior to Closing, TFI shall have paid bonuses totaling \$150,000 to Cindi Campbell, Steve Disharon and Steve Akins.

(e) Annuity. Prior to Closing, TFI shall have made provision for an incentive compensation plan in the amount of \$150,000 for the benefit of Cindi Campbell, Steve Disharon and Steve Akins.

SECTION 5.2 Conditions to Obligation of Shareholder to Effect the Stock Purchase. The obligation of Shareholder to effect the Stock Purchase shall be subject to the fulfillment at or prior to the Closing of the following additional conditions; provided that Shareholder may waive any of such conditions in his sole discretion:

(a) Performance of Obligations; Representations and Warranties. Lone Star shall have performed in all material respects each of its agreements contained in this Agreement required to be performed on or

prior to the Closing, each of the representations and warranties of Lone Star contained in this Agreement shall be true and correct on and as of the date of Closing as if made on and as of such date.

(b) Officers' Certificate. Lone Star shall have furnished to Shareholder a certificate, dated the Closing, signed by an appropriate officer of Lone Star, certifying to the effect that, to his knowledge and belief, the conditions set forth in Section 5.1 and Section 5.2(a) have been satisfied in full.

(c) Incentive Stock Options. PEC shall have granted incentive stock options under the Patterson Energy, Inc. 1993 Stock Incentive Plan to the following persons in the following amounts: Steve Akins - option to purchase 3,000 shares of common stock, \$.01 share ("PEC Common Stock"); Cindi Campbell - option to acquire 1,000 shares of PEC Common Stock; Mark Campbell - option to acquire 4,000 shares of PEC Common Stock, and Steve Disharon - option to acquire 2,000 shares of PEC Common Stock, and Lone Star shall have included Steve Akins, Cindi Campbell and Steve Disharon as participants in the Lone Star deferred compensation plan.

(d) Opinion of Baker & Hostetler, LLP. Shareholder shall have received an opinion of counsel from Baker & Hostetler, L.L.P., counsel to Lone Star, dated as of the Closing, substantially to the effect that:

(i) The incorporation, existence and good standing of Lone Star are as stated in this Agreement.

(ii) Lone Star has full power and authority to execute, deliver and perform this Agreement, and this Agreement has been duly authorized, executed and delivered by Lone Star, and (assuming the due and valid authorization, execution and delivery by Shareholder) constitutes the legal, valid and binding agreement of Lone Star enforceable against Lone Star in accordance with its terms, except to the extent enforceability may be limited by bankruptcy, insolvency, reorganization, moratorium, fraudulent transfer or other similar laws of general applicability relating to or affecting the enforcement of creditors' rights and by the effect of general principles of equity (regardless of whether enforceability is considered in a proceeding in equity or at law).

(iii) The execution and performance by Lone Star of this Agreement will not violate the Articles of Incorporation or Bylaws of Lone Star and, to the knowledge of such counsel, will not violate, result in a breach of, or constitute a default under, any material lease, mortgage, contract, agreement, instrument, law, rule, regulation, judgment, or order or decree known to such counsel to which Lone Star is a party or to which it or any of its properties or assets may be bound.

(iv) The Non-Competition Agreement and Employment Agreement dated the date of Closing among Lone Star and M Campbell constitute the legal, valid and binding agreement of Lone Star enforceable against Lone Star in accordance with its terms, except to the extent enforceability may be limited by bankruptcy, insolvency, reorganization, moratorium, fraudulent transfer, or other similar laws of general applicability relating to or affecting the enforcement of creditors' rights and by the effect of general principles of equity whether enforceability is considered in a proceeding in equity or at law.

(v) To the knowledge of such counsel, no consent approval, authorization or order of any court or governmental agency or body which has not been obtained is required on behalf of Lone Star for consummation of the transactions contemplated by this Agreement.

(vi) To the knowledge of such counsel, there are no actions, suits or proceedings, pending or threatened, against or affecting Lone Star by any Governmental Entity which seeks to restrain, prohibit or invalidate the transactions contemplated by the Agreement.

In rendering such opinion, counsel for Lone Star may rely as to matters of fact upon the representations of officers of Lone Star contained in any certificate delivered to such counsel and certificates of

public officials. Such opinion shall be limited to the laws of the United States of America and the State of Texas.

(e) Delivery of Stock Purchase Consideration. Lone Star shall have made delivery of the Stock Purchase Consideration.

SECTION 5.3 Conditions to Obligations of Lone Star to Effect the Stock Purchase. The obligations of Lone Star to effect the Stock Purchase shall be subject to the fulfillment at or prior to the Closing of the following additional conditions, provided that Lone Star may waive any such conditions in its sole discretion:

(a) Performance of Obligations; Representations and Warranties. Shareholder shall have performed in all material respects each of his agreements contained in this Agreement required to be performed on or prior to the Closing and each of the respective representations and warranties of Shareholder contained in this Agreement shall be true and correct on and as of the Closing as if made on and as of such date.

(b) Officers' Certificate. Shareholder shall have furnished to Lone Star a certificate, dated as of the Closing, certifying to the effect that, to the knowledge and belief of Shareholder, the conditions set forth in Section 5.1 and Section 5.3(a) have been satisfied.

(c) Opinion of Davis, Hutchinson & Wilkerson, L.L.P. Lone Star shall have received an opinion of counsel from Davis, Hutchinson & Wilkerson, L.L.P., counsel to Shareholder and TFI, dated as of the Closing, substantially to the effect that:

(i) The incorporation, existence, good standing, and capitalization of TFI are as stated in this Agreement; the authorized shares of TFI Common Stock are as stated in this Agreement; all outstanding shares of TFI Common Stock are duly and validly authorized and issued, fully paid and non-assessable.

(ii) Shareholder has full power and authority to execute, deliver and perform this Agreement, and this Agreement has been duly authorized, executed and delivered by Shareholder, and (assuming the due and valid authorization, execution and delivery by Lone Star) constitutes the legal, valid and binding agreement of Shareholder enforceable against Shareholder in accordance with its terms, except to the extent enforceability may be limited by bankruptcy, insolvency, reorganization, moratorium, fraudulent transfer or other similar laws of general applicability relating to or affecting the enforcement of creditors' rights and by the effect of general principles of equity (regardless of whether enforceability is considered in a proceeding in equity or at law).

(iii) The execution and performance by Shareholder of this Agreement will not violate the Articles of Incorporation or Bylaws of TFI and, to the knowledge of such counsel, will not violate, result in a breach of, or constitute a default under, any material lease, mortgage, contract, agreement, instrument, law, rule, regulation, judgment, order or decree known to such counsel to which either Shareholder or TFI is a party or to which him or it or any of his or its properties or assets may be bound.

(iv) The Non-Competition Agreement and Employment Agreement dated the date of Closing among Lone Star and M Campbell constitute the legal, valid and binding agreement of M Campbell enforceable against M Campbell in accordance with its terms, except to the extent enforceability may be limited by bankruptcy, insolvency, reorganization, moratorium, fraudulent transfer, or other similar laws of general applicability relating to or affecting the enforcement of creditors' rights and by the effect of general principles of equity whether enforceability is considered in a proceeding in equity or at law.

(v) To the knowledge of such counsel, no consent, approval, authorization or order of any court or governmental agency or body which has not been obtained is

required on behalf of either of M Campbell or TFI for consummation of the transactions contemplated by this Agreement.

(vi) To the knowledge of such counsel, there are no actions, suits or proceedings, pending or threatened, against or affecting either of M Campbell or TFI by any Governmental Entity which seeks to restrain, prohibit or invalidate the transactions contemplated by the Agreement.

In rendering such opinion, counsel for M Campbell and TFI may rely as to matters of fact upon the representations of officers of TFI and M Campbell contained in any certificate delivered to such counsel and certificates of public officials. Such opinion shall be limited to the laws of the United States of America and the State of Texas.

(d) Officer and Director Resignation Letters. Lone Star shall have received a resignation letter dated the date of the Closing from each of the directors and officers of TFI.

(e) TFI Stock Certificates. Lone Star shall have received all of the certificates evidencing the TFI Common Stock duly endorsed to Lone Star.

(f) Evidence of Insurability. M Campbell shall have provided Lone Star with proof that he is insurable with life insurance underwritten by Massachusetts Mutual Life Insurance Company in the face amount of at least \$2 million.

(g) Non-Competition Agreements. A Non-Competition Agreement in the form attached hereto as Exhibit C shall have been executed and delivered by each of the following persons: Steve Akins, Cindi Campbell and Steve Disharon.

ARTICLE VI

GENERAL PROVISIONS

SECTION 6.1 Notices. All notices and other communications hereunder shall be in writing and shall be deemed given if delivered personally, sent by overnight courier or telecopied (with a confirmatory copy sent by overnight courier) to the parties at the following addresses (or at such other address for a party as shall be specified by like notice):

- (a) to Lone Star, to:
 Lone Star Mud, Inc.
 415 West Wall Street, Suite 530
 Midland, Texas 79701
 Facsimile: (915) 684-7473
 Attention: Spencer D. Armour III
 President

with copies to:

Patterson Energy, Inc.
 4510 Lamesa Highway
 P.O. Box 1416
 Snyder, Texas 79550
 Facsimile: (915) 537-0281
 Attention: Cloyce A. Talbott
 Chairman and Chief
 Executive Officer

Thomas H. Maxfield, Esq.
 Baker & Hostetler LLP
 303 East 17th Avenue, Suite 1100
 Denver, Colorado 80203-1264
 Facsimile: (303) 861-2307

(b) if to M Campbell, to:
 Mark Campbell
 6262 Weber, Suite 112
 Corpus Christi, Texas 78413
 Facsimile: (512) 851-8155

with copies to:

Marshall R. Wilkerson
 Davis, Hutchinson & Wilkerson, L.L.P.
 Frost Bank Plaza
 802 N. Carancahua, Suite 1270
 Corpus Christi, Texas 78470-0400
 Facsimile: (512) 882-1191

SECTION 6.2 Interpretation. When a reference is made in this Agreement to a Section, such reference shall be to a Section of this Agreement unless otherwise indicated, and the words "hereof," "herein" and "hereunder" and similar terms refer to this Agreement as a whole and not to any particular provision of this Agreement, unless the context otherwise requires. The table of contents and headings contained in this Agreement are for reference purposes only and shall not affect in any way the meaning or interpretation of this Agreement. Whenever the words "include," "includes" or "including" is used in this Agreement, they shall be deemed to be followed by the words "without limitation."

SECTION 6.3 Counterparts. This Agreement may be executed in counterparts, all of which shall be considered one and the same agreement and shall become effective when one or more counterparts have been signed by each of the parties and delivered to the other parties.

SECTION 6.4 Entire Agreement; No Third-Party Beneficiaries. This Agreement, including the documents and instruments referred to herein, (i) constitutes the entire agreement and supersedes all prior agreements and understandings, both written and oral, among the parties with respect to the subject matter hereof and (ii) is not intended to confer upon any person other than the parties any rights or remedies hereunder; provided, however, that legal counsel for the parties hereto may rely upon the representations and warranties contained herein and in the certificates delivered pursuant to Sections 5.2(c) and 5.3(c).

SECTION 6.5 Governing Law. This Agreement shall be governed by, and construed in accordance with, the laws of the State of Texas, regardless of the laws that might otherwise govern under applicable principles of conflicts of laws thereof.

SECTION 6.6 Assignment. Neither this Agreement nor any of the rights, interests or obligations hereunder shall be assigned by any of the parties without the prior written consent of the other parties. Subject to the preceding sentence, this Agreement shall be binding upon, inure to the benefit of, and be enforceable by, the parties and their respective successors and assigns.

SECTION 6.7 Severability. If any term or other provision of this Agreement is invalid, illegal or incapable of being enforced by any rule of law, or public policy, all other conditions and provisions of this Agreement shall nevertheless remain in full force and effect so long as the economic or legal substance of the transactions contemplated hereby are not affected in any manner materially adverse to any party. Upon such determination that any term or other provision is invalid, illegal or incapable of being enforced, the parties shall negotiate in good faith to modify this Agreement so as to effect the original intent of the parties as closely as possible in a mutually acceptable manner in order that the transactions be consummated as originally contemplated to the fullest extent possible.

SECTION 6.8 Enforcement of This Agreement. The parties agree that irreparable damage would occur in the event that any of the provisions of this Agreement were not performed in accordance with their specific terms or were otherwise breached. It is accordingly agreed that the parties shall be entitled to an injunction or injunctions to prevent breaches of this Agreement and to enforce specifically the terms and provisions hereof in any court of the United States or any state having jurisdiction, this being in addition to any other remedy to which they are entitled at law or in equity.

IN WITNESS WHEREOF, Lone Star and M Campbell have executed this Agreement as of the date first written above.

LONE STAR:

LONE STAR MUD, INC.

By: /s/ SPENCER D. ARMOUR III

Spencer D. Armour III
President

M CAMPBELL:

/s/ MARK CAMPBELL

Mark Campbell

PATTERSON ENERGY, INC.,

LONE STAR MUD, INC.

AND

MARK CAMPBELL

NON-COMPETITION AGREEMENT

THIS NON-COMPETITION AGREEMENT is made and entered into this day of September, 1998 (this "Agreement"), between and among PATTERSON ENERGY, INC., a Delaware corporation ("PEC"), Lone Star MUD, INC., a Texas corporation ("Lone Star") wholly-owned by PEC, and MARK CAMPBELL, an individual residing in Corpus Christi, Texas ("M Campbell").

RECITALS:

A. Simultaneously with the execution of this Agreement, (i) Lone Star and M Campbell have consummated the transactions contemplated by that certain Stock Purchase Agreement dated of even date herewith (the "Stock Purchase Agreement"), among Lone Star and M Campbell providing for, among other things, the acquisition by Lone Star from M Campbell of all of the outstanding capital stock of Tejas Fluids, Inc. ("TFI"), a Texas corporation wholly owned by M Campbell (the "Stock Purchase"); and (ii) Lone Star and M Campbell have entered into an employment agreement (the "M Campbell Employment Agreement").

B. M Campbell is or was an officer, a director and a stockholder of TFI.

C. The execution and delivery of this Agreement is a condition to the consummation of the Stock Purchase contemplated by the Stock Purchase Agreement, and the parties are entering into this Agreement in order to fulfill such condition.

NOW, THEREFORE, in consideration of the foregoing, the mutual covenants and agreements contained herein, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties, intending to be legally bound, hereby agree as follows:

1. Period of Agreement. The period of this Agreement shall commence on the date hereof and remain in effect through the first to occur of (a) termination of the M Campbell Employment Agreement (i) by Lone Star without "Cause" as that term is defined in Section 10(a) of the M Campbell Employment Agreement or (ii) by M Campbell as a result of a material breach of the M Campbell Employment Agreement by Lone Star pursuant to Section 10(b) thereof, or (b) December 31, 2005, unless M Campbell is still in the employ of Lone Star on that date, in which event this Agreement shall terminate on the second anniversary of the termination of the employment of M Campbell with Lone Star (the "Non-Compete Period").

2. Covenant Not to Compete.

(a) M Campbell covenants and agrees that during the Non-Compete Period, M Campbell shall not, without the prior written consent of PEC and Lone Star, directly or indirectly, and whether as a principal or as an agent, officer, director, employee, consultant, or otherwise, alone or in association with any other person, carry on, be engaged, concerned, or take part in, render services to, or own, share in the earnings of, or invest in the stock, bonds, or other securities of, any person which is engaged in the drilling fluids business (the "Competitive Business") within the states of Texas, Louisiana, New Mexico and Oklahoma or in any other states in which Lone Star

is conducting the Competitive Business at the time of termination of the M Campbell Employment Agreement; provided, however, that M Campbell may (i) invest in stock, bonds, or other securities of any Competitive Business (but without otherwise participating in the Competitive Business) if: (A) such stock, bonds, or other securities are listed on any national securities exchange or are registered under Section 12(g) of the Securities Exchange Act of 1934, as amended; (B) the investment does not exceed, in the case of any class of capital stock of any one issuer, two percent (2%) of the issued and outstanding shares, or, in the case of bonds or other securities of any one issuer, two percent (2%) of the aggregate principal amount thereof issued and outstanding; and (C) such investment would not prevent, directly or indirectly, the transaction of business by PEC or Lone Star or any affiliate of PEC or Lone Star with any state, district, territory, or possession of the United States or any governmental subdivision, agency, or instrumentality thereof by virtue of any statute, law, regulation or administrative practice. The period of time during which M Campbell is prohibited from engaging in certain activities by this Section shall be extended by the length of time during which M Campbell is in breach of the terms of this section.

(b) It is understood by and between the parties hereto that the foregoing covenant by M Campbell not to enter into competition with PEC or Lone Star as set forth in Section 2(a) hereof is an essential element of this Agreement, the Stock Purchase Agreement and the M Campbell Employment Agreement and that, but for the agreement of M Campbell to comply with such covenant, Lone Star would not have agreed to enter into this Agreement, the Stock Purchase Agreement and the M Campbell Employment Agreement. PEC and Lone Star on the one hand and M Campbell on the other hand have independently consulted with their respective counsel and have been advised in all respects concerning the reasonableness and propriety of such covenant, with specific regard to the nature of the business conducted by PEC and Lone Star and their respective affiliates. M Campbell agrees that such covenant is reasonable in scope, geographic area, and duration.

