Diamond president: Overbuilding years away

By Linda Hsieh, Associate Editor

IN THE RIG market, the possibility of overbuilding always looms in the background, said **Larry Dickerson**, president and chief operating officer of **Diamond Offshore**. "There isn't an exact number of newbuilds you can calculate to match exactly with demand, and markets frequently overbuild. However, in the current market, the fact that building continues and there's continued contracting for rigs to be built, I think that's a powerful signal that we haven't yet reached the overbuilding point," he said. "The No. 1 question that operators continue to ask is, 'When can I get a rig?' "

Larry Dickerson

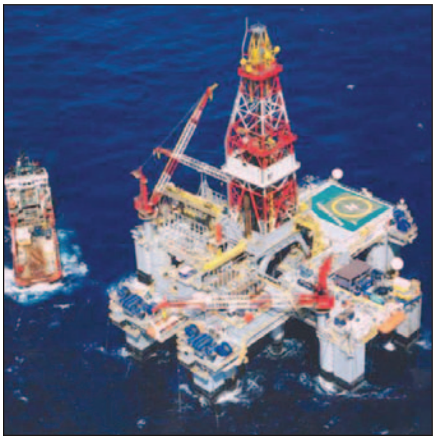
Diamond is currently building 2 new jackups, as well as upgrading a series of Victory-class semisubmersibles.

The KFELS MOD V B-Class jackups, to be named the Ocean Scepter and the Ocean Shield, will be capable of drilling in water depths up to 350 ft. Estimated delivery price for each rig is approximately $150 million, and both are scheduled for delivery in the first quarter of 2008.

Diamond also has two 5th-generation semis being upgraded by **Keppel FELS** – the Ocean Endeavor and the Ocean Monarch. The rigs are designed for water depths up to 10,000 ft upon completion of the upgrades. The latest-announced upgrade, for the Ocean Monarch, is expected to be completed in the fourth quarter of 2008.

"There's some capacity constraint on the number of rigs that can be delivered, and there's very long lead times for equipment. So I don't think we'll even be able to reach the point of overbuilding for several years," Mr Dickerson said. "The new rigs will be coming out in small increments per year, and I think the market will be able to absorb that."

With the current situation of commodity prices, it's no wonder operators are putting the extra push on production, Mr Dickerson said, "but as we get more rigs out there, I think we can help step up exploration."



Diamond Offshore's deepwater semisubmersible Ocean Baroness will begin a 3-year extension with Amerada Hess in November.

Even with such unprecedented growth, industry veterans who've been around are remembering to take each step with care.

"We've been through the ups and downs, so we've learned to stay a little cautious. We manage so there's a combination of term contracts on our existing fleet and of not overcommitting our financial resources," Mr Dickerson said.

A DIFFERENT SITUATION

Still, despite what experience teaches you, previous boom-and-bust cycles can't be accurate predictors of this cycle, he said, because things are different now than in 1979-81 and 1996-99. "Those 2 previous up-cycles fell apart when product prices came undone. That's what killed the rig market. And now, it's very difficult to see how oil and gas prices are going to move down in the face of high demand bolstered by the industrialization of countries like China and India.

"Additionally, despite all our efforts, it's very difficult now to bring forth huge amounts of additional supplies of oil. In the '80s and '90s, there was a perception that oil was in short supply, but it didn't take very much effort to suddenly bring in significant supply. Now, however, there doesn't appear to be major projects on the horizon that will swamp the market with oil, so demand and supply is staying very finely balanced."

There's certainly an increase in the number and length of long-term contracts, especially in deepwater. Operators' concern about rig availability, Mr Dickerson said, is now stretching out terms even for jackups. "Jackups used to be primarily well to well, and although a healthy portion of it still is, now we're seeing jackups reaching out for 1-year or 2-year contracts," he said.

With operators seeking access to rigs everywhere in the world, it's no wonder rig markets have been climbing so steadily for the past 2 years.

"You keep thinking, 'This is as far as it can go,' or 'They need to stop and rest for a while,' but rates just keep going up," he commented.

An interesting phenomenon he's observed is rate convergence in the deepwater market. "The 5th-generations have established a price band, and the 4th-generations are very close to that. Now, we're seeing 2nd- and 3rd-generation rigs approaching that band. There's not the amount of separation you might have guessed," Mr Dickerson said. "As the newer units get committed and out of circulation, some customers are left with the older 2nd- and 3rd-generation units. But the price of oil is so strong that virtually all of their prospects have the ability to make money."

In the US Gulf of Mexico, he pointed out, there may be room for more rate increases because of last year's hurricanes.

Insurance coverage is undergoing drastic change in the region. Premiums increasing, and higher deductibles and limits on the amount of damages that underwriters will pay out mean drilling contractors are retaining more risks, he said. Dayrates should increase to reflect higher risk in the Gulf of Mexico, otherwise rigs may continue to move out of the Gulf of Mexico to other markets.

Of course, Diamond is taking measure to prevent rig damage in future hurricanes. "Diamond plans to have additional mooring lines deployed by the middle of this summer, in advance of the heavy part of the hurricane season, for all of our moored rigs in the Gulf of Mexico, so I feel comfortable that we're doing all that we can in preparation for this year's storms," Mr Dickerson said.