Contractors see dramatic rise in North Sea dayrates

THE NORTH SEA, like virtually every other offshore rig market around the world, is enjoying 100% utilization of marketed rigs. Dayrates are significantly higher than those from a year ago, and most believe they could rise even more. Due to the strong market and the belief that it will remain strong for at least the next couple of years, one drilling contractor is reactivating a semisubmersible that had been idle for the past couple of years.

There is good acreage availability as several North Sea countries are in the midst of offshore licensing rounds. The UK, Norway and Denmark are all offering acreage, with the UK offering its entire sector of the North Sea for the first time since 1998.

STRONG SEMI MARKET

North Sea semisubmersibles, most of which operate in the UK sector, are primarily rated for mid-water depths generally below 2,000 ft of water. Only a handful of deepwater units rated to work in about 4,500 ft and deeper are operating in the North Sea, most offshore Norway.

North Sea semisubmersible dayrates increased significantly during the past year. The GSF Rig 140, while receiving a rate in the $50s under a drilling contract negotiated prior to the dramatic run up in dayrates, was expected to command a significantly higher rate as its next contract is negotiated.

The platform rig market, primarily in the UK sector, is a mature market with few new opportunities, although one contractor that manages platform rigs targeted expansion into other North Sea sectors. New platform rig management opportunities are scarce due to the prevalence of subsea production systems tied into existing platforms.

The semisubmersible market is effectively 100% utilized with only three units available from inventory, all cold-stacked rigs owned by **Transocean**.

A fourth previously cold-stacked semisubmersible, **GlobalSantaFe's** Arctic II, is being reactivated after having been idle since May 2003. It is expected to be available for work in August and is under contract to **ADTI**, the contractor's turnkey division, to drill a well for **Endeavour International**. Dayrate for this project is $165,000.

"We held the rig in inventory, as others have, to watch demand build," said **Roger Hunt**, Senior Vice President of Marketing for GlobalSantaFe.

"We thought the timing of putting rigs back into service was a very critical issue," he continued, "but it became obvious to us that the demand period through winter and into the summer was such that another rig could enter the market without upsetting the pricing equation."

As it turned out, obtaining a $165,000 dayrate supported that thesis. Additionally, GlobalSantaFe is talking with other operators about projects that could keep the rig busy through this winter and into next summer.

GlobalSantaFe demonstrated that the current UK semisubmersible market can command $160,000 or more. To illustrate the sharp rise in dayrates, the contractor's three other semisubmersibles, currently working under contracts negotiated before the increase in pricing, are significantly lower.

However, at least one of its semisubmersibles has a contract with dayrates that steadily escalate.

The Arctic III, which was working for $80,000 under a contract that expired last May, is next to work for **ExxonMobil** for $110,000 per day and then to **Marathon** for a rate in the low $150s. This will be followed by a year-long contract from Shell.

The Arctic IV is working for **BP** for a rate in the high $80s, and RIG 140 will be working for BP for a dayrate in the $50s. These rates are expected to increase with the next contracts.

Mr Hunt believes there is a shortage of semisubmersibles in the UK sector of the North Sea when all of the projects in the area are tallied, and that operators will be forced to push some of their programs from this year into 2006 as a result. He sees that as a good thing, though, as it flattens out the curves and increases the length of the market.

"Right now, the visibility is such that the (semisubmersible) fleet is going to be fully employed well into and through summer 2006," he said.

Les Van Dyke, Director of Investor Relations for **Diamond Offshore**, believes there is a shortfall of semisubmersibles for the Norwegian market, noting that some operators in Norway seeking rigs for scheduled programs are unable to contract them presently.

"Capacity is also tight in the UK right now," Mr Van Dyke said. "There are a few other rigs around the world that could possibly be drawn to Norway under the right circumstances, however, the market is so strong elsewhere that contractors are not moving them to other regions."

Diamond Offshore operates three semisubmersibles in the UK sector in addition to the semisubmersible in Norway. To illustrate the significant increase in dayrates from a year ago the contracts that were negotiated earlier for the contractor's three UK rigs are receiving dayrates in the $80s.

Now, "the market is in the $150-$160 range," Mr Van Dyke said.

Transocean operates 17 semisubmersibles in the region, 12 in the UK sector (three of which are cold-stacked) and five offshore Norway where one unit is cold-stacked. All of Transocean's marketed North Sea semisubmersibles are contracted, with many at dayrates significantly higher than their previous contracts.

The Transocean Rather is contracted to BP at $165,000, up from its previous contract at $95,000 per day. The rig is then sublet to **Shell** for one well in October at $190,000 and then goes back to BP at $165,000.

Another example shows Transocean's Sedco 714, previously contracted at $55,000 per day, is now working for ADTI at $145,000.

Not all of Transocean's dayrate increases are as dramatic but all are higher than the previous terms. The Sedco 704 contracted to **Venture** is receiving a rate of $50,000 under a contract that expired in June 2005.

That dayrate increased to $91,000 under a contract with the same operator that expires in June 2006. The Sedco 706, contracted by **Total**, saw its dayrate increase from $57,000 to $78,000 under a contract that began last January.