3. Restrictions on Soliciting Business of PEC and Lone Star. M Campbell further covenants and agrees that during the Non-Compete Period, M Campbell will not, either for himself or for any other person or entity, directly or indirectly, engage in any of the following activities in a Competitive Business without the express prior written consent of PEC and Lone Star:

(a) Solicit or hire any of the employees of PEC or Lone Star or solicit or take away any of PEC's or Lone Star's customers, lessors, or suppliers or attempt any of the foregoing;

(b) Acquire or attempt to acquire rights providing any product or service in a Competitive Business within the territory described in Section 2 hereof; or

(c) Engage in any act which would interfere with or harm any business relationship PEC or Lone Star has with any customer, lessor, employee, principal or supplier.

4. Specific Performance. Without intending to limit the remedies available to PEC or Lone Star, M Campbell acknowledges that PEC or Lone Star will have no adequate remedies at law if M Campbell violates the terms of Section 2 or 3, hereof. In such event, M Campbell agrees that PEC or Lone Star shall have the right, in addition to any other rights it may have, to obtain in any court of competent jurisdiction specific performance of such Sections of this Agreement or injunctive relief to restrain any breach or threatened breach thereof. Nothing herein shall be construed as prohibiting PEC or Lone Star from pursuing any other remedies available to PEC or Lone Star (whether at law or in equity) for such breach or threatened breach, including, without limitation, the recovery of monetary damages from M Campbell.

The provisions of this Section 4 shall survive the expiration, termination or cancellation of this Agreement.

5. Attorneys Fees and Costs. If an action at law or in equity is necessary to enforce or interpret the terms of this Agreement, the prevailing party shall be entitled to reasonable attorneys fees, costs and necessary expenses in addition to any other relief to which that party may be entitled. This provision is applicable to this entire Agreement.

6. Representations and Warranties of PEC, Lone Star and M Campbell.

(a) Representations and Warranties of PEC and Lone Star. PEC and Lone Star hereby jointly and severally represent and warrant to M Campbell that: (i) they have all requisite power to enter into and perform their obligations under this Agreement; (ii) this Agreement has been duly and validly authorized by all necessary corporate action on the part of PEC and Lone Star; (iii) the execution of this Agreement by PEC and Lone Star and performance of their obligations hereunder do not require the consent or approval of any other party; and (iv) this Agreement is a valid and binding obligation of PEC and Lone Star.

(b) Representations and Warranties of M Campbell. M Campbell hereby represents and warrants to PEC and Lone Star that: (i) M Campbell has the capacity and power to enter into and perform the obligations of M Campbell under this Agreement; (ii) M Campbell has duly and validly executed this Agreement; (iii) the execution of this Agreement and performance of obligations of M Campbell hereunder do not require the consent or approval of any other party; and (iv) this Agreement constitutes a valid and binding obligation of M Campbell.

7. General Provisions.

(a) Compliance with Laws. The parties agree that they will comply with all applicable laws and regulations of government bodies or agencies in their respective performance of their obligations under this Agreement.

(b) Governing Law and Construction. This Agreement will be governed by and construed in accordance with the laws of the State of Texas without reference to its conflict-of-laws principles. This Agreement's final form resulted from review and negotiations among the parties and their attorneys, and no part of this Agreement should be construed against any party on the basis of authorship.

(c) Forum for Dispute Resolution. If any dispute arises among the parties concerning the interpretation or performance of any portion of this Agreement which the parties are unable to resolve themselves, and any party brings an action against any other party seeking a declaratory order, specific performance, damages, or any other legal or equitable relief based on this Agreement, the parties agree that the forum for any such action shall be an appropriate federal or state court in Texas having jurisdiction, agree that venue will be proper in such courts, and waive any objections based on inconvenience of the forum, and further agree that the prevailing party in any such action, as determined by the court, shall be awarded its reasonable attorneys' fees and costs in addition to any relief or judgment the court awards.

(d) Entire Agreement; Amendment. This Agreement constitutes the entire agreement between the parties with respect to the subject matter contained herein and supersedes any previous oral or written communications, representations, understandings or agreements with respect thereto. The terms of this Agreement may be modified only in a writing, signed by authorized representatives of both parties.

(e) Assignability. The rights and duties of any party under this Agreement shall not be assignable by such party except that this Agreement and all right and obligations hereunder may be assigned by Lone Star or PEC to, and assumed by, any corporation or other business entity which succeeds to all or substantially all of the assets and business of Lone Star or PEC, as the case may be, through merger, consolidation, acquisition of assets or other corporate reorganization.

(f) Waiver. A waiver of a breach or default under this Agreement will not constitute a waiver of any other breach or default. Failure or delay by either party to enforce compliance with any term or condition of this Agreement will not constitute a waiver of such term or condition.

(g) Severability. If any provision of this Agreement is declared to be invalid, the parties agree that such invalidity will not affect the validity of the remaining provisions of this Agreement, and further agree, to the extent possible, to substitute for the invalid provision a valid provision that approximates the intent and economic effect of the invalid provision as closely as possible.

(h) Headings. The titles of the Sections and subsections of this Agreement are for convenience of reference only and are not to be considered in construing this Agreement.

(i) Notice. Any notice, request, consent, demand or other communication required to be given under this Agreement will be in writing and will be given personally, by facsimile or by mailing the same, first-class, postage prepaid to the appropriate address and facsimile number set forth below or to such other person or at such other address as may hereafter be designated by like notice. Notices by mail will be considered delivered and become effective three days after the mailing thereof. All notices by facsimile will be considered delivered and become effective immediately upon the confirmed (by answer back or other tangible printed verification or successful receipt) sending thereof.

To PEC:

Patterson Energy, Inc.
4510 Lamesa Highway
P.O. Drawer 1410
Snyder, Texas 79550
Facsimile: (915) 573-0281
Attention: Cloyce A. Talbott
Chairman and Chief Executive Officer

To Lone Star:

Lone Star Mud, Inc.
415 West Wall Street, Suite 530
Midland, Texas 79701
Facsimile: (915) 684-7446
Attention: Spencer D. Armour III
President

To M Campbell:

Mark Campbell
6262 Weber, Suite 112
Corpus Christi, Texas 78413
Facsimile: (512) 851-8155

(j) Counterparts. This Agreement may be executed in counterparts and by the parties hereto in separate counterparts, each of which will be deemed an original, but all of which together will constitute one and the same instrument.

(k) Effective Time. This Agreement shall become effective simultaneously with the Closing (as defined in the Stock Purchase Agreement) of the Stock Purchase.

IN WITNESS WHEREOF, the undersigned have caused this Agreement to be executed by their respective representatives as of the day and year first above written.

"PEC"

PATTERSON ENERGY, INC.

By:

James C. Brown
Vice President and Chief Financial Officer

"LONE STAR"

LONE STAR MUD, INC.

By:

Spencer D. Armour III
President

"M CAMPBELL"

Mark Campbell

EMPLOYMENT AGREEMENT

THIS EMPLOYMENT AGREEMENT ("Agreement") is made and entered into as of September __, 1998, by and between LONE STAR MUD, INC., a Texas corporation (hereinafter referred to as "Employer") wholly owned by Patterson Energy, Inc., a Delaware corporation ("PEC"), and MARK CAMPBELL of Corpus Christi, Texas (hereinafter referred to as "Employee").

W I T N E S S E T H:

WHEREAS, Employee was employed by TEJAS FLUIDS, INC. ("TFI"), a Texas corporation, from the inception of TFI through the consummation on this date of the purchase by Employer from Employee of all of the outstanding capital stock of TFI (the "Stock Purchase") pursuant to the terms of the Stock Purchase Agreement dated of even date herewith between Employer and Employee (the "Stock Purchase Agreement");

WHEREAS, Employer desires to continue to employ Employee.

NOW, THEREFORE, in consideration of the premises and the mutual promises and covenants herein contained, Employee and Employer hereby agree as follows:

1. Employment. Employer agrees to employ Employee as South Texas and Texas Gulf Coast Regional Manager, subject to the terms and conditions hereinafter set forth. Employee hereby accepts such employment and agrees that he will, during the continuance hereof, devote his full time and attention and abilities to the duties of employment assigned to him by the Vice President of Operations or President of Employer.

2. Term. The term of this Agreement shall begin on the date of this Agreement and shall end on December 31, 2003, subject to the terms and conditions hereinafter contained.

3. Place of Employment. Employer agrees that Employee will have his principal office at and will perform his principal duties at Employer's field office, located in Corpus Christi, Texas. Notwithstanding the foregoing, Employee acknowledges that it may be necessary from time to time for him in the performance of his duties, to travel on behalf of the Company and to perform such duties while temporarily away from his principal office.

4. Compensation. As compensation to Employee for his performance of the services required hereunder, and for his acceptance of the responsibilities herein contained, and for his performance of all the additional obligations of employment, Employer agrees to pay and Employee agrees to accept the following salary, other compensation and benefits, in addition to any other compensation and benefits under this Agreement:

(a) Salary. Employee shall be entitled to receive a salary payable monthly at an annual rate of \$90,000.

(b) Bonus. For each year of employment of Employee with Employer under this Agreement beginning with the year ended December 31, 1999, that the "Incentive Goals" (as defined below) relating to sales of drilling fluids in Region I (as defined below) are met, Lone Star will pay a cash bonus to Employee of 33% of the "Region I Net Profit" (as defined below) up to a maximum bonus for that year of \$500,000. Such bonus, if payable for a particular year, will be paid on or before March 31 of the following year. The calculation of the various amounts necessary to determine whether the bonus for a particular year is payable and, if so, the amount of the bonus, will be based on generally accepted accounting principles. For purposes of the bonus:

"Base Year" means the trailing 12 months ending December 31, 1998.

"Incentive Goals" means both (i) a growth in Region I Gross Sales (as defined below) for each calendar year of at least year, 25% over the Base Year compounded annually, and (ii) a Region I Net Profit (as defined below) of at least 15% of Region I Gross Sales for the calendar year in question. For example, if Region I Gross Sales for the Base Year were \$1,000,000, Region I Gross Sales for the year ending December 31, 1999 must be at least \$1,250,000, Region I Gross Sales for the year ending December 31, 2000 must be at least \$1,562,500, Region I Gross Sales for the year ending December 31, 2001 must be at least \$1,953,125, Region I Gross Sales for the year ending December 31, 2002 must be at least \$2,441,406, and Region I Gross sales for the year ending December 31, 2003 must be at least \$3,051,758.

"Region I" means the South Texas and Texas Gulf Coast region consisting of Texas Railroad Commission Districts 1 (excluding Val Verde, Edwards and Maverick Counties), 2, 3 and 4, and all international sales of Ultralube II generated by Employee.

"Region I Gross Profit" means the amount determined by subtracting day-to-day Region I operating expenses (excluding interest, taxes and depreciation) for the current calendar year on an accrual basis from net sales (gross sales less cost of goods sold) of drilling fluids for that year within Region I.

"Region I Gross Sales" means all revenues received by Employer from the sale of drilling fluids in Region I by employees of Employer including, but not limited to, Employee.

"Region I Net Profit" means the amount determined by subtracting the sum of the Quarterly Region I Allocable Share of Sales Overhead and Corporate Overhead (as defined below) for a current calendar year from Region I Gross Profit for that year.

"Quarterly Region I Allocable Share of Sales and Corporate Overhead" means the ratio of Region I Gross Sales to Total Regional Gross Sales, determined on a calendar quarter basis using Region I Gross Sales and Total Regional Gross Sales for the three-month period immediately preceding such calendar quarter, multiplied by the sum of Sales Overhead and Corporate Overhead using Sales Overhead and Corporate Overhead for such three-month period.

"Total Regional Gross Sales" means the sum of all revenues received by Lone Star from the sale of drilling fluids by employees of Lone Star including, but not limited to, Employee, in Region I, Midcontinent region and Permian Basin region and in any other regions in which drilling fluids are sold by Employer.

"Sales Overhead" means expenses associated with the drilling fluids sales operations of Employer.

"Corporate Overhead" means the expenses associated with the day-to-day operations of Employer, including Employer's proportionate share of the overhead of PEC, but excluding Sales Overhead and interest, taxes and depreciation.

(c) Further Benefits. Employee shall be entitled to participate, as long as he is employed by Employer, in all employee benefit plans of Employer or of PEC for employees of PEC and subsidiaries of PEC.

5. Vacations. Employee shall be entitled each calendar year to a vacation or vacations aggregating a total of ___ working days (or a pro rata number of working days for any period less than a calendar year) and such public holidays as are provided by Lone Star to other employees of Employer; provided that such number of working days for the first calendar year ending December 31, 1998, shall be reduced by the number of vacation days taken by Employee between January 1, 1998, and the date of this Agreement. Employer and Employee shall mutually agree as to when Employee may take his vacation or vacations. Unused vacation time shall not be carried forward to subsequent years.

6. Expenses. Employer shall pay or reimburse Employee for reasonable or necessary out-of-pocket expenses incurred by Employee in conjunction with the performance of his duties hereunder; provided that such expenses are properly documented in accordance with normal procedures of Employer.

7. Confidentiality. Employee acknowledges that information used by PEC and its subsidiaries, including Employer, in the conduct of their respective business is confidential information which is the sole and exclusive property of PEC and its subsidiaries. Employee agrees that he will not, during the term of this Agreement or at any time after the termination hereof, disclose any of such confidential information to any third party or use such confidential information in any way to compete with or to act in any other way adverse to Employer and its subsidiaries. Provisions of this paragraph shall not however apply to information which is or which becomes available to the general public through no fault of Employee. Upon termination of Employee's employment hereunder, regardless of the reason for such termination, Employee agrees promptly to deliver all tangible materials constituting confidential information and all other property of PEC and its subsidiaries, including Employer, to PEC.

8 Enforcement. The parties agree that upon any violation of the provisions of paragraph 7 hereof, monetary damages would be inadequate and difficult to ascertain. The parties therefore agree that upon the existence of any such violation or threatened violation, provided that Employer is not then in default hereunder, Employer may obtain a temporary restraining order, preliminary injunction or other appropriate that constitutes a felony in the jurisdiction involved not subject to further appeal or review, if such conviction or plea is injurious to Employer.

9. Withholding of Appropriate Taxes. It is understood and agreed by the parties hereto that Employer shall withhold appropriate taxes from compensation and with respect to any other economic benefits herein provided when such withholding is, in the reasonable judgment of Employer, required by law or regulation.

10. Termination.

(a) By Employer. Employer may terminate this Agreement only for Cause (as defined below) upon 30 days prior written notice to Employee.

(i) If the written notice is issued, such notice shall specify that termination is being made for Cause and it shall state the basis therefor.

(ii) For purposes of this Agreement, termination for "Cause" shall mean termination because of:

a. The continued failure by Employee to substantially perform or the gross negligence in the performance of his duties hereunder after the Board of Directors of Employer has made a written demand for performance which specifically identifies the

manner in which it believed that Employee has not substantially performed his duties.

b. The commission by Employee of a willful act of dishonesty or misconduct which is injurious to Employer, or the breach of a fiduciary duty to Employer.

c. A conviction or a plea of guilty or nolo contendere in connection with fraud or any crime that constitutes a felony in the jurisdiction involved not subject to further appeal or review, if such conviction or plea is injurious to Employer.

d. The commission by Employee of an act of substance abuse.

(b) By Employee. Employee shall have the right to terminate this Agreement only: (i) for cause, limited to a material breach of this Agreement by Employer which remains uncured after reasonable notice; or (ii) if both A. Glenn Patterson and Spencer D. Armour cease being employees of PEC and/or Employer.

11. Miscellaneous.

(a) The rights and duties of either party under this Agreement shall not be assignable by either party except that this Agreement and all rights and obligations hereunder may be assigned by Employer to, and assumed by, any corporation or other business entity which succeeds to all or substantially all of the assets and business of Employer through merger, consolidation, acquisition of assets or other corporate reorganization.

(b) This Agreement shall be governed by, construed, applied and enforced in accordance with the laws of the State of Texas except that no doctrine of choice of law shall be used to apply any law other than that of Texas, and no defense, counterclaim or right of set-off given or allowed by the laws of any other state or jurisdiction, or arising out of the enactment, modification or repeal of any law, regulation, ordinance or decree of any foreign jurisdiction, be interposed in any action hereon. Subject to Section 11(c) below, Employee and Employer agree that any action or proceeding to enforce or arising out of this Agreement may be commenced in the courts of the state of Texas or the United States District Courts in Dallas, Texas. Employee and the Company consent to such jurisdiction, agree that venue will be proper in such courts and waive any objections based upon forum non conveniens. The choice of forum set forth in this Section 11 shall not be deemed to preclude the enforcement of any judgment obtained in such forum or the taking of any action under this Agreement to enforce same in any other jurisdiction.

(c) Employee or Employer agree that any dispute between or among the parties to this Agreement relating to or in respect of this Agreement, its negotiation, execution, performance, subject matter, or any course of conduct or dealing or actions under or in respect of this Agreement, shall be submitted to, and Resolved exclusively pursuant to arbitration in accordance with the commercial arbitration rules of the American Arbitration Association. Such arbitration shall take place in Dallas, Texas, and shall be subject to the substantive law of the State of Texas. Decisions pursuant to such arbitration shall be final, conclusive and binding on the parties subject to confirmation, modification or challenge pursuant to 9 U.S.C. Section 1 et. seq. Upon the conclusion of arbitration, Employee or Employer may apply to any court of the type described in

Section 10(b) above to enforce the decision pursuant to such arbitration. In connection with the foregoing, the parties hereby waive any rights to a jury trial to resolve any disputes or claims relating to this Agreement.

(d) This Agreement and all provisions hereof shall bind and inure to the benefit of Employer, Employee and their respective personal representatives, heirs, successors and assigns.

(e) This Agreement and all questions arising hereunder shall be governed by the laws of the State of Texas.

(f) If any provision of this Agreement shall be held to be invalid, illegal or unenforceable, such provision shall be severed or enforced to the extent possible and such invalidity, illegality or unenforceability shall not affect the remainder of this Agreement.

(g) This Agreement supersedes any prior agreements or understandings, oral or written, with respect to employment of Employee and constitutes the entire agreement with respect thereto. This Agreement may be amended or modified only by written agreement subscribed to by both of the parties hereto.

(h) The waiver by either party of a breach of any provision of this Agreement by the other shall not operate or be construed as a waiver of any subsequent breach of the same provision or any other provision of this Agreement.

(i) All notices and other communications hereunder shall be in writing and shall be deemed given if delivered personally, sent by overnight courier or telecopier (with a confirmation copy sent by overnight courier) to the parties at the following addresses (or at such other address for a party as shall be specified by like notice):

(i) To Employee, to:

Mark Campbell
6262 Weber, Suite 112
Corpus Christi, , Texas 78413
Facsimile: (512) 851-8155

(ii) To Employer, to:

Lone Star Mud, Inc.
415 West Wall Street, Suite 530
Midland, Texas 79701
Facsimile: (915) 684-7446
Attention: Spencer D. Armour III
President

with copies to:

Patterson Energy, Inc.
4510 Lamesa Highway
P.O. Box 1416
Snyder, Texas 79550
Facsimile: (915) 573-0281
Attention: Cloyce A. Talbott
Chairman and Chief Executive Officer

(j) This Agreement shall become effective simultaneously with the Closing (as defined in the Stock Purchase Agreement) of the Stock Purchase.

IN WITNESS WHEREOF, Employee and Employer have duly executed this Agreement.

EMPLOYER:

LONE STAR MUD, INC., a Texas corporation

By:

Spencer D. Armour III
President

EMPLOYEE:

Mark Campbell

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AGREEMENT

AMONG

PATTERSON ENERGY, INC.,
PATTERSON DRILLING COMPANY

AND

PADRE INDUSTRIES, INC.

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AGREEMENT

AGREEMENT, dated as of January ___, 1999 (this "Agreement"), among PATTERSON ENERGY, INC., a Delaware corporation ("PEC"), PATTERSON DRILLING COMPANY, a Delaware corporation ("PDC"), wholly-owned by PEC, and PADRE INDUSTRIES, INC., a privately-held Texas corporation ("Padre").

WITNESSETH:

WHEREAS, Padre owns, among other assets, five drilling rigs, related drilling equipment and rolling stock (collectively, the "Drilling Rigs, Equipment and Rolling Stock"), and a shop, office, warehouse and yard located in Corpus Christi, Texas (collectively, the "Real Property"), all as more particularly described on Annex 1, in the case of the Drilling Rigs, Equipment and Rolling Stock, and in the Real Property Lease/Option to Purchase (as defined in the next recital), in the case of the Real Property;

WHEREAS, PDC desires to (i) purchase all of Padre's right, title and interest in and to the Drilling Rigs, Equipment and Rolling Stock (the "Asset Purchase") and (ii) lease the Real Property with an option to purchase (the "Real Property Lease/Option to Purchase") (the Asset Purchase and the Real Property Lease/Option to Purchase are collectively referred to herein as the "Transaction") for the consideration set forth and provided for herein;

WHEREAS, Padre desires to enter into the Transaction; and

WHEREAS, PDC, on the one hand, and Padre, on the other, desire to make certain representations, warranties and agreements in connection with the Transaction and also prescribe various conditions to the Transaction.

NOW, THEREFORE, in consideration of the premises and the representations, warranties and agreements herein contained, the parties agree as follows:

ARTICLE I
THE TRANSACTION

SECTION 1.1 The Transaction. Upon the terms and subject to the conditions of this Agreement, at the Closing (as defined in Section 1.3 below) provided herein: (a) PDC shall purchase from Padre and Padre shall sell to PDC, all of Padre's right, title and interest in and to the Drilling Rigs, Equipment and Rolling Stock; and (b) PDC and Padre shall enter into a lease, with an option to purchase, the Real Property providing for, among other matters, a one-year lease for a total lease payment of \$100,000, payable in equal monthly installments, and a \$1 million purchase price.

SECTION 1.2 Asset Purchase-Purchase Consideration.

(a) In consideration for all of Padre's right, title and interest in and to the Drilling Rigs, Equipment and Rolling Stock, PDC agrees to pay or deliver to Padre at the Closing (as defined in Section 1.3) 800,000 shares of common stock of PEC ("PEC Shares"; also sometimes referred to herein as the "Purchase Consideration").

(b) PDC further agrees that:

(i) if the "Closing Date Share Price" (as defined below in this Section) for the PEC Shares on the Closing Date (as defined in Section 1.3) is less than \$5.00 per PEC Share, PDC shall pay to Padre on the Anniversary Date (as defined below in this Section) such amount in cash as is equal to 10% of the product of the difference between \$5.00 and the Closing Date Share Price, times the difference between 800,000 and the number of PEC Shares Sold/Purchased (as defined below in this Section) times the Reduction Ratio (as defined below in this Section) (the "First Supplemental Cash Payment"); and

(ii) if the "Anniversary Date Share Price" (as defined below in this Section) is less than \$5.00 per PEC Share, PEC shall pay to Padre on the Anniversary Date such amount in cash as is equal to the product of the difference between 800,000 and the number of PEC Shares Sold/Purchased (as defined below in this Section) times the difference between \$5.00 and the greater of (i) the Closing Date Share Price or (ii) the Anniversary Date Share Price (the "Second Supplemental Cash Payment") [the First Supplemental Cash Payment and the Second Supplemental Cash Payment are collectively referred to herein as the "Supplemental Cash Payments"]; provided that if the Closing Date Share Price is at least \$5.00 or the Anniversary Date Share Price is at least \$5.50 there shall be no Supplemental Cash Payments.

By way of examples: (i) if the Closing Date Share Price and the Anniversary Date Share Price were both \$4.00 per PEC Share, the First Supplemental Cash Payment would be \$80,000 (10% of the product of \$1.00 [the difference between \$5.00 and the \$4.00 Closing Date Share Price] times 800,000) and the Second Supplemental Cash Payment would be \$800,000 (the product of 800,000 times \$1.00 [the difference between \$5.00 and the \$4.00 Anniversary Date Share Price]); (ii) if the Closing Date Share Price were \$3.00 and the Anniversary Date Share Price were \$4.50, the First Supplemental Cash Payment would be \$160,000 (10% of the product of 800,000 times \$2.00 [the difference between \$5.00 and the \$3.00 Closing Date Share Price]), and the Second Supplemental Cash Payment would be \$400,000 (the product of 800,000 times \$.50 [the difference between \$5.00 and the \$4.50 Anniversary Date Share Price]); (iii) if the Closing Date Share Price were less than \$5.00 and the Anniversary Date Share Price were at least \$5.50, there would be no First Supplemental Cash Payment or Second Supplemental Cash Payment; (iv) if the Closing Date Share Price were at least \$5.00, there would be no First Supplemental Cash Payment or Second Supplemental Cash Payment, regardless of the Anniversary Date Share Price; and (v) if the Closing Date Share Price were \$3.00, the Anniversary Date Share Price were \$5.10 and there were 200,000 PEC Shares Sold, the First Supplemental Cash Payment would be \$96,000 (10% of the product of \$2.00 [the difference between \$5.00 and the \$3.00 Closing Date Share Price] times 600,000 [the difference between 800,000 and the 200,000 PEC Shares Sold] times the 80% Reduction Ratio [the \$.40 difference between \$5.50 and the \$5.10 Anniversary Date Share Price divided by \$.50]) and there would be no Second Supplemental Cash Payment.

(c) If prior to the Anniversary Date the PEC Shares are increased or decreased into a different number of PEC Shares as a result of a stock dividend or stock split, the Closing Date Share Price and all dollar figures and numbers contained in Section 1.2(b) shall be contemporaneously increased or decreased in inverse proportions.

(d) For purposes of this Agreement: (i) "PEC Shares Sold/Purchased" means the total of: (x) such number of PEC Shares sold by Padre or by any transferee of Padre as a part of an incidental registration under the Registration Rights Agreement attached hereto as Exhibit B, and (y) such number of PEC Option Shares purchased by PEC pursuant to the provisions of Section 6.1 of this

Agreement; (ii) "Closing Date Share Price" and "Anniversary Date Share Price," respectively, mean the average of the daily closing price of the shares of Common Stock of PEC, rounded to four decimal places, as reported under Nasdaq National Market Issues Reports, the New York Stock Exchange Composite Transactions or the American Stock Exchange Composite Transactions, as the case may be, in The Wall Street Journal for each of the first 10 consecutive Trading Days in the period commencing 12 Trading Days prior to the Closing Date or the Anniversary Date, as the case may be; (iii) "Trading Day" means a day on which the National Association of Securities Dealers, Inc., National Market ("Nasdaq National Market") is open for trading; (iv) "Reduction Ratio" means a fraction (expressed as a percentage) the numerator of which is equal to the difference between \$5.50 and the greater of \$5.00 or the Anniversary Date Share Price (but not to exceed \$5.50) and the denominator of which is \$0.50; (v) "Change of Control" shall be deemed to have occurred if PEC shall be merged or consolidated into another entity and PEC is not the surviving corporation; and (vi) "Anniversary Date" means the first to occur of the following: (x) the first anniversary of the Closing Date; (y) the last Trading Day immediately preceding the date PEC ceases to exist as a separate entity by way of a Change in Control or otherwise ("Cessation of Existence"); or (z) the last Trading Day immediately preceding the date the shares of Common Stock of PEC cease to be traded on the Nasdaq National Market, the New York Stock Exchange or the American Stock Exchange ("Cessation of Trading").

SECTION 1.3 Closing. The closing of the Transaction (the "Closing") shall take place in the offices of The Kleberg Law Firm, PC in Corpus Christi, Texas, at 9:00 a.m., local time, on the date of this Agreement, or at such other time and place as PDC and Padre shall agree. (The date on which the Closing is held is referred to herein as the "Closing Date.")

ARTICLE II REPRESENTATIONS AND WARRANTIES OF PEC AND PDC

PEC and PDC represents and warrants to Padre as follows:

SECTION 2.1 Organization, Standing and Power. Each of PEC and PDC (i) is a corporation duly incorporated, validly existing and in good standing under the laws of the State of Delaware and has the requisite corporate power and authority to carry on its business as now being conducted, and (ii) is in good standing in each jurisdiction where the character of its business owned or held under lease or the nature of its activities makes such qualification necessary, except where the failure to be so qualified would not individually or in the aggregate, have a Material Adverse Effect on PEC. "Material Adverse Change" or "Material Adverse Effect" means, when used with respect to PEC, PDC or Padre, as the case may be, any change or effect that is or, so far as can reasonably be determined, is likely to be materially adverse to the assets, properties, condition (financial or otherwise), business or results of operations of PEC and its subsidiaries taken as a whole or Padre, as the case may be.

SECTION 2.2 Authority; Non-Contravention. Each of PEC and PDC has all requisite power and authority to enter into this Agreement and to consummate the Transaction. The execution and delivery by each of PEC and PDC of this Agreement and the consummation by each of PEC and PDC of the Transaction have been duly authorized by all necessary corporate action on the part of PEC and PDC, as the case may be. This Agreement has been duly executed and delivered by PEC and PDC and (assuming the valid authorization, execution and delivery of this Agreement by Padre) constitutes a valid and binding obligation of PEC and PDC enforceable against PEC and PDC in accordance with its terms, except to the extent enforceability may be limited by bankruptcy, insolvency, reorganization, moratorium, fraudulent transfer or other similar laws of general applicability relating to or affecting the enforcement of creditors' rights and by the effect of general principles of equity (regardless of whether enforceability is considered in a proceeding in equity or at law). The execution and delivery of this Agreement do not, and

the consummation of the transactions contemplated hereby and compliance with the provisions hereof will not, conflict with, or result in any violation of, or default (with or without notice or lapse of time, or both) under, or give rise to a right of termination, cancellation or acceleration of any obligation or to the loss of a material benefit under, or result in the creation of any lien, security interest, charge or encumbrance upon any of the properties or assets of PEC or PDC under, any provision of (i) the Certificate of Incorporation or Bylaws of PEC or PDC, (ii) any loan or credit agreement, note, bond, mortgage, indenture, lease or other agreement, instrument, permit, concession, franchise or license applicable to PDC or PEC, or (iii) any judgment, order, decree, statute, law, ordinance, rule or regulation applicable to PDC or PEC or any of their respective properties or assets, other than, in the case of clauses (ii) or (iii), any such conflicts, violations, defaults, rights, losses, liens, security interests, charges or encumbrances that, individually or in the aggregate, would not have a Material Adverse Effect on PEC or PDC, materially impair the ability of PEC or PDC to perform its obligations hereunder or prevent the consummation of any of the transactions contemplated hereby. No filing or registration with, or authorization, consent or approval of, any domestic (federal and state), foreign or supranational court, commission, governmental body, regulatory agency, authority or tribunal (a "Governmental Agency") is required by or with respect to PEC or PDC in connection with the execution and delivery of this Agreement by PDC or is necessary for the consummation by PEC or PDC of the Transaction, except for (i) in connection or in compliance, with the provisions of the Securities Act of 1933, as amended (the "Securities Act"), and the Securities Exchange Act of 1934 (the "Exchange Act"), (ii) such consents and approvals, orders, registrations, authorizations, declarations and filings as may be required under the "Blue Sky" laws of the State of Texas, and (iii) such other consents, orders, authorizations, registrations, declarations and filings, the failure of which to be obtained or made would not, individually or in the aggregate, have a Material Adverse Effect on either PEC or PDC, materially impair the ability of PEC or PDC to perform its obligations hereunder or prevent the consummation of the transaction contemplated hereby.

SECTION 2.3 Capital Structure. As of the date hereof, the authorized capital stock of PEC consists of 50,000,000 shares of common stock, par value \$0.01 per share ("PEC Common Stock") and 1,000,000 shares of preferred stock, par value \$0.01 per share ("PEC Preferred Stock"). At the close of business on the day immediately preceding the date of this Agreement, (i) 31,671,132 shares of PEC Common Stock were validly issued and outstanding, fully paid and nonassessable and free of preemptive rights, and (ii) no shares of PEC Preferred Stock are issued and outstanding. The PEC Common Stock is designated as a national market security on an inter-dealer quotation system by the National Association of Securities Dealers, Inc. All shares of PEC Common Stock issuable pursuant to the Asset Purchase in accordance with this Agreement will be, when so issued, duly authorized, validly issued, fully paid and non-assessable and free of preemptive rights.

SECTION 2.4 SEC Documents. PEC has filed all required documents with the Securities and Exchange Commission ("SEC") since January 1, 1997 (the "PEC/SEC Documents"). As of their respective dates, the PEC/SEC Documents complied in all material respects with the requirements of the Securities Act or the Exchange Act, as the case may be, and none of the PEC/SEC Documents contained any untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading. The consolidated financial statements of PEC (the "PEC Financial Statements") included in the PEC/SEC Documents comply as to form in all material respects with applicable accounting requirements and the published rules and regulations of the SEC with respect thereto, have been prepared in accordance with generally accepted accounting principles (except, in the case of the unaudited statements, as permitted by Form 10-Q of the SEC) applied on a consistent basis during the periods involved (except as may be indicated therein or in the notes thereto) and fairly present the consolidated financial position of PEC and its consolidated subsidiaries (including PDC) as at the dates thereof and the consolidated results of their operations and statements of cash flows for the periods then

ended (subject, in the case of the unaudited statements, to normal year-end audit adjustments and to any other adjustments described therein). There has been no Material Adverse Change in PEC since the date of the most recent PEC Financial Statements, other than as may be set forth in the Memorandum dated January 22, 1999 (the "Memorandum") containing a copy of PEC's Annual Report on Form 10-K for the year ending December 31, 1997, all other reports filed by PEC with the SEC since January 1, 1998, and PEC's Third Quarter 1998 Quarterly Report to Stockholders, a copy of which Memorandum has been previously furnished to Padre.

SECTION 2.5 Brokers. No broker, investment banker or other person is entitled to any broker's, finder's or similar fee or commission in connection with the transactions contemplated by this Agreement based upon arrangements made by or on behalf of PEC or PDC.