Semisubmersible dayrates in the Norwegian sector are higher than those in the UK due to several factors, including higher labor costs and generally higher operating costs in order to meet more stringent environmental and other regulations. Like the UK sector, semisubmersibles in Norway have also seen dayrates increase in recent months.

Diamond Offshore's Ocean Vanguard will be working for a rig-sharing consortium of operators beginning in August at a rate of $140,000 per day. The group includes **Statoil**, **Total**, **Esso** and **Shell**. This contract was negotiated in 2004 but began only recently due to the rig undergoing repairs following storm damage.

Several of Transocean's semisubmersibles posted similar dayrate increases. The Transocean Leader, for example, is currently working for Statoil at a rate of $173,500 until February 2006, when a new one-year contract with the operator calls for a rate of $245,000 to take effect. This rig was previously contracted in Norway at a rate of $107,500.

In other examples, the Transocean Arctic is receiving a dayrate of $168,000, although this is down from its previous rate of $200,000. The Polar Pioneer, however, is working at a rate of $170,000, up from just over $110,000 per day, and Transocean Searcher is under contract to Statoil in the low $120s, up from $103,800 during its previous contract.

JACKUP MARKET

Jackups are generally readily movable in the southern North Sea between the UK, Denmark and the Netherlands without a great deal of cost, meaning working in the various areas don't have a great deal of impact on pricing and utilization.

Jackups, like semisubmersibles, face certain barriers to the Norwegian market due to environmental and other regulations.

Like the semisubmersible market, some

Recent jackup dayrates in the southern North Sea have seen dayrates increase to the $70s and $80s, with one unit commanding a dayrate in the $90s for a contract commencing in 2006. With the current tight market and a dayrate fixture in the $90s, more contractors are expected to bid at or near that price for future contracts. ENSCO International's jackup ENSCO 71 pictured above is working in the southern North Sea.

drilling contractors believe there is a shortage of jackups in the North Sea by as many as 3-4 rigs.

Richard LeBlanc, Vice President, Investor Relations for **ENSCO International**, says he doesn't see any jackup rig availability for the balance of 2005, resulting in ongoing rig requirements by operators being pushed into 2006 in some cases.

"We are in a position, unfortunately, where we have to turn away work in the near term because we don't have the rig availability," he explained.

One contractor's possible solution is a rig-sharing scheme similar to the group that shares a Diamond Offshore semi-submersible.

Bill Provine, Vice President, Investor Relations for **Rowan Companies**, said he recently visited with several independent operators working in the North Sea that had to postpone some of their E&P programs from this year and into 2006 due to lack of jackups.

"The majors that have finished their plans are keeping the rigs," he said. "The independents that bought a lot of assets are hustling to pick up a rig."

Rowan is presently talking with several independents about a rig-sharing contract in the North Sea and is hoping to present a proposal later this year that might also entail moving one of its rigs from another region to the North Sea, possibly one of its Gorilla class jackups from the Gulf of Mexico.

GlobalSantaFe's Hunt noted that "other than perhaps some Central North Sea opportunities, I would not expect jackups to migrate to the North Sea."

Rowan currently has its Gorilla V and VII working in the region, both of which are commanding dayrates between $120,000 and $130,000. Mr Provine said those rigs could receive between $175,000 and $200,000 for new contracts in today's market.

The Gorilla V is working in the Central North Sea, which generally sees jackups with higher dayrates than in the southern North Sea due to somewhat harsher sea and current conditions. The Gorilla VII is working in the southern area.

Dayrates in the Southern North Sea have increased of late with recent contracts ranging from the $70s to $80s. GlobalSantaFe, however, is receiving $90,000 per day for its Labrador jackup for a project for **PetroCanada** commencing in January 2006.

"In this kind of market, when it is tight enough that you see a fixture in the $90s, you would expect contractors to bid at similar levels during the next round of bids," Mr Hunt noted.

Illustrating the significant dayrate difference between the Southern and Central North Sea, GlobalSantaFe's Magellan, currently contracted to Total in the Central North Sea for around $100,000 per day, will begin a contract during the first quarter of 2006 for a rate in the $140s.

PLATFORM RIGS

There is not a lot of upside to dayrates in the platform rig market, most of which in the North Sea are oil company-owned but managed and operated by drilling contractors. However, many of the platform rig management contracts have significant incentive earning potential.

Realistically, there is little opportunity for new platforms and, subsequently, platform rigs to be added to the North Sea market due to the fact that most new developments are produced via subsea completions tied to existing platforms.

However, there appears to be at least one encouraging trend, according to **KCA DEUTAG**, which manages and operates 18 platform rigs in the North Sea.

"We may not see any more platform rigs built," said **Brian Taylor**, Group Director, UK, Norway, Caspian and Sakhalin for KCA DEUTAG. "It may be a case of drilling out what we have.

"What I do see as an encouraging trend is the number of independent operators coming in to operate."