SECTION 2.6 Litigation. There is no suit, action, investigation or proceeding pending or, to the knowledge of the executive officers of PEC, threatened against PEC at law or in equity before or by any federal, state, municipal or other governmental department, commission, board, bureau, agency or instrumentality, domestic or foreign, or before any arbitrator of any kind, that would impair the ability of PEC to perform its obligations hereunder or to consummate the transactions contemplated hereby that would have a Material Adverse Effect on PEC in the event of an unfavorable decision, finding or outcome, and there is no judgment, decree, injunction, rule or order of any court, governmental department, commission, board, bureau, agency, instrumentality or arbitrator to which PEC is subject that would impair the ability of PEC to perform its obligations hereunder or to consummate the transactions contemplated hereby.

ARTICLE III REPRESENTATIONS AND WARRANTIES OF PADRE

Padre represents and warrants to PEC and PDC as follows:

SECTION 3.1 Organization, Standing and Power. Padre is a corporation duly incorporated, validly existing and in good standing under the laws of the State of Texas and has the requisite corporate power and authority to carry on its business as now being conducted.

SECTION 3.2 Authority; Non-Contravention. Padre has all requisite power and authority to enter into this Agreement and to consummate the Transaction. The execution and delivery of this Agreement by Padre and the consummation by Padre of the transactions contemplated hereby have been duly authorized by all necessary corporate action on the part of Padre. This Agreement has been duly executed and delivered by Padre and (assuming the valid authorization, execution and delivery of this Agreement by PEC and PDC) constitutes a valid and binding obligation of Padre enforceable against it in accordance with its terms, except to the extent enforceability may be limited by bankruptcy, insolvency, reorganization, moratorium, fraudulent transfer or other similar laws of general applicability relating to or affecting the enforcement of creditors' rights and by the effect of general principles of equity (regardless of whether enforceability is considered in a proceeding in equity or at law). The execution and delivery of this Agreement do not, and the consummation of the Transaction and compliance with the provisions hereof will not, conflict with, or result in any violation of, or default (with or without notice of lapse of time, or both) under, or give rise to a right of termination, cancellation or acceleration of any obligation or to the loss of a material benefit under, or result in the creation of any lien, security interest, charges or encumbrances upon any of the properties or assets of Padre under, any provision of (i) the Articles of Incorporation or Bylaws of Padre (true and complete copies of which as of the date hereof have been delivered to PEC and PDC), (ii) any loan or credit agreement, note, bond, mortgage, indenture, lease or other agreement, instrument, permit, concession, franchise or license

applicable to Padre, or (iii) any judgment, order, decree, statute, law, ordinance, rule or regulation applicable to Padre or any of its respective properties or assets, other than, in the case of clauses (ii) or (iii), any such conflicts, violations, defaults, rights, losses, liens, security interests, charges or encumbrances that individually or in the aggregate, would not have a Material Adverse Effect on Padre, materially impair the ability of Padre to perform its obligations hereunder or prevent the consummation of any of the transactions contemplated hereby. No filing or registration with, or authorization, consent or approval of, any Governmental Entity is required by or with respect to Padre in connection with the execution and delivery of this Agreement by Padre or is necessary for the consummation by Padre of the Transaction.

SECTION 3.3 Capital Structure. All of the issued and outstanding shares of Padre capital stock ("Padre Stock") are owned of record and beneficially by Thomas J. Billings and Marilyn F. Billings. There are no options, warrants, rights, commitments, agreements, arrangements or undertakings of any kind to which Padre is a party or by which it is bound obligating Padre to issue, deliver or sell or cause to be issued, delivered or sold additional shares of Padre Stock. True and correct copies of the Articles of Incorporation and Bylaws have been furnished to PEC and PDC.

SECTION 3.4 Environmental Matters.

(a) Except to the extent that the inaccuracy of any of the following, individually or in the aggregate, would not have a Material Adverse Effect on Padre, to the Actual Knowledge of Padre:

(i) Padre holds, and is in compliance with and has been in compliance with for the last three years, all Environmental Permits, and is otherwise in substantial compliance and has been in substantial compliance for the last three years with, all applicable Environmental Laws and there is no condition that is reasonably likely to prevent or materially interfere prior to the Closing Date with compliance by Padre with Environmental Laws;

(ii) no modification, revocation, reissuance, alteration, transfer or amendment of any Environmental Permit, or any review by, or approval of, any third party of any Environmental Permit is required in connection with the execution or delivery of this Agreement or the consummation by Padre of the transactions contemplated hereby or the operation of the business of Padre on the date of the Closing;

(iii) Padre has not received any Environmental Claim, nor has any Environmental Claim been threatened against Padre;

(iv) Padre has not entered into, agreed to or is not subject to any outstanding judgment, decree, order or consent arrangement with any governmental authority under any Environmental Laws, including without limitation those relating to compliance with any Environmental Laws or to the investigation, cleanup, remediation or removal of Hazardous Materials;

(v) there are no circumstances that are reasonably likely to give rise to liability under any agreements with any person pursuant to which Padre would be required to defend, indemnify, hold harmless, or otherwise be responsible for any violation by or other liability or expense of such person, or alleged violation by or other liability or expense of such person, arising out of any Environmental Law; and

(vi) there are no other circumstances or conditions that are reasonably likely to give rise to liability of Padre under any Environmental Laws.

(b) For purposes of this Agreement, the terms below shall have the following meanings:

"Acknowledge Knowledge of Padre" means the present awareness of T Billings.

"Environmental Claim" means any written complaint, notice, claim, demand, action, suit or judicial, administrative or arbitrable proceeding by any person to Padre asserting liability or potential liability (including without limitation, liability or potential liability for investigatory costs, cleanup costs, governmental response costs, natural resource damages, property damage, personal injury, fines or penalties) arising out of, relating to, based on or resulting from (i) the presence, discharge, emission, release or threatened release of any Hazardous Materials at any location, (ii) circumstances forming the basis of any violation or alleged violation of any Environmental Laws or Environmental Permits, or (iii) otherwise relating to obligations or liabilities of Padre under any Environmental Law.

"Environmental Permits" means all permits, licenses, registrations, exemptions and other governmental authorizations required under Environmental Laws for Padre to conduct its operations as presently conducted.

"Environmental Laws" means all applicable foreign, federal, state and local statutes, rules, regulations, ordinances, orders, decrees and common law relating in any manner to pollution or protection of the environment, to the extent and in the form that such exist at the date hereof.

"Hazardous Materials" means all hazardous or toxic substances, wastes, materials or chemicals, petroleum (including crude oil or any fraction thereof) and petroleum products, asbestos and asbestos-containing materials, pollutants, contaminants and all other materials and substances, including but not limited to radioactive materials regulated pursuant to any Environmental Laws or that could result in liability under any Environmental Laws.

SECTION 3.5 Title. Set forth in Annex 1 and Annex 2 is a description of the Drilling Rigs, Equipment and Rolling Stock and of the Real Property, respectively, which description is accurate and complete in all material respects. Padre has good and, in the case of the Real Property, indefeasible title to a 100% interest in the Drilling Rigs, Equipment and Rolling Stock and in the Real Property, subject, in each case, to no Liens except for (i) Liens for taxes not yet delinquent or the validity of which is being contested in good faith; and (ii) any Liens arising by operation of law securing obligations not yet overdue. For purposes of this Agreement "Liens" means liens, mortgages, pledges, security interests, encumbrances, claims or charges of any kind.

SECTION 3.6 Labor Matters. (i) Padre is not a party to any collective bargaining agreement or other material contract or agreement with any labor organization or other representative of employees nor is any such contract being negotiated; (ii) there is no material unfair labor practice charge or complaint pending nor, to the knowledge of the executive officers of Padre, threatened, with regard to employees of Padre; (iii) there is no labor strike, material slowdown, material work stoppage or other material labor controversy in effect, or, to the knowledge of the executive officers of Padre, threatened against Padre; (iv) as of the date hereof, no representation question exists, nor to the knowledge of the executive officers of Padre are there any campaigns being conducted to solicit cards from the employees of Padre to authorize representation by a labor organization; (v) Padre is not party to, or is not otherwise bound by, any consent decree with any governmental authority relating to employees or employment practices of Padre; and (vi) Padre is in compliance with all applicable agreements, contracts and policies relating to employment, employment practices, wages, hours and terms and conditions of employment of

the employees, except where the failure to be in compliance with each such agreement, contract and policy would not, either singly or in the aggregate, have a Material Adverse Effect on Padre.

SECTION 3.7 Drilling Contracts. Padre is not a party to any Drilling Contracts (as defined in Section 4.3 hereof) which have not been completed as of the date hereof.

SECTION 3.8 Litigation. There is no suit, action, investigation or proceeding pending or, to the knowledge of the executive officers of Padre, threatened against Padre at law or in equity before or by any federal, state, municipal or other governmental department, commission, board, bureau, agency or instrumentality, domestic or foreign, or before any arbitrator of any kind, that would impair the ability of Padre to perform its obligations hereunder or to consummate the transactions contemplated hereby, and there is no judgment, decree, injunction, rule or order of any court, governmental department, commission, board, bureau, agency, instrumentality or arbitrator to which Padre is subject that would impair the ability of Padre to perform its obligations hereunder or to consummate the transactions contemplated hereby.

SECTION 3.9 Drilling Rigs, Equipment and Rolling Stock. Annex 1 sets forth or incorporates by reference a list of all drilling rigs, equipment and rolling stock relating to the contract drilling operations of Padre, which list is true, correct and complete in all material respects, all of which drilling rigs, equipment and rolling stock are included in the Drilling Rigs, Equipment and Rolling Stock.

SECTION 3.10 Brokers. No broker, investment banker or other person is entitled to any broker's, finder's or other similar fee or commission in connection with the transactions contemplated by this Agreement based upon arrangements made by or on behalf of Padre, except for Steven B. Erickson. Padre will be solely responsible for paying Mr. Erickson for his services.

SECTION 3.11 Vote of the Padre Stockholders. No vote of the stockholders of Padre is required by law, the Articles of Incorporation or Bylaws of Padre or otherwise to adopt this Agreement and approve the Transaction.

ARTICLE IV ADDITIONAL AGREEMENTS

SECTION 4.1 Fees and Expenses. All costs and expenses incurred by PEC or PDC in connection with this Agreement and the transactions contemplated hereby shall be paid by PEC; such costs and expenses incurred by Padre shall be paid by Padre.

SECTION 4.2 Reasonable Best Efforts. Upon the terms and subject to the conditions set forth in this Agreement, each of the parties agrees to use all reasonable best efforts to take, or cause to be taken, all actions, and to do, or cause to be done, and to assist and cooperate with the other parties in doing, all things necessary, proper or advisable to consummate and make effective, in the most expeditious manner practicable, the Transaction and the other transactions contemplated by this Agreement and the prompt satisfaction of the conditions hereto.

SECTION 4.3 Padre Performance of Drilling Contracts. Padre shall fully perform all obligations of Padre under each of the contract drilling contracts (collectively, the "Drilling Contracts") to which Padre is a party as of the Closing Date, if any.

SECTION 4.4 Padre and T Billings Indemnification. On and after the date of Closing, Padre and Thomas J. Billings ("T Billings"), the Chairman of the Board of Padre, shall jointly and

severally indemnify and hold PEC and PDC harmless against and in respect of all actions, suits, demands, judgments, costs and expenses (including reasonable attorneys' fees of PEC or PDC), relating to any misrepresentation, breach of any representation or warranty or non-fulfillment of any agreement on the part of Padre contained in this Agreement. This indemnification provided for in this Section 4.4 shall terminate and be of no further force and effect two years from the Closing Date, except as to any representation or warranty as to which a written notice of claim for indemnification has been given to Padre and T Billings prior to the expiration of such two-year period.

SECTION 4.5 PEC and PDC Indemnification. On and after the Closing Date, PEC and PDC shall jointly and severally indemnify and hold Padre harmless against and in respect of all actions, suits, demands, judgments, costs and expenses (including reasonable attorneys' fees of Padre) relating to (i) any misrepresentation, breach of any representation or warranty or non-fulfillment of any agreement on the part of PEC or PDC contained in this Agreement or the Memorandum, or (ii) any of the drilling contracts entered into by PDC or PEC on or after the Closing Date involving the drilling rigs included as a part of the Drilling Rigs, Equipment and Rolling Stock.

SECTION 4.6 Public Announcements. Unless otherwise required by law or the rules and regulations of the SEC or the Nasdaq National Market, neither PDC, PEC nor Padre shall issue (a) any press release or make any public statement with respect to the Transaction prior to Closing, or (b) any press release or make any public statement with respect to the Transaction after Closing which discloses the Purchase Consideration.

SECTION 4.7 Nasdaq National Market. PEC shall use its reasonable best efforts to list on the Nasdaq National Market, upon official notice of issuance to Padre, the shares of PEC Common Stock to be issued in connection with the Transaction.

SECTION 4.8 Personal Property Taxes. Padre and PDC agree that ad valorem taxes for 1999 on the Drilling Rigs, Equipment and Rolling Stock shall be prorated between Padre and PDC to the Closing Date. The parties agree that the proration of these ad valorem taxes shall be based on the 1999 property tax statement or statements for ad valorem taxes on the Drilling Rigs, Equipment and Rolling Stock. The prorations shall be made promptly upon receipt of these tax statements. Padre agrees that PDC shall have the right to protest the 1999 appraised property values on the Drilling Rigs, Equipment and Rolling Stock. If PDC elects to do so, Padre will execute and deliver to PDC such documents as PDC may request in connection with its protest.

SECTION 4.9 Sales and Transfer Taxes. Padre and PDC agree that Padre will be pay all sales and transfer taxes, if any, attributable to the sale hereby of the Drilling Rigs and Equipment, and PDC will pay all sales and transfer taxes, if any, attributable to the sale hereby of the Rolling Stock.

ARTICLE V CONDITIONS PRECEDENT TO THE TRANSACTION

SECTION 5.1 Conditions to Each Party's Obligation to Effect the Transaction. The respective obligations of each party to effect the Transaction shall be subject to the fulfillment or waiver (where permissible) at or prior to the date of Closing of each of the following conditions:

(a) Nasdaq National Market Listing. The 800,000 shares of PEC Shares issuable on the Closing Date pursuant to this Agreement shall have been authorized for listing on the Nasdaq National Market upon official notice of issuance.

(b) No Order. No Governmental Entity or court of competent jurisdiction shall have enacted, issued, promulgated, enforced or entered any law, rule, regulation, executive order, decree, injunction or other order (whether temporary, preliminary or permanent) which is then in effect and has the effect of prohibiting the Transaction; provided that, in the case of any such decree, injunction or other order, each of the parties shall have used reasonable best efforts to prevent the entry of any such injunction or other order and to appeal as promptly as practicable any decree, injunction or other order that may be entered.

(c) Lease with Option to Purchase. The Lease with Option to Purchase relating to the Real Property in the form attached hereto as Exhibit A shall have been executed and delivered by PDC and Padre.

(d) Registration Rights Agreement. The Registration Rights Agreement, relating to the PEC Shares, in the form attached hereto as Exhibit B shall have been executed and delivered by Padre and PEC.

SECTION 5.2 Conditions to Obligation of Padre to Effect the Transaction. The obligation of Padre to effect the Transaction shall be subject to the fulfillment at or prior to the Closing of the following additional conditions; provided that Padre may waive any of such conditions in its sole discretion:

(a) Performance of Agreements and Representations and Warranties. PEC and PDC shall have performed in all material respects each of their agreements contained in this Agreement required to be performed on or prior to the Closing, and each of the representations and warranties of PEC and PDC contained in this Agreement shall be true and correct on and as of the Closing Date as if made on and as of such date.

(b) Officers' Certificate. PEC and PDC shall have furnished to Padre a certificate, dated the Closing, signed by the respective appropriate officers of PEC and PDC, certifying to the effect that to the best of the knowledge and belief of each of them, the conditions set forth in Section 5.1 and Section 5.2(a) have been satisfied in full.

(c) Opinion of Baker & Hostetler LLP. Padre shall have received an opinion from Baker & Hostetler LLP, counsel to PEC and PDC, dated the Closing Date, substantially to the effect that:

(i) The incorporation, existence and good standing of PEC and PDC are as stated in this Agreement; the authorized shares of PEC and PDC are as stated in this Agreement; all outstanding shares of PEC Common Stock are duly and validly authorized and issued, fully paid and nonassessable and have not been issued in violation of any preemptive right of any stockholders.

(ii) Each of PEC and PDC has full corporate power and authority to execute, deliver and perform this Agreement and this Agreement has been duly authorized, executed and delivered by PEC or PDC, as the case may be, and (assuming due and valid authorization, execution and delivery by Padre) constitutes the legal, valid and binding agreement of PEC and PDC, enforceable against PEC and PDC in accordance with its terms, except to the extent enforceability may be limited by bankruptcy, insolvency, reorganization, moratorium, fraudulent transfer or other similar laws of general applicability relating to or affecting the enforcement of creditors' rights and by the effect of general principles of equity (regardless of whether enforceability is considered in a proceeding in equity or at law), and except as rights to indemnity may be limited by applicable law.

(iii) The execution and performance by PEC and PDC of this Agreement will not violate the Certificate of Incorporation or Bylaws of PEC or PDC, respectively, and, to the knowledge of such counsel, will not violate, result in a breach of or constitute a default under any material lease, mortgage, contract, agreement, instrument, law, rule, regulation, judgment, order or decree to which PEC or PDC is a party or by which they or any of their properties or assets may be bound.

(iv) To the knowledge of such counsel, no consent, approval, authorization or order of any court or governmental agency or body which has not been obtained is required on behalf of PEC and PDC for the consummation of the transactions contemplated by this Agreement.

(v) To the knowledge of such counsel, there are no actions, suits or proceedings, pending or threatened against or affecting PEC or PDC by any Governmental Entity which seek to restrain, prohibit or invalidate the transactions contemplated by this Agreement.

(vi) The shares of PEC Common Stock to be issued pursuant to this Agreement will be, when so issued, duly authorized, validly issued and outstanding, fully paid and nonassessable.

(vii) The 800,000 PEC Shares have been authorized for listing on the Nasdaq National Market subject to official notice of issuance.

In rendering such opinion, counsel for PEC may rely as to matters of fact upon the representations of officers of PEC or PDC contained in any certificate delivered to such counsel and certificates of public officials. Such opinion shall be limited to the General Corporation Law of the State of Delaware and the laws of the United States of America and the State of Texas.

(d) Delivery of Purchase Consideration. PEC and PDC shall have made delivery of the Purchase Consideration as provided in Section 1.2 of this Agreement.

SECTION 5.3 Conditions to Obligations of PEC and PDC to Effect the Transaction. The obligations of PEC and PDC to effect the Transaction shall be subject to the fulfillment at or prior to the Closing of the following additional conditions, provided that PEC may waive any such conditions in its sole discretion:

(a) Performance of Obligations; Representations and Warranties. Padre shall have performed in all material respects each of its agreements contained in this Agreement required to be performed on or prior to the Closing and each of the respective representations and warranties of Padre contained in this Agreement shall be true and correct on and as of the Closing as if made on and as of such date.

(b) Officers' Certificate. Padre shall have furnished to PEC a certificate, dated the Closing, certifying to the effect that to the best of the knowledge and belief of Padre, the conditions set forth in Section 5.1 and Section 5.3(a) have been satisfied.

(c) Opinion of The Kleberg Law Firm, a Professional Corporation. PEC shall have received an opinion from The Kleberg Law Firm, a Professional Corporation, counsel to Padre, dated the Closing Date, substantially to the effect that:

(i) The incorporation, existence and good standing of Padre are as stated in this Agreement.

(ii) Padre has full corporate power and authority to execute, deliver and perform this Agreement and its Non-Competition Agreement, and this Agreement and its Non-Competition Agreement have each been duly authorized, executed and delivered by Padre, and each (assuming the due and valid authorization, execution and delivery by PEC and PDC) constitutes the legal, valid and binding agreement of Padre enforceable against Padre in accordance with its terms, except to the extent enforceability may be limited by bankruptcy, insolvency, reorganization, moratorium, fraudulent transfer or other similar laws of general applicability relating to or affecting the enforcement of creditors' rights and by the effect of general principles of equity (regardless of whether enforceability is considered in a proceeding in equity or at law), and except as rights to indemnity may be limited by applicable law.

(iii) The execution and performance by Padre of this Agreement and its Non-Competition Agreement will not violate the Articles of Incorporation or Bylaws of Padre and will not violate, result in a breach of, or constitute a default under, any material lease, mortgage, contract, agreement, instrument, law, rule, regulation, judgment, order or decree known to such counsel to which Padre is a party or to which it or any of its properties or assets may be bound.

(iv) To the knowledge of such counsel, no consent, approval, authorization or order of any court or governmental agency or body which has not been obtained is required on behalf of Padre for consummation of the transactions contemplated by this Agreement.

(v) To the knowledge of such counsel, there are no actions, suits or proceedings, pending or threatened against or affecting Padre by any Governmental Entity which seek to restrain, prohibit or invalidate the transactions contemplated by this Agreement.

(vi) The Non-Competition Agreement between PEC, PDC and T Billings constitutes the legal, valid and binding agreement of T Billings enforceable against him in accordance with its terms, except to the extent enforceability may be limited by bankruptcy, insolvency, reorganization, moratorium, fraudulent transfer or other similar laws of general applicability relating to or affecting the enforcement of creditors' rights and by the effect of general principles of equity (regardless of whether enforceability is considered in a proceeding in equity or at law), and except as rights to indemnity may be limited by applicable law.

In rendering such opinion, counsel for Padre may rely as to matters of fact upon the representations of officers of Padre contained in any certificate delivered to such counsel and certificates of public officials. Such opinion shall be limited to the laws of the United States of America and the State of Texas.

(d) Bill of Sale and Assignment. Padre shall have executed and delivered the Bill of Sale and Assignment, in the form attached hereto as Exhibit C, covering the Drilling Rigs, Equipment and Rolling Stock set forth on Annex 1.

(e) Non-Competition Agreements. A Non-Competition Agreement in the respective forms attached hereto as Exhibits D(I) and D(II) shall have been executed and delivered by PEC, PDC and Padre or T Billings, as the case may be.

(f) Titles. Padre shall have endorsed and delivered the title certificates to the Rolling Stock described in Annex 1.

(g) Investment Representation Letter. Padre shall have executed and delivered an investment representation letter substantially in the form attached hereto as Exhibit E.

ARTICLE VI
POST-CLOSING AGREEMENTS

Section 6.1 Purchase Option. Padre agrees that PEC shall have the option ("Option"), exercisable as provided in this Section, to purchase from Padre up to 300,000 PEC Shares (the "PEC Option Shares") at a price of \$5.50 per share (the "Option Price"). Except as provided below in this Section, the Option may be exercised on, but only on, the third Trading Day after the first anniversary of the date on which the PEC Option Shares are issued to Padre pursuant to Section 1.2 of this Agreement, this date being referred to herein as the "Option Date." For example, if the PEC Option Shares were issued to Padre on January 27, 1999, the Option Date would be February 1, 2000. The Option must be exercised by giving written notice to Padre specifying the number of PEC Option Shares as to which the Option is exercised accompanied by a certified or bank check for the full amount of the purchase price. Padre agrees that it will not sell, transfer or otherwise dispose of any of the PEC Option Shares before the Option Date or the earlier expiration of the Option as provided in the next two sentences of this Section. If PEC shall cease to exist as a separate corporate entity prior to the Option Date other than as a result of a Change of Control, the Option described in this Section shall become null and void. If in connection with a Change of Control the PEC Shares are converted into cash, the Option may be exercised by PEC on, but only on, the Trading Day immediately preceding the closing date of such Change of Control. If in connection with a Change of Control the PEC Shares are converted into stock or securities of the surviving corporation (collectively, the "Surviving Stock"), then the surviving corporation shall have the option to purchase up to 100% of the Surviving Stock on the Option Date by paying to Padre an amount equal to the product of (i) the percentage of the Surviving Stock as to which the option is exercised, times (ii) \$1,650,000. The surviving corporation may exercise its option in the same manner as required of PEC under this Section. In the event of a stock dividend or stock split of the shares of PEC Common Stock prior to the Option Date, the number of PEC Option Shares and the Option Price shall be contemporaneously increased or decreased, as the case may be, in inverse proportions in the manner provided in Section 1.2(c) of this Agreement.

ARTICLE VII
GENERAL PROVISIONS

SECTION 7.1 Notices. All notices and other communications hereunder shall be in writing and shall be deemed given if delivered personally, sent by overnight courier or telecopied (with a confirmatory copy sent by overnight courier) to the parties at the following addresses (or at such other address for a party as shall be specified by like notice):

(a) if to PEC or PDC, to:

Patterson Energy, Inc.
4510 Lamesa Highway
P.O. Drawer 1416
Snyder, Texas 79550
Attention: Cloyce A. Talbott
Chairman and Chief Executive Officer

with copies to:

Thomas H. Maxfield, Esq.
Baker & Hostetler LLP
303 East 17th Avenue, Suite 1100
Denver, Colorado 80203-1264

(b) if to Padre, to:

Thomas J. Billings
1111 Hermann Drive 14D
Houston, Texas 77004

with copies to:

Richard L. Leshin, Esq.
The Kleberg Law Firm, P.C.
Suite 900 North Tower
800 N. Shoreline Blvd.
Corpus Christi, Texas 78401

SECTION 7.2 Interpretation. When a reference is made in this Agreement to a Section, such reference shall be to a Section of this Agreement unless otherwise indicated, and the words "hereof," "herein" and "hereunder" and similar terms refer to this Agreement as a whole and not to any particular provision of this Agreement, unless the context otherwise requires. The table of contents and headings contained in this Agreement are for reference purposes only and shall not affect in any way the meaning or interpretation of this Agreement. Whenever the words "include," "includes" or "including" are used in this Agreement, they shall be deemed to be followed by the words "without limitation."

SECTION 7.3 Counterparts. This Agreement may be executed in counterparts, all of which shall be considered one and the same agreement and shall become effective when one or more counterparts have been signed by each of the parties and delivered to the other parties.

SECTION 7.4 Entire Agreement; No Third-Party Beneficiaries. This Agreement, including the documents and instruments referred to herein, (i) constitutes the entire agreement and supersedes all prior agreements and understandings, both written and oral, among the parties with respect to the subject matter hereof and (ii) is not intended to confer upon any person other than the parties any rights or remedies hereunder; provided, however, that legal counsel for the parties hereto may rely upon the representations and warranties contained herein and in the certificates delivered pursuant to Sections 5.2(c) and 5.3(c).

SECTION 7.5 Governing Law. This Agreement shall be governed by, and construed in accordance with, the laws of the State of Texas, regardless of the laws that might otherwise govern under applicable principles of conflicts of laws thereof.

SECTION 7.6 Assignment. Neither this Agreement nor any of the rights, interests or obligations hereunder shall be assigned by any of the parties without the prior written consent of the other parties; provided, however, that Padre may assign some or all of its rights under this Agreement to T Billings. Subject to the preceding sentence, this Agreement shall be binding upon, inure to the benefit of, and be enforceable by, the parties and their respective successors and assigns.

SECTION 7.7 Severability. If any term or other provision of this Agreement is invalid, illegal or incapable of being enforced by any rule of law, or public policy, all other conditions and provisions of this Agreement shall nevertheless remain in full force and effect so long as the economic or legal substance of the transactions contemplated hereby are not affected in any manner materially adverse to any party. Upon such determination that any term or other provision is invalid, illegal or incapable of being enforced, the parties shall negotiate in good faith to modify this Agreement so as to effect the original intent of the parties as closely as possible in a mutually acceptable manner in order that the transactions be consummated as originally contemplated to the fullest extent possible.

SECTION 7.8 Enforcement of This Agreement. The parties agree that irreparable damage would occur in the event that any of the provisions of this Agreement were not performed in accordance with their specific terms or were otherwise breached. It is accordingly agreed that the parties shall be entitled to an injunction or injunctions to prevent breaches of this Agreement and to enforce specifically the terms and provisions hereof in any court of the United States or any state having jurisdiction, this being in addition to any other remedy to which they are entitled at law or in equity.

IN WITNESS WHEREOF, PEC, PDC and Padre have executed this Agreement as of the date first written above.

PEC:

PATTERSON ENERGY, INC.

By: /s/ JAMES C. BROWN

James C. Brown
Vice President - Finance

PDC:

PATTERSON DRILLING COMPANY

By: /s/ JAMES C. BROWN

James C. Brown
Vice President - Finance

PADRE:

PADRE INDUSTRIES, INC.

By: /s/ THOMAS J. BILLINGS

Thomas J. Billings
Chairman of the Board

TO INDUCE PATTERSON ENERGY, INC. AND PATTERSON DRILLING COMPANY TO ENTER INTO THIS AGREEMENT AND FOR OTHER GOOD AND VALUABLE CONSIDERATION, THE RECEIPT AND SUFFICIENCY OF WHICH ARE HEREBY ACKNOWLEDGED, THE UNDERSIGNED, BEING AN OFFICER, DIRECTOR AND STOCKHOLDER OF PADRE INDUSTRIES, INC, HEREBY ACCEPTS AND AGREES TO BE BOUND BY THE INDEMNIFICATION PROVISIONS OF SECTION 4.4 OF THE ABOVE AGREEMENT.

/s/ THOMAS J. BILLINGS

Thomas J. Billings

ANNEX 1
TO
AGREEMENT

DESCRIPTION OF DRILLING RIGS, EQUIPMENT AND ROLLING STOCK

A. Drilling Rigs and Equipment

Rig No. -----	Drawworks Manufacturer -----
Rig No. 4.....	RMI Model 4610
Rig No. 7	Skytop Model H4610
Rig No. 8	Skytop Model H14610
Rig No. 9.....	RMI Model 4610
Rig No. 10.....	RMI Model 4610

All parts and equipment, including engines, mud pumps, hooks and blocks, derricks, substructures, rotary tables, blow-out prevention equipment, drill bits and all tubular goods on the rigs and in the yard owned by Padre, all of which are set forth on Attachment A to Appendix I to the Bill of Sale and Assignment attached to this Agreement as Exhibit C.

B. Rolling Stock

All rolling stock set forth on Attachment B to Appendix I to the Bill of Sale and Assignment attached to this Agreement as Exhibit C.

[LEASE WITH OPTION TO PURCHASE]

REGISTRATION RIGHTS AGREEMENT

This Registration Rights Agreement ("Agreement") is made and entered into as of the ___ day of January, 1999, by and between Patterson Energy, Inc., a Delaware corporation (hereinafter called the "Company"), and Padre Industries, Inc., a Texas corporation (hereinafter called "Padre").

WHEREAS, pursuant to that certain Agreement of even date herewith (the "Asset Purchase Agreement"), by and between the Company and Padre, the Company has agreed to issue 800,000 shares of the Company's common stock, par value \$.01 per share (the "Common Stock") to Padre; and

WHEREAS, this Agreement is being entered into in connection with and as a condition to the parties closing the transactions contemplated under the Asset Purchase Agreement.

NOW, THEREFORE, the parties hereto agree as follows:

1. Certain Definitions. As used in this Agreement the following terms shall have the following respective meanings:

"Affiliate" shall mean a person that directly, or indirectly through one or more intermediaries, controls or is controlled by, or is under common control with, the person specified.

"Closing Date" shall mean the date on which the Shares are issued to the Holder.

"Commission" shall mean the United States Securities and Exchange Commission and any successor federal agency having similar powers.

"Exchange Act" shall mean the Securities Exchange Act of 1934, or any successor thereto, as the same shall be amended from time to time.

"Holder" shall mean Padre and its successors and assigns, and any subsequent successors and assigns, of the Registrable Securities or any portion thereof.

The terms "register," "registered," and "registration" refer to a registration effected by preparing and filing a registration statement in compliance with the Securities Act, and the declaration or ordering of the effectiveness of such registration statement.

"Registrable Securities" shall mean (i) the Shares (as defined below) and (ii) any securities issued or issuable with respect to the Shares by way of stock dividend or stock split or in connection with a combination of shares, recapitalization, merger, consolidation or other reorganization or otherwise.

"Registration Expenses" shall mean all expenses incurred by Company in connection with the Company's complying with Section 3 hereof, including, without limitation, all registration and filing fees, printing expenses, fees and disbursements of counsel for the Company, blue sky fees and expenses and accountants' expenses, including without limitation, any special audits or "comfort" letters incidental to or required by any such registration and any fees and disbursements of underwriters customarily paid by issuers or sellers of securities (but excluding underwriting discounts and commissions).

Ex. B-1

"Requesting Holder" shall mean any Holder of Registrable Securities who shall request registration of Registrable Securities pursuant hereto.

"Securities Act" shall mean the Securities Act of 1933, or any successor thereto, as the same shall be amended from time to time.

"Shares" shall mean 500,000 shares of the total 800,000 shares of Common Stock.

2. Restrictions on Transfer. The Shares are being acquired for investment for Padre's own account and not as a nominee or agent and not with a present view to the resale or distribution of any part thereof, except in compliance with the Securities Act. Padre acknowledges that the Shares are considered "restricted securities" within the meaning of the Securities Act.

3. Registration Under Securities Act, etc.

3.1 Incidental Registration.

(a) Right to Include Registrable Securities. If during the one-year period ending on the first anniversary of this Agreement the Company proposes to register any of its equity securities under the Securities Act, whether or not for sale for its own account, on a form and in a manner which would permit registration of Registrable Securities for sale to the public under the Securities Act, it will each such time give prompt written notice to all Holders of its intention to do so, describing such securities and specifying the form and manner and the other relevant facts involved in such proposed registration and upon the written request of any such Holder delivered to the Company within twenty (20) business days after the giving of any such notice (which request shall specify the Registrable Securities intended to be disposed of by such Holder and the intended method or methods of disposition thereof), the Company will use its best efforts to effect the registration under the Securities Act of all Registrable Securities which the Company has been so requested to register by Holders to the extent requisite to permit the disposition (in accordance with the intended methods as aforesaid) of the Registrable Securities so to be registered, provided that (i) if, at any time after giving such written notice of its intention to register any of its securities and prior to the effective date of the registration statement filed in connection with such registration, the Company shall determine for any reason not to register such securities, the Company may, at its election give written notice of such determination to each Holder and thereupon shall be relieved of its obligation to register any Registrable Securities in connection with such registration (but not from its obligation to pay the Registration Expenses in connection therewith as provided herein); (ii) if (A) the registration so proposed by the Company involves an underwritten primary registration on behalf of the Company to be distributed (on a firm commitment basis) by or through one or more underwriters of recognized standing under underwriting terms appropriate for such a transaction, and (B) the managing underwriter of such underwritten offering shall advise the Company in writing that, in its good faith judgment, all the shares to be offered by the Company and other parties are greater than can be accommodated without interfering with the successful marketing of all the securities to be then offered publicly for the account of the Company, then the managing underwriter or underwriters shall include in such registration (1) first, the securities the Company proposes to register to sale, and (2) second, the Registrable Securities requested to be included in such registration by the Requesting Holders, pro rata, and (3) any other securities requested by persons other than Holders to be included in such registration, if any, pro rata; (iii) if (A) the registration so proposed by the Company is an underwritten secondary registration on behalf of holders

Ex. B-2

of the Company's securities, to be distributed (on a firm commitment basis) by or through one or more underwriters of recognized standing under underwriting terms appropriate for such a transaction, and (B) the managing underwriter of such underwritten offering shall advise the Company in writing that, in its good faith judgment, all the shares to be offered by such requesting holder, the Company and other parties are greater than can be accommodated without interfering with the successful marketing of all of the securities to be then offered publicly for the account of the Company, then the managing underwriter shall include in such registration (1) first, the securities requested to be included therein by the holders requesting such registration, (2) second, the securities which are Registrable Securities, (3) any securities to be included in such registration on behalf of the Company, and (4) any other securities requested by persons other than Holders to be included in such registration, if any, pro rata.