Mr Taylor noted that the Ninian platform was sold by **Chevron** to **Oryx**, then to **Kerr-McGee** and then to **CNR**, so within the period of 7-8 years the Ninian assets have been owned by four different operators. The independents are much more aggressive than some of the majors.

KCA DEUTAG manages and operates platform rigs for a number of independents beside CNR, including **Nexen**, **Lundin** and **Venture Production**.

The contractor also operates platform rigs for majors including BP, Total, **Britannia** (a joint venture of **Chevron** and **ConocoPhillips**) and **ExxonMobil**.

Mr Taylor noted that the contractor's business is fairly divided between independents and majors, although he emphasized that independents are becoming an increasingly important part of the company's business.

The contractor presently operates platform rigs only in the UK North Sea, but is hoping to expand its operations and has set Norway as a target for that expansion.

"A lot of operators are increasingly looking for what we would call a Pan European solution," Mr Taylor explained. "They want a contractor that can work on both sides of the North Sea, the UK and Norway."

There are a number of ways to accomplish that, including trying to win contracts and grow organically, work in a joint venture with a Norwegian company, or buy a Norwegian company, which Mr Taylor views as an extreme solution.

The way to expand business is to bid competitively when operators seek new contractors to manage their platform rigs, according to Mr Taylor.

The Norwegian platform drilling market is not going to grow with the installation of new platforms.

Any new business for KCA DEUTAG will be on existing installations, but Mr Taylor explains that they probably will have much longer life than platforms in the more mature UK sector.

ACREAGE AVAILABILITY

While the North Sea is considered a mature area, with fields in production since the 1970s, there still are exploration opportunities, particularly with the present level of commodity prices.

Three countries, the UK, Norway and Denmark, are in the midst of new licensing rounds. As noted earlier, the UK is offering its entire available area of the North Sea, the first time since 1998.

Norway. The Norwegian Ministry of Petroleum and Energy received nominations from 19 companies for blocks for its 19th licensing round covering the Norwegian continental shelf, including blocks in the Norwegian and Barents Seas.

The number of companies nominating blocks is up from the 14 companies that nominated blocks in the country's 18th licensing round, indicating significantly stronger interest.

Rowan Drilling operates two Gorilla Class jackups in the Central and Southern North Sea. Both rigs are commanding dayrates between $120,000 and $130,000 under contracts negotiated earlier. The company believes those rigs could receive between $175,000 and $200,000 for new contracts.

Sixty-six blocks or parts of blocks were nominated by two or more companies.

The companies' nominations are given considerable weight when the Ministry will consider acreage to be included in the 19th licensing round.

Companies nominating blocks are **Amerada Hess**, **BG**, **BP**, **Chevron**, **ConocoPhillips**, **DNO**, **Eni**, **Gaz de France**, **Norske Hydro**, **Idemitsu**, **Lundin**, **Marathon**, **RWE Dea**, **Shell**, **Statoil**, **Svenska**, **Talisman**, **Total** and **Wintershall**.

The companies were invited to nominate blocks on 14 October 2004. As in the 18th licensing round, each company could nominate up to 15 blocks to ensure focus on the blocks viewed the most interesting by the different companies.

The Ministry plans to announce the round before summer 2005. Awards may then take place in the first quarter of 2006.

UK. For the first time since 1998 the entire UK North Sea is open for oil and gas exploration with a record breaking 1,329 blocks on offer in the 23rd Offshore Oil and Gas Licensing Round.

More than 50 previously Fallow blocks will be on offer in this round that were not available in the previous round.

The Fallow initiative requires that once the primary term of a license has passed, the companies must have drilled wells, shot new seismic or had other significant activity to continue to hold acreage.

The government's recent innovations in licensing will again be available in this round with the new Frontier and Promote Licenses being offered alongside the more traditional type license.

Recognizing the particular challenges in the West of Shetland region, the Frontier license is only on offer in this area, while the Promote license is offered in areas excluding the West of Shetland. The Traditional license will apply to all regions.

Under the 'Frontier' and 'Promote' Licenses, the rental fee will be cut by 90% for the first two years compared to the rate for a Traditional Production License.

Denmark. The Danish Energy Authority invited oil companies to submit tenders by 1 November 2005 for the country's 6th Licensing Round.

The areas of the 6th Licensing Round include blocks in the Central Graben where the majority of the Danish fields have been found until now and partly in the areas further east where other oil discoveries have been made.

Although exploration activities have now been ongoing for almost 40 years, assessments made by the Danish Energy Authority show that the area holds considerable amounts of oil and gas still to be found.

As in previous rounds the government will be a partner in the new licenses with a 20% share, leaving 80% for the oil companies. In the past licensing rounds, DONG (Danish Oil & Natural Gas) has been partner on behalf of the Danish State.

However, this role will now be handled by a new national unit, which will contribute to the exploration activities and have part in the proceeds when oil and gas is found.

In 2003 the Danish taxation regulations of oil/gas licenses were changed in order to ensure the government higher revenue from the North Sea.

When assessing the tenders in November the Danish Energy Authority will, among other things, consider the number of wells the oil companies plan to drill in order to locate oil and gas in the Danish sector.