(b) Expenses. The Company will pay all Registration Expenses in connection with each registration of Registrable Securities pursuant to this Agreement.

3.2 Registration Procedures. If and whenever the Company effects the registration of any Registrable Securities under the Securities Act as provided in Section 3.1, the Company will promptly:

(a) prepare and (in any event within sixty (60) days) file with the Commission a registration statement with respect to such Registrable Securities and use its reasonable best efforts to cause such registration statement to become effective, such registration statement to comply as to form and content in all material respects with the Commission's forms, rules and regulations.

(b) prepare and file with the Commission such amendments and supplements to such registration statement and the prospectus used in connection therewith as may be necessary to keep such registration statement effective and to comply with the provisions of the Securities Act with respect to the disposition of all Registrable Securities and other securities covered by such registration statement until the earlier of (i) such time as all of such Registrable Securities and other securities have been disposed of in accordance with the intended methods of disposition by the seller or sellers thereof set forth in such registration statement or (ii) the expiration of six (6) months in the case of a registration of Registrable Securities, after such registration statement becomes effective, and will furnish to each such seller prior to the filing thereof a copy of any amendment or supplement to such registration statement or prospectus and shall not file any such amendment or supplement to which any such seller shall have reasonably objected on the grounds that such amendment or supplement does not comply in all material respects with the requirements of the Securities Act or of the rules or regulations thereunder;

(c) furnish to each seller of Registrable Securities one originally executed registration statement, with all amendments, supplements and additional documentation; such number of conformed copies of such registration statement and of each such amendment and supplement thereto (in each case including all exhibits) as such seller may reasonably request; such number of copies of the prospectus included in such registration statement (including each preliminary prospectus and any summary prospectus) as required by the Securities Act as such seller may reasonably request; such documents, if any, incorporated by reference in such registration statement or prospectus; and such other documents as such seller may reasonably request.

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(d) use its reasonable best efforts to register or qualify all Registrable Securities and other securities covered by such registration statement under such other securities or blue sky laws of such jurisdiction as each seller shall reasonably request, to keep such registration or qualification in effect for so long as such registration statement stays in effect, and do any and all other acts and things which may be necessary or advisable to enable such seller to consummate the disposition in such jurisdictions of its Registrable Securities covered by such registration statement, except that the Company shall not for any such purpose be required to qualify generally to do business as a foreign corporation in any jurisdiction wherein it would not but for the requirements of this subdivision (d) be obligated to be so qualified, or to subject itself to taxation in any such jurisdiction, or to consent to general service of process in any such jurisdiction;

(e) otherwise use its best efforts to comply with all applicable rules and regulations of the Commission, and make available to its securities holders, as soon as reasonably practicable, an earnings statement covering the period of at least twelve (12) months beginning with the first month of the first fiscal quarter after the effective date of such registration statement, if such earnings statement is necessary to satisfy the provisions of Section 11(a) of the Securities Act;

(f) provide and cause to be maintained a transfer agent and registrar for all Registrable Securities covered by such registration statement from and after a date not later than the effective date of such registration statement; and

(g) use its reasonable best efforts to list all Common Stock covered by such registration statement on each securities exchange on which any Common Stock is then listed or quote all such Common Stock on NASDAQ if the Company's Common Stock is quoted on NASDAQ, or, if the Company's Common Stock is not then quoted on NASDAQ or listed on any national securities exchange, use its best efforts to have such Common Stock covered by such registration statement quoted on NASDAQ or, at the option of the Company, listed on a national securities exchange.

The Company may require each seller of Registrable Securities as to which any registration is being effected to furnish the Company such information regarding such seller and the distribution of such securities as the Company may from time to time reasonably request in writing and as shall be required by law or by the Commission in connection therewith.

3.3 Underwritten Offerings.

(a) Inclusion of Registrable Securities. If the Company at any time proposed to register any of its securities under the Securities Act as contemplated by Section 3.1 and such securities are to be distributed by or through one or more underwriters, the Company will use its best efforts, if requested by any Holder who requests incidental registration of Registrable Securities in connection therewith pursuant to Section 3.1, to arrange for such underwriters to include the Registrable Securities to be offered and sold by such Holder among the securities to be distributed by or through such underwriters; provided that, for purposes of this sentence, best efforts shall not require the Company to reduce the amount of sales price of such securities proposed to be distributed by or through such underwriters. Holders of Registrable Securities to be distributed by such underwriters shall be parties to the underwriting agreement between the Company and such underwriters and the representations and warranties by, and the other agreements on the part of, the Company to and for the benefit of such underwriters shall also be made to and for the benefit of such Holders of Registrable Securities. The Company will

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cooperate with such Holders to the end that the conditions precedent to the obligations of such Holders under such underwriting agreement shall not include conditions that are not customary in underwriting agreements with respect to combined primary and secondary distributions and shall be otherwise satisfactory to such Holders. No such Holder shall be required by the Company to make any representations or warranties other than reasonable representations, warranties or agreements regarding such Holder, such Holder's Registrable Securities and such Holder's intended method or methods of distribution and any other representations required by law.

(b) Holdback Agreements. If any registration pursuant to Section 3.1 shall be in connection with an underwritten public offering, each Holder of Registrable Securities agrees by acquisition of such Registrable Securities, if so required by the managing underwriter, not to effect any public sale or distribution of Registrable Securities (other than as part of such underwritten public offering) within seven (7) days prior to the effective date of such registration statement or ninety (90) days after the effective date of such registration statement.

3.4 Indemnification.

(a) Indemnification by the Company. In the event of any registration of any securities of the Company under the Securities Act, the Company will, and hereby does, indemnify and hold harmless Holder, its directors, trustees, employees, and officers and each other person, if any, who controls Holder within the meaning of the Securities Act, in each case, against any losses, claims, damages, liabilities or expenses, joint or several (including, without limitation, the costs and expenses of investigating, preparing for and defending any legal proceeding, including reasonable attorney's fees), to which such Holder or any such director, trustee, officer, employee or controlling person may become subject under the Securities Act or otherwise, insofar as such losses, claims, damages, liabilities or expenses (or actions or proceedings in respect thereof) arise out of or are based upon (i) any untrue statement or alleged untrue statement of any material fact contained in any registration statement under which such securities were registered under the Securities Act, any preliminary prospectus, final prospectus or summary prospectus contained therein, or any amendment or supplement thereto, or any document incorporated by reference therein, or (ii) any omission or alleged omission to state therein a material fact required to be stated therein or necessary to make the statements therein not misleading, and the Company will reimburse Holder and each such director, trustee, officer, employee, and controlling person for any legal or any other expenses incurred by them in connection with investigating or defending or settling any such loss, claim, liability, action or proceeding; provided that the Company shall not be liable in any such case to the extent that any loss, claim, damage, liability or expense (or action or proceeding in respect thereof) arises out of or is based upon an untrue statement or alleged untrue statement or omission or alleged omission made in such registration statement, any such preliminary prospectus, final prospectus, summary prospectus, amendment or supplement in reliance upon and in conformity with written information furnished to the Company through an instrument duly executed by Holder or any such director, trustee, officer, employee or controlling person specifically stating that it is for use in preparation thereof. Such indemnity shall remain in full force and effect regardless of any investigation made by or on behalf of Holder or any such director, trustee, officer, employee or controlling person and shall survive the transfer of such securities by Holder. The Company will make provision for contribution in lieu of any such indemnity that may be disallowed as shall be reasonably requested by Holder.

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(b) Indemnification by Holder. In the event of any registration of any securities of the Company under the Securities Act (pursuant to which Holder sells Registrable Securities covered by such registration statement), Holder will, and hereby does, indemnify and hold harmless the Company, each director of the Company, each officer of the Company who shall sign such registration statement and each other person, if any, who controls the Company within the meaning of the Securities Act from and against losses, claims, damages and liabilities caused by any untrue statement or alleged untrue statement of material fact contained in such registration statement, any preliminary prospectus, final prospectus or summary prospectus included therein, or any amendment or supplement thereto, or caused by any omission or alleged omission to state therein a material fact required to be stated therein or necessary to make statements therein not misleading, if such statement or omission was made in reliance upon and in conformity with written information furnished to the Company through an instrument duly executed by Holder specifically stating that it is for use in the preparation of such registration statement, preliminary prospectus, final prospectus, summary prospectus, amendment or supplement. Such indemnity shall remain in full force and effect regardless of any investigation made by or on behalf of the Company or any such director, officer or controlling person and shall survive the transfer of such securities by Holder.

(c) Notice of Claims, etc. In case any proceeding (including any governmental investigation) shall be instituted involving any person in respect of which indemnity may be sought pursuant to this Section 3.4, such person (hereinafter called the "indemnified party") shall promptly notify the person against whom such indemnity may be sought (hereinafter called the "indemnifying party") in writing and the indemnifying party, upon request of the indemnified party, shall retain counsel reasonably satisfactory to the indemnified party to represent the indemnified party and any other party the indemnifying party may designate in such proceeding and shall pay the fees and disbursements of such counsel related to such proceeding. In any such proceeding, any indemnified party shall have the right to retain its own counsel, but the fees and expenses of such counsel shall be at the expense of such indemnified party unless (i) the indemnifying party and the indemnified party shall have mutually agreed to the retention of such counsel or (ii) the named parties to any such proceeding (including any impleaded parties) include both the indemnifying party and the indemnified party and representation of both parties by the same counsel would be inappropriate due to actual or potential differing interests between them. The indemnifying party shall not be liable for the settlement of any proceeding effected without its written consent, but if settled with such consent or if there is a final judgment for the plaintiff, the indemnifying party agrees to indemnify the indemnified party from and against any loss or liability by reason of such settlement or judgment.

(d) Indemnification Unavailable. If the indemnification provided for in this Section 3.4 is unavailable as a matter of law to an indemnified party in respect of any losses, claims, damages or liabilities referred to therein, then each indemnifying party under any such paragraph, in lieu of indemnifying such indemnified party thereunder, shall contribute to the amount paid or payable by such indemnified party as a result of such losses, claims, damages or liabilities (i) in such proportion as is appropriate to reflect the relative benefits received by such indemnified party on the one hand and the indemnifying parties on the other or (ii) if the allocation provided by clause (i) above is not permitted by applicable law, or such proportion as is appropriate to reflect not only the relative benefits referred to in clause (i) above but also the relative fault of such indemnified party on the one hand and the indemnifying parties on the other in connection with the statement or omissions which resulted in such losses, claims,

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damages or liabilities, as well as any other relevant equitable considerations. The relative fault of such indemnified party and the indemnifying parties shall be determined by reference to, among other things, whether the untrue or alleged untrue statement of a material fact or the omission to state a material fact relates to information supplied by such parties and the parties' relative intent, knowledge, access to information and opportunity to correct or prevent such statement or omission. The parties agree that it would not be just and equitable if contribution pursuant to this Section 3.4(d) were determined by pro rata allocation or by any other method of allocation which does not take account of the equitable considerations referred to above. The amount paid or payable by an indemnified party as a result of the losses, claims, damages and liabilities referred to above shall be deemed to include, subject to the limitations set forth above, any legal or other expenses incurred by such indemnified party in connection with investigating, defending or settling any such action or claim.

(e) No Settlement, etc. No indemnifying party shall, except with the written consent of the indemnified party, consent to entry of any judgment or entry into settlement that does not include as an unconditional term thereof the giving by the claimant or plaintiff to such indemnified party of a release from all liability in respect to such claim or action. No Holder or person controlling such Holder other than the Company shall be obligated to make contribution hereunder that in the aggregate exceeds the total public offering price of the Registrable Securities sold by such Holder, less the aggregate amount of any damages that such Holder and its controlling persons have otherwise been required to pay in respect to the same claim or any substantially similar claim. The obligations of such Holders to contribute are several in proportion to their respective ownership of the securities covered by such registration statement and not joint.

(f) Indemnity Operative and in Full Force. The indemnity and contribution agreements contained in this Section 3.4 shall remain operative and in full force and effect regardless of any termination of this Agreement.

4. Rule 144. At all times following completion by the Company of its initial public offering of equity securities pursuant to registration in accordance with the Securities Act, the Company shall take such action as Holder may reasonably request, all to the extent required from time to time to enable such Holder to sell shares of Registrable Securities without registration under the Securities Act within the limitation of the exemptions provided by (a) Rule 144 under the Securities Act, as such Rule may be amended from time to time, or (b) any similar rule or regulation hereafter adopted by the Commission. Upon the request of any Holder, the Company will deliver to such Holder a written statement as to whether it has complied with such requirements.

5. Amendments and Waivers. This Agreement may be amended, and the Company may take any action herein prohibited or omit to perform any act herein required to be performed by it, only if the Company shall have obtained a written consent to such amendment, action or omissions to act of the Holder or Holders of at least 51% or more of the shares of Registrable Securities (and, in the case of any amendment, action or omission to act which adversely affects any Holder of Registrable Securities or a group of holders of Registrable Securities, the written consent of each such Holder or each member of such group).

6. Nominees for Beneficial Owners. In the event that any Registrable Securities are held by a nominee for the beneficial owner thereof, the beneficial owner thereof may, at its election, be treated as the Holder of such Registrable Securities for purposes of any request or other action by any Holder or Holders of Registrable Securities pursuant to this Agreement or any determination of any number or

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percentage of shares of Registrable Securities held by any Holder or Holders of Registrable Securities contemplated by this Agreement. If the beneficial owner of any Registrable Securities so elects, the Company may require assurances reasonably satisfactory to it of such owner's beneficial ownership of such Registrable Securities.

7. Notices. Notices and other communications under this Agreement shall be in writing and shall be sent by registered mail, postage prepaid, addressed:

(a) to any Holder at the address provided to the Company in writing by such Holder or as shown on stock transfer books of the Company unless such Holder has advised the Company in writing of a different address as to which notices shall be sent under this Agreement, and

(b) if to the Company at P.O. Drawer 1416, Snyder, Texas 79550 to the attention of its President or to such other address as the Company shall have furnished to each Holder.

8. Assignment. This Agreement may not be assigned by either party without the prior written consent of the other party; provided that Padre may assign this Agreement to an Affiliate of Padre without the prior written consent of the Company, but with reasonably prompt notice to the Company of such assignment.

9. Miscellaneous. This Agreement shall be binding upon and inure to the benefit of and be enforceable by the respective successors and assigns of the parties hereto, whether so expressed or not, and, in particular, shall inure to the benefit of and be enforceable by, any Holder or Holders of Registrable Securities. This Agreement embodies the entire agreement and understanding between the Company and the other parties hereto with respect to the subject matter hereof and supersedes all prior agreements and understandings relating to the subject matter hereof. This Agreement shall be construed and enforced in accordance with and governed by the laws of the State of Texas. The headings in this Agreement are for purposes of reference only and shall not limit or otherwise affect the meaning hereof. This Agreement may be executed in any number of counterparts, each of which shall be an original but all of which together shall constitute one instrument.

IN WITNESS WHEREOF, the parties have caused this Agreement to be executed and delivered by their respective officers thereunto duly authorized as of the date first above written.

PATTERSON ENERGY, INC.

By: _____
James C. Brown
Vice President - Finance

PADRE INDUSTRIES, INC.

By: _____
Thomas J. Billings
President

BILL OF SALE AND ASSIGNMENT

KNOW ALL MEN BY THESE PRESENTS, that, pursuant to that certain Agreement, dated January ____, 1999 (the "Agreement"), among PATTERSON ENERGY, INC., a Delaware corporation ("PEC"), PATTERSON DRILLING COMPANY ("PDC"), a Delaware corporation wholly owned by PEC, and PADRE INDUSTRIES, INC. ("Padre"), a Texas corporation (Padre is referred to herein as the "Assignor"), the Assignor, for good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, hereby grants, bargains, sells, conveys and transfers unto PDC (the "Assignee"), all of the Assignor's right, title and interest in and to the Drilling Rigs, Equipment and Rolling Stock set forth in Appendix I attached hereto and incorporated herein by this reference ("Assets").

Assignor disclaims to the maximum extent permitted by law any and all implied warranties (other than with respect to title) concerning the Assets.

TO HAVE AND TO HOLD the same unto the Assignee and the Assignee's successors and assigns forever. The Assignor hereby covenants and agrees that it has the full right, power and authority to sell, convey and transfer the foregoing property to the Assignee pursuant to this Bill of Sale and Assignment.

IN WITNESS WHEREOF, the Assignor has caused this Bill of Sale and Assignment to be duly executed by its duly authorized officer as of the ____ day of January, 1999.

PADRE:

PADRE INDUSTRIES, INC.

By: _____

Thomas J. Billings
Chairman of the Board

Ex. C-1

APPENDIX I
TO
BILL OF SALE AND ASSIGNMENT
FROM
PADRE INDUSTRIES, INC.
TO
PATTERSON DRILLING COMPANY
(List of Assets Assigned)

A. Drilling Rigs and Equipment

Rig No. -----	Drawworks Manufacturer -----
Rig No. 4.....	RMI Model 4610
Rig No. 7	Skytop Model H4610
Rig No. 8	Skytop Model H14610
Rig No. 9.....	RMI Model 4610
Rig No. 10.....	RMI Model 4610

All parts and equipment, including engines, mud pumps, hooks and blocks, derricks, substructures, rotary tables, blow-out prevention equipment, drill bits and all tubular goods on the rigs and in the yard owned by Padre, all of which are set forth on Attachment A to this Appendix I to the Bill of Sale and Assignment.

B. ROLLING STOCK

All rolling stock set forth on Attachment B to this Appendix I to the Bill of Sale and Assignment.

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PATTERSON ENERGY, INC.
AND
PATTERSON DRILLING COMPANY
NON-COMPETITION AGREEMENT

THIS NON-COMPETITION AGREEMENT is made and entered into this day of January, 1999 (this "Agreement"), between and among PATTERSON ENERGY, INC., a Delaware corporation ("PEC"), PATTERSON DRILLING COMPANY, a Delaware corporation ("PDC") wholly owned by PEC, and PADRE INDUSTRIES, INC., a Texas corporation ("Padre").

RECITALS:

A. Simultaneously with the execution of this Agreement, PDC has consummated the transactions contemplated by that certain Agreement, dated January 27, 1999 (the "Asset Purchase Agreement"), among PEC, PDC and Padre providing for, among other things, the purchase by PDC of the drilling rigs, related equipment and rolling stock owned by Padre and the lease by PDC of certain real property, with improvements thereon, owned by Padre.

B. The execution and delivery of this Agreement is a condition to the consummation of the transactions contemplated by the Asset Purchase Agreement, and the parties are entering into this Agreement in order to fulfill such condition.

NOW, THEREFORE, in consideration of the foregoing, the mutual covenants and agreements contained herein, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties, intending to be legally bound, hereby agree as follows:

1. Period of Agreement.

The period of this Agreement shall commence on the date hereof and remain in effect through the earlier of: (i) January 27, 2004, or (ii) 30 days after the date on which payments are to be made to Padre pursuant to Section 1.2 of the Asset Purchase Agreement, if the payments are not made during this 30-day period (the "Non-Compete Period").

2. Covenant Not to Compete.

(a) Padre covenants and agrees that during the Non-Compete Period, Padre shall not, without the prior written consent of PEC and PDC, directly or indirectly, alone or in association with any other person, carry on, be engaged, concerned, or take part in, render services to, or own, share in the earnings of, or invest in the stock, bonds, or other securities of, any person which is engaged in the business of contract drilling oil and gas wells within the State of Texas (the "Competitive Business"); provided, however, that Padre may: (i) invest and/or engage in any business that routinely provides third-party services (as such term is commonly used in the contract oil and gas well drilling business) to a Competitive Business, but is not engaged in the actual conduct of a Competitive Business; or (ii) invest in stock, bonds, or other securities of any Competitive Business (but without otherwise participating in the Competitive Business) if: (A) such stock, bonds, or other securities are listed on any national securities exchange or are registered under Section 12(g) of the Securities Exchange Act of 1934, as amended; (B) the investment does not exceed, in the case of any class of capital stock of any one issuer, two percent

(2%) of the issued and outstanding shares, or, in the case of bonds or other securities of any one issuer, two percent (2%) of the aggregate principal amount thereof issued and outstanding; and (C) such investment would not prevent, directly or indirectly, the transaction of business by PEC or PDC or any affiliate of PEC or PDC with any state, district, territory, or possession of the United States or any governmental subdivision, agency, or instrumentality thereof by virtue of any statute, law, regulation or administrative practice. The period of time during which Padre is prohibited from engaging in certain activities by this Section shall be extended by the length of time during which Padre is in breach of the terms of this section.

(b) It is understood by and between the parties hereto that the foregoing covenant by Padre not to enter into competition with PEC or PDC as set forth in Section 2(a) hereof is an essential element of this Agreement and the Asset Purchase Agreement and that, but for the agreement of Padre to comply with such covenant, neither PEC nor PDC would have agreed to enter into this Agreement or the Asset Purchase Agreement. PEC and PDC on the one hand, and Padre on the other hand, have independently consulted with their respective counsel and have been advised in all respects concerning the reasonableness and propriety of such covenant, with specific regard to the nature of the business conducted by PEC and PDC and their respective affiliates. Padre also agrees that such covenant is reasonable in scope, geographic area, and duration, and that compliance with such covenant would not impose economic hardship on Padre.

3. Restrictions on Soliciting Business of PEC and PDC.

Padre further covenants and agrees that during the Non-Compete Period, Padre will not, either for itself or for any other person or entity, directly or indirectly, engage in any of the following activities in a Competitive Business without the express prior written consent of PEC and PDC:

(a) Solicit or hire any of the employees of PEC or PDC or solicit or take away any of PEC's or PDC's customers, lessors, or suppliers or attempt any of the foregoing;

(b) Acquire or attempt to acquire rights providing any product or service in a Competitive Business within the territory described in Section 2 hereof; or

(c) Engage in any act which would interfere with or harm any business relationship PEC or PDC has with any customer, lessor, employee, principal or supplier.

4. Specific Performance.

Without intending to limit the remedies available to PEC or PDC, Padre acknowledges that PEC or PDC will have no adequate remedies at law if Padre violates the terms of Section 2 or 3, hereof. In such event, Padre agrees that PEC or PDC shall have the right, in addition to any other rights it may have, to obtain in any court of competent jurisdiction specific performance of such Sections of this Agreement or injunctive relief to restrain any breach or threatened breach thereof. Nothing herein shall be construed as prohibiting PEC or PDC from pursuing any other remedies available to PEC or PDC (whether at law or in equity) for such breach or threatened breach, including, without limitation, the recovery of monetary damages from Padre.

The provisions of this Section 4 shall survive the expiration, termination or cancellation of this Agreement.

Ex. D(I)-2

5. Attorneys Fees and Costs.

If an action at law or in equity is necessary to enforce or interpret the terms of this Agreement, the prevailing party shall be entitled to reasonable attorneys fees, costs and necessary expenses in addition to any other relief to which that party may be entitled. This provision is applicable to this entire Agreement.

6. Representations and Warranties of PEC, PDC and Padre.

(a) Representations and Warranties of PEC and PDC. PEC and PDC hereby joint and severally represent and warrant to Padre that: (i) it has all requisite power to enter into and perform their obligations under this Agreement; (ii) this Agreement has been duly and validly authorized by all necessary corporate action on the part of PEC and PDC; (iii) the execution of this Agreement by PEC and PDC and performance of their obligations hereunder do not require the consent or approval of any other party; and (iv) this Agreement is a valid and binding obligation of PEC and PDC.

(b) Representations and Warranties of Padre. Padre hereby represents and warrants to PEC and PDC that: (i) Padre has the capacity and power to enter into and perform obligations of Padre under this Agreement; (ii) Padre has duly and validly executed this Agreement; (iii) the execution of this Agreement and performance of obligations of Padre hereunder do not require the consent or approval of any other party; and (iv) this Agreement constitutes a valid and binding obligation of Padre.

7. General Provisions.

(a) Compliance with Laws. The parties agree that they will comply with all applicable laws and regulations of government bodies or agencies in their respective performance of their obligations under this Agreement.

(b) Governing Law and Construction. This Agreement will be governed by and construed in accordance with the laws of the State of Texas without reference to its conflict-of-laws principles. This Agreement's final form resulted from review and negotiations among the parties and their attorneys, and no part of this Agreement should be construed against any party on the basis of authorship.

(c) Forum for Dispute Resolution. If any dispute arises among the parties concerning the interpretation or performance of any portion of this Agreement which the parties are unable to resolve themselves, and any party brings an action against any other party seeking a declaratory order, specific performance, damages, or any other legal or equitable relief based on this Agreement, the parties agree that the forum for any such action shall be an appropriate federal or state court in Texas having jurisdiction, agree that venue will be proper in such courts, and waive any objections based on inconvenience of the forum, and further agree that the prevailing party in any such action, as determined by the court, shall be awarded its reasonable attorneys' fees and costs in addition to any relief or judgment the court awards.

(d) Entire Agreement; Amendment. This Agreement constitutes the entire agreement between the parties with respect to the subject matter contained herein and supersedes any previous oral or written communications, representations, understandings or agreements with respect thereto. The terms of this Agreement may be modified only in a writing, signed by authorized representatives of both parties.

Ex. D(I)-3

(e) Assignability. This Agreement will be binding upon the parties' respective successors and permitted assigns. Neither party may assign this Agreement and/or any of its rights and/or obligations hereunder without the prior written consent of the other party, and any such attempted assignment will be void; provided, however, that PEC or PDC may assign this Agreement to a subsidiary or affiliate without the prior written consent of Padre, and provided further that a transfer by PEC or PDC as a result of a merger or sale of all or substantially all of the assets of PDC or PEC to a third party that assumes PDC's or PEC's obligations and rights hereunder, as the case may be, by operation of law or otherwise, shall not constitute a prohibited assignment under this Section 7(e).

(f) Waiver. A waiver of a breach or default under this Agreement will not constitute a waiver of any other breach or default. Failure or delay by either party to enforce compliance with any term or condition of this Agreement will not constitute a waiver of such term or condition.

(g) Severability. If any provision of this Agreement is declared to be invalid, the parties agree that such invalidity will not affect the validity of the remaining provisions of this Agreement, and further agree, to the extent possible, to substitute for the invalid provision a valid provision that approximates the intent and economic effect of the invalid provision as closely as possible.

(h) Headings. The titles of the Sections and subsections of this Agreement are for convenience of reference only and are not to be considered in construing this Agreement.

(i) Notice. Any notice, request, consent, demand or other communication required to be given under this Agreement will be in writing and will be given personally, by facsimile or by mailing the same, first-class, postage prepaid to the appropriate address and facsimile number set forth below or to such other person or at such other address as may hereafter be designated by like notice. Notices by mail will be considered delivered and become effective three days after the mailing thereof. All notices by facsimile will be considered delivered and become effective immediately upon the confirmed (by answer back or other tangible printed verification or successful receipt) sending thereof.

To PEC: Patterson Energy, Inc.
4510 Lamesa Highway
P.O. Drawer 1410
Snyder, Texas 79550
Facsimile: (915) 573-0281
Attention: Cloyce A. Talbott
Chairman and Chief Executive Officer

To PDC: Patterson Drilling Company
4510 Lamesa Highway
P.O. Drawer 1410
Snyder, Texas 79550
Facsimile: (915) 573-0281
Attention: A. Glenn Patterson
President and Chief Operating Officer

Ex. D(I)-4

To Padre: Padre Industries, Inc.
c/o The Kleberg Law Firm, P.C.
Suite 900 North Tower
800 N. Shoreline Blvd.
Corpus Christi, Texas 78401
Attention: Richard L. Leshin

To T Billings: Thomas J. Billings
c/o The Kleberg Law Firm, P.C.
Suite 900 North Tower
800 N. Shoreline Blvd.
Corpus Christi, Texas 78401
Attention: Richard L. Leshin

(j) Counterparts. This Agreement may be executed in counterparts and by the parties hereto in separate counterparts, each of which will be deemed an original, but all of which together will constitute one and the same instrument.

IN WITNESS WHEREOF, the undersigned have caused this Agreement to be executed by their respective representatives as of the day and year first above written.

PEC:

PATTERSON ENERGY, INC.

By: _____
James C. Brown
Vice President - Finance

PDC:

PATTERSON DRILLING COMPANY

By: _____
James C. Brown
Vice President - Finance

PADRE:

PADRE INDUSTRIES, INC.

By: _____
Thomas J. Billings
Chairman of the Board

Ex. D(I)-5

PATTERSON ENERGY, INC.
AND
PATTERSON DRILLING COMPANY
NON-COMPETITION AGREEMENT

THIS NON-COMPETITION AGREEMENT is made and entered into this day of January, 1999 (this "Agreement"), between and among PATTERSON ENERGY, INC., a Delaware corporation ("PEC"), PATTERSON DRILLING COMPANY, a Delaware corporation ("PDC") wholly owned by PEC, and THOMAS J. BILLINGS, an individual residing in Corpus Christi, Texas ("T Billings").

RECITALS:

A. Simultaneously with the execution of this Agreement, PDC has consummated the transactions contemplated by that certain Agreement, dated January 27, 1999 (the "Asset Purchase Agreement"), among PEC, PDC and PADRE INDUSTRIES, INC. ("Padre"), providing for, among other things, the purchase by PDC of the drilling rigs, related equipment, rolling stock and certain real property with improvements thereon owned by Padre.

B. T Billings is an officer, a director and one of two stockholders of Padre.

C. The execution and delivery of this Agreement is a condition to the consummation of the transactions contemplated by the Asset Purchase Agreement, and the parties are entering into this Agreement in order to fulfill such condition.

NOW, THEREFORE, in consideration of the foregoing, the mutual covenants and agreements contained herein, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties, intending to be legally bound, hereby agree as follows:

1. Period of Agreement.

The period of this Agreement shall commence on the date hereof and remain in effect through the earlier of (i) January 27, 2004, (ii) the death of T Billings, or (iii) 30 days after the date on which payments are to be made to Padre pursuant to Section 1.2 of the Asset Purchase Agreement, if the payments are not made during this 30-day period (the "Non-Compete Period").

2. Covenant Not to Compete.

(a) T Billings covenants and agrees that during the Non-Compete Period, T Billings shall not, without the prior written consent of PEC and PDC, directly or indirectly, and whether as a principal or as an agent, officer, director, employee, consultant, or otherwise, alone or in association with any other person, carry on, be engaged, concerned, or take part in, render services to, or own, share in the earnings of, or invest in the stock, bonds, or other securities of, any person which is engaged in the business of contract drilling oil and gas wells within the State of Texas (the "Competitive Business"); provided, however, that T Billings may: (i) invest and/or engage in any business that routinely provides third-party services (as such term is commonly used in the contract oil and gas well drilling business) to a Competitive Business, but is not engaged in the actual conduct of a Competitive Business; or (ii) invest in stock, bonds, or other securities of any Competitive Business (but without otherwise participating in the

Competitive Business) if: (A) such stock, bonds, or other securities are listed on any national securities exchange or are registered under Section 12(g) of the Securities Exchange Act of 1934, as amended; (B) the investment does not exceed, in the case of any class of capital stock of any one issuer, two percent (2%) of the issued and outstanding shares, or, in the case of bonds or other securities of any one issuer, two percent (2%) of the aggregate principal amount thereof issued and outstanding; and (C) such investment would not prevent, directly or indirectly, the transaction of business by PEC or PDC or any affiliate of PEC or PDC with any state, district, territory, or possession of the United States or any governmental subdivision, agency, or instrumentality thereof by virtue of any statute, law, regulation or administrative practice. The period of time during which T Billings is prohibited from engaging in certain activities by this Section shall be extended by the length of time during which T Billings is in breach of the terms of this section.

(b) It is understood by and between the parties hereto that the foregoing covenant by T Billings not to enter into competition with PEC or PDC as set forth in Section 2(a) hereof is an essential element of this Agreement and the Asset Purchase Agreement and that, but for the agreement of T Billings to comply with such covenant, neither PEC nor PDC would have agreed to enter into this Agreement or the Asset Purchase Agreement. PEC and PDC on the one hand and T Billings on the other hand have independently consulted with their respective counsel and have been advised in all respects concerning the reasonableness and propriety of such covenant, with specific regard to the nature of the business conducted by PEC and PDC and their respective affiliates. T Billings also agrees that such covenant is reasonable in scope, geographic area, and duration, and that compliance with such covenant would not impose economic or professional hardship on T Billings.

3. Restrictions on Soliciting Business of PEC and PDC.

T Billings further covenants and agrees that during the Non-Compete Period, T Billings will not, either for himself or for any other person or entity, directly or indirectly, engage in any of the following activities in a Competitive Business without the express prior written consent of PEC and PDC:

(a) Solicit or hire any of the employees of PEC or PDC or solicit or take away any of PEC's or PDC's customers, lessors, or suppliers or attempt any of the foregoing;

(b) Acquire or attempt to acquire rights providing any product or service in a Competitive Business within the territory described in Section 2 hereof; or

(c) Engage in any act which would interfere with or harm any business relationship PEC or PDC has with any customer, lessor, employee, principal or supplier.

4. Specific Performance.

Without intending to limit the remedies available to PEC or PDC, T Billings acknowledges that PEC or PDC will have no adequate remedies at law if T Billings violates the terms of Section 2 or 3, hereof. In such event, T Billings agrees that PEC or PDC shall have the right, in addition to any other rights it may have, to obtain in any court of competent jurisdiction specific performance of such Sections of this Agreement or injunctive relief to restrain any breach or threatened breach thereof. Nothing herein shall be construed as prohibiting PEC or PDC from pursuing any other remedies available to PEC or PDC (whether at law or in equity) for such breach or threatened breach, including, without limitation, the recovery of monetary damages from T Billings.

The provisions of this Section 5 shall survive the expiration, termination or cancellation of this Agreement.

Ex. D(II)-2

5. Attorneys Fees and Costs.

If an action at law or in equity is necessary to enforce or interpret the terms of this Agreement, the prevailing party shall be entitled to reasonable attorneys fees, costs and necessary expenses in addition to any other relief to which that party may be entitled. This provision is applicable to this entire Agreement.

6. Representations and Warranties of PEC, PDC and T Billings.

(a) Representations and Warranties of PEC and PDC. PEC and PDC hereby jointly and severally represent and warrant to T Billings that: (i) they have all requisite power to enter into and perform their obligations under this Agreement; (ii) this Agreement has been duly and validly authorized by all necessary corporate action on the part of PEC and PDC; (iii) the execution of this Agreement by PEC and PDC and performance of their obligations hereunder do not require the consent or approval of any other party; and (iv) this Agreement is a valid and binding obligation of PEC and PDC.

(b) Representations and Warranties of T Billings. T Billings hereby represents and warrants to PEC and PDC that: (i) T Billings has the capacity and power to enter into and perform obligations of T Billings under this Agreement; (ii) T Billings has duly and validly executed this Agreement; (iii) the execution of this Agreement and performance of obligations of T Billings hereunder do not require the consent or approval of any other party; and (iv) this Agreement constitutes a valid and binding obligation of T Billings.

7. General Provisions.

(a) Compliance with Laws. The parties agree that they will comply with all applicable laws and regulations of government bodies or agencies in their respective performance of their obligations under this Agreement.

(b) Governing Law and Construction. This Agreement will be governed by and construed in accordance with the laws of the State of Texas without reference to its conflict-of-laws principles. This Agreement's final form resulted from review and negotiations among the parties and their attorneys, and no part of this Agreement should be construed against any party on the basis of authorship.

(c) Forum for Dispute Resolution. If any dispute arises among the parties concerning the interpretation or performance of any portion of this Agreement which the parties are unable to resolve themselves, and any party brings an action against any other party seeking a declaratory order, specific performance, damages, or any other legal or equitable relief based on this Agreement, the parties agree that the forum for any such action shall be an appropriate federal or state court in Texas having jurisdiction, agree that venue will be proper in such courts, and waive any objections based on inconvenience of the forum, and further agree that the prevailing party in any such action, as determined by the court, shall be awarded its reasonable attorneys' fees and costs in addition to any relief or judgment the court awards.

(d) Entire Agreement; Amendment. This Agreement constitutes the entire agreement between the parties with respect to the subject matter contained herein and supersedes any previous oral or written communications, representations, understandings or agreements with respect thereto. The terms of this Agreement may be modified only in a writing, signed by authorized representatives of both parties.

(e) Assignability. This Agreement will be binding upon the parties' respective successors and permitted assigns. Neither party may assign this Agreement and/or any of its rights and/or obligations hereunder without the prior written consent of the other party, and any such attempted assignment will be void; provided, however, that PEC or PDC may assign this Agreement to a subsidiary or affiliate without the prior written consent of T Billings, and provided further that a transfer by PEC or PDC as a result of a merger or sale of all or substantially all of the assets of PDC with or to a third party that assumes PDC's or PEC's obligations and rights, as the case may be, by operation of law or otherwise, shall not constitute a prohibited assignment under this Section 7(e).

(f) Waiver. A waiver of a breach or default under this Agreement will not constitute a waiver of any other breach or default. Failure or delay by either party to enforce compliance with any term or condition of this Agreement will not constitute a waiver of such term or condition.

(g) Severability. If any provision of this Agreement is declared to be invalid, the parties agree that such invalidity will not affect the validity of the remaining provisions of this Agreement, and further agree, to the extent possible, to substitute for the invalid provision a valid provision that approximates the intent and economic effect of the invalid provision as closely as possible.

(h) Headings. The titles of the Sections and subsections of this Agreement are for convenience of reference only and are not to be considered in construing this Agreement.

(i) Notice. Any notice, request, consent, demand or other communication required to be given under this Agreement will be in writing and will be given personally, by facsimile or by mailing the same, first-class, postage prepaid to the appropriate address and facsimile number set forth below or to such other person or at such other address as may hereafter be designated by like notice. Notices by mail will be considered delivered and become effective three days after the mailing thereof. All notices by facsimile will be considered delivered and become effective immediately upon the confirmed (by answer back or other tangible printed verification or successful receipt) sending thereof.

To PEC: Patterson Energy, Inc.
 4510 Lamesa Highway
 P.O. Drawer 1410
 Snyder, Texas 79550
 Facsimile: (915) 573-0281
 Attention: Cloyce A. Talbott
 Chairman and Chief Executive Officer

To PDC: Patterson Drilling Company
 4510 Lamesa Highway
 P.O. Drawer 1410
 Snyder, Texas 79550
 Facsimile: (915) 573-0281
 Attention: A. Glenn Patterson
 President and Chief Operating Officer

Ex. D(II)-4

To T Billings: Thomas J. Billings
c/o The Kleberg Law Firm, P.C.
Suite 900 North Tower
800 N. Shoreline Blvd.
Corpus Christi, Texas 78401
Attention: Richard L. Leshin

(j) Counterparts. This Agreement may be executed in counterparts and by the parties hereto in separate counterparts, each of which will be deemed an original, but all of which together will constitute one and the same instrument.

IN WITNESS WHEREOF, the undersigned have caused this Agreement to be executed by their respective representatives as of the day and year first above written.

PEC:

PATTERSON ENERGY, INC.

By:

James C. Brown
Vice President - Finance

PDC:

PATTERSON DRILLING COMPANY

By:

James C. Brown
Vice President - Finance

T BILLINGS:

Thomas J. Billings

Ex. D(II)-5

FORM
OF
INVESTMENT REPRESENTATION LETTER

January 27, 1999

Patterson Energy, Inc.
4510 Lamesa Highway
Snyder, Texas 79549

This letter is being submitted to Patterson Energy, Inc. ("PEC") in connection with and as a condition to PEC's closing of the transaction contemplated by the Agreement among PEC, Patterson Drilling Company ("PDC") and Padre Industries, Inc. ("Padre"), dated of even date with this letter (the "Agreement"). Capitalized terms not defined herein shall have the meaning given them in the Memorandum (as defined below).

1. Representations and Warranties.

The undersigned hereby represents and warrants to PEC that the following statements are true:

a. The undersigned has been furnished a copy of the Memorandum, dated January 20, 1999 (the "Memorandum") containing a copy of PEC's Annual Report on Form 10-K for the fiscal year ended December 31, 1997, and all other reports filed by PEC with the Securities and Exchange Commission since January 1, 1998 (collectively, the "Reports") and has carefully reviewed the Memorandum and the Reports, including, but not limited to, (i) the statements in the Memorandum relating to taxation of the transaction and lack of free transferability of the PEC Shares to be issued by PEC as consideration for the transaction, and (ii) the section entitled "Disclosure Concerning Forward-Looking Statements," setting forth certain Cautionary Statements or risk factors relating to PEC and PDC and their businesses and operations.

b. The undersigned has such knowledge and experience in financial and business matters that it is capable of evaluating the merits and risks of an investment in PEC vis-a-vis the PEC Shares to be issued by PEC as consideration for the transactions.

c. The undersigned has had an opportunity to ask questions of PEC and PDC and its management concerning PEC and PDC, the businesses of PEC and PDC and the PEC Shares and, if asked, all such questions have been answered to the full satisfaction of the undersigned.

d. The undersigned understands that PEC has not registered the offer or sale of the PEC Common Stock under the Securities Act of 1933, as amended (the "Act"), in reliance upon an exemption therefrom under Section 4(2) of the Act and the provisions of Regulation D promulgated thereunder. The undersigned therefore acknowledges that in no event may it sell or otherwise transfer the PEC Common Stock without registration under the Act (see paragraph (h) below), unless an exemption from registration is available.

e. The undersigned represents that it will acquire the PEC Shares for its own account, with no intention to distribute or offer to distribute the same to others without registration under the Act (unless an exemption from registration is available), and understands that the issuance by PEC of the PEC Common Stock will be predicated upon the undersigned's lack of such intention.

Ex. E-1

f. The undersigned understands that neither the Securities and Exchange Commission nor the securities commissioner of any state has received or reviewed any documents relative to an investment in PEC, or has made any finding or determination relating to the fairness of an investment in PEC.

g. The undersigned acknowledges that stop transfer instructions will be placed with PEC's transfer agent to restrict the resale, pledge, hypothecation or other transfer of the PEC Shares.

h. The undersigned acknowledges that, except as provided in the Registration Rights Agreement attached to the Agreement as Exhibit B, PEC is under no obligation to register the PEC Shares for sale under the Act or to assist the undersigned in complying with any exemption from registration under the Act, or any state securities laws.

i. If other than a natural person, the undersigned was not organized for the specific purpose of acquiring the PEC Common Stock.

j. The undersigned understands and acknowledges that the foregoing representations and warranties will be relied upon by PEC in connection with the issuance of the PEC Shares.

k. Each of the two stockholders of the undersigned has an individual net worth, or joint net worth with the undersigned's spouse in excess of \$1 million.

1. The undersigned has total assets of at least \$5,000,000 and was not formed for the specific purpose of acquiring the PEC Common Stock.

2. Indemnification.

The undersigned agrees to indemnify and hold harmless PEC and PDC, or either of them, the officers, directors and affiliates of either of them and each other person, if any, who controls either of them, within the meaning of Section 15 of the Act, against any and all loss, liability, claim, damage and expense whatsoever (including, but not limited to, any and all expenses reasonably incurred in investigating, preparing or defending against any litigation commenced or threatened or any claim whatsoever) arising out of or based upon any false representation or warranty or failure by the undersigned to comply with any covenant or agreement made by the undersigned herein.

3. Survival.

All representations, warranties and covenants contained in this letter shall survive the closing of the transactions.

Very truly yours,

PADRE:

PADRE INDUSTRIES, INC.

By:

Thomas J. Billings
President

Ex. E-2

</TEXT>
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[NORWEST BANK LETTERHEAD]

March 29, 1999

Mr. Cloyce Talbott
Mr. James Brown
Chief Financial Officer
Patterson Energy, Inc.
4510 Lamesa Highway
Snyder, TX 79549

RE: NON-COMPLIANCE WITH LOAN AGREEMENT DATED DECEMBER 9, 1997 (AMENDED
MARCH 26, 1998)
REPLACEMENT OF NET INCOME COVENANT WITH EBITDA/INTEREST COVERAGE
COVENANT

Dear Cloyce and James:

In accordance with the Loan Agreement between Patterson Energy, Inc. (Borrower). and Norwest Bank Texas, N.A. (Lender), this letter shall serve as formal acknowledgment by Lender and notification to all parties that Borrower is not in compliance with Article 6.22 (Net Income Covenant) of said Loan Agreement.

For the period ending 12/31/98 only, Lender agrees to waive the subject performance requirement provided that the Borrower has fully satisfied its payment obligations under the terms of its note for both the February 1st and March 1st, 1999 note payments. Such waiver does not preclude the Lender from exercising any right or remedy in the future. It is the Lender's intention for Borrower to be in full compliance with all provisions of the Loan Agreement.

Since it is likely that this covenant may not be met in March of this year, we would offer to modify the covenant in the following manner:

Article 6.22 will be deleted.

Article 6.26 will be added reflecting that the borrower will maintain its ratio of Earnings Before Interest Expense, Taxes, Depreciation, Depletion and Amortization to Interest Expense of at least 2.25x to 1.00 (measured on a quarterly basis).

The company will agree to provide a pledge of its oil and gas properties (or a mutually agreeable indirect pledge of its oil and gas properties).

The company will agree to provide financial information on a monthly basis (loan agreement monitoring will remain quarterly).

Upon receipt and review of the Borrower's quarter-end financial statements for the period ending March 31, 1999, Lender will notify Borrower of any provision of the loan agreement that is out of compliance and any action that the Bank will be taking.

Patterson Energy, Inc.
Net Income Covenant Waiver
Page 2
March 29, 1999

If you have any questions relating to this letter, please contact me at
940/766-8322.

Sincerely,

/s/ JAMES B. FRANK

James B. Frank
Business Banking Manager

ACKNOWLEDGED AND ACCEPTED THIS 29TH DAY OF MARCH, 1999.

PATTERSON ENERGY, INC.

BY: /s/ CLOYCE TALBOTT

CLOYCE TALBOTT, CHAIRMAN OF THE BOARD
AND CHIEF EXECUTIVE OFFICER

PATTERSON DRILLING COMPANY
AS GUARANTOR

BY: /s/ JAMES C. BROWN

JAMES C. BROWN
CHIEF FINANCIAL OFFICER

PATTERSON PETROLEUM, INC.
AS GUARANTOR

BY: /s/ JAMES C. BROWN

JAMES C. BROWN
CHIEF FINANCIAL OFFICER

Patterson Energy, Inc.
Net Income Covenant Waiver
Page 3
March 29, 1999

PATTERSON PETROLEUM TRADING COMPANY, INC.
AS GUARANTOR

BY: /s/ JAMES C. BROWN

JAMES C. BROWN
CHIEF FINANCIAL OFFICER

CC: CHARLIE FREEL - BANK ONE
KEVIN HUMPHRIES - BANK OF OKLAHOMA

</TEXT>
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AIRCRAFT LEASE

By this Aircraft Lease TALBOTT AVIATION, INC., a Texas corporation ("Lessor"), whose address is P.O. Drawer 1416, Snyder, Texas 79550, leases to PATTERSON ENERGY, INC., a Delaware corporation ("Lessee"), whose address is P.O. Box 410, Snyder, Texas 79550, the aircraft described below, on the following terms and conditions:

1. Description of Aircraft. The property leased under this agreement is a 1981 Beech King-Air 90 airplane, manufacturer's serial No. LA-121 and Department of Transportation, Federal Aviation Administration No. N182CA.

2. Term of Lease. The term of this Lease is for a period of one (1) year, commencing as of January 1, 1999 and terminating on December 31, 1999.

3. Rental Payments. Lessee agrees to pay Lessor as rent for the use of the aircraft a total sum of \$9,200.00 per month, payable in advance on the first day of each month during the term of this Lease, beginning January 1, 1998.

Rental payments shall be made at Lessor's address as set forth above or at any other place that may be designated by Lessor or its assignees. Any rental payment not made by Lessee within ten (10) days of its due date shall be subject to a late charge of five percent (5%) of the amount not paid when due for each ten days the amount remains unpaid.

4. Delivery of Aircraft. Lessor agrees to deliver the aircraft to Lessee at Scurry County Airport, Snyder, Texas. At delivery to Lessee on January 1, 1998, the aircraft shall be in an airworthy condition and registered in the name of Lessor with the Secretary of Transportation, pursuant to Section 1401, Title 49 of the United States Code, and shall be covered by a Certificate of Airworthiness issued by the Federal Aviation Administration.

5. Maintenance. During the term of the Lease, Lessee shall at its own expense maintain the aircraft, including the airframe, engines, propellers, instruments, equipment, appliances, and accessories in fully operable condition, and in compliance with all applicable maintenance and safety requirements of the Federal Aviation Administration and the Federal Aviation Administration approved 1981 Beech King-Air airplane maintenance manual (the "Maintenance Manual"). All maintenance and repair work shall be performed by personnel duly certified to perform such work by the Federal Aviation Administration. Work shall be in accordance with minimum standards of the Federal Aviation Administration and in accordance with standards set forth in the Maintenance Manual.

Dated this 20th day of December, 1998.

LESSOR:

TALBOTT AVIATION, INC.

/s/ CLOYCE A. TALBOTT

CLOYCE A. TALBOTT, PRESIDENT

</TEXT>

</DOCUMENT>

LESSEE:

PATTERSON ENERGY, INC.

/s/ GLENN PATTERSON

GLENN PATTERSON, PRESIDENT

CONSENT OF INDEPENDENT ACCOUNTANTS

We consent to the incorporation by reference in the registration statements of Patterson Energy, Inc. on Form S-8 (File No.'s 333-47917, 33-97972, 33-39471 and 33-35399) and on Forms S-3, as amended, (File No.'s 333-43739 and 333-39537) of our report dated March 1, 1999, on our audits of the consolidated financial statements of Patterson Energy, Inc. as of December 31, 1997 and 1998 and for the years ended December 31, 1996, 1997 and 1998, which report is included in this Annual Report on Form 10-K.

/s/ PricewaterhouseCoopers LLP

Dallas, Texas
March 31, 1999
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