

GSF Senior VP: Market in balance — so far

By Linda Hsieh, Associate Editor

THE LAST TIME GlobalSantaFe took a hard look at the newbuild statistics, about 42 to 44 jackups were under construction. With those numbers, said **Roger Hunt**, senior vice president of marketing for GlobalSantaFe, you need a 5% increase in demand in 2007, a 3.5% increase in 2008 and a 1% increase in 2009 to keep utilization of the total fleet at about 96%.

“These are relatively nominal increases in demand. When 40-something jackups were being built, we were fairly confident that the visible demand we saw would consume the published capacity additions,” he said.

The story’s a bit different now, he noted, with at least 57 new jackups under construction. “That’s about another 20% increase in capacity.”



Roger Hunt

While 57 newbuild jackups – representing a 30% increase in units capable of drilling in water depths of 300 ft or greater – is a significant increase, it’s not as significant as the capacity additions to the deepwater fleet, according to Mr Hunt. Twenty-seven newbuilds have been announced for ultra-deepwater, he said, which translates into an 84% increase from the previous ultra-deepwater fleet, defined as those capable of drilling in at least 7,500 ft.

Yet, he continued, it appears that the market has – so far – stayed in “relative balance.”

DEMOGRAPHICS, DEMAND

There are 2 sides to consider when looking at the newbuilds, Mr Hunt said:

- demographics of ownership – who’s building them; and
- demand – how many long-term contracts exist against the rigs.

“On the jackup side, I know of only 2 out of 57 being ordered against a customer’s contract. If you look at the ones that have



GlobalSantaFe’s semisubmersible GSF Celtic Sea is currently operating in the Gulf of Mexico on a dayrate in the low \$100s. It will go through 4 weeks of upgrades this summer and already has 2 contracts lined up: a 4-month term in the mid-\$170s followed by a 1-year term in the mid-\$320s.

won contracts before delivery, that number probably only goes up to 10,” Mr Hunt said. “On the floater side, I think 11 of 27 currently have contracts, which means two-thirds are on spec.”

On the demographics side, more than half – about 72% – are being built for what are considered new entrants into the market, he said.

With such significant jumps in the newbuild number, he said, it’s become a question mark whether there’s enough visible demand to keep rigs fully employed into and beyond 2009. “However, we’re still seeing customers interested in long-term contracts, especially for deepwater,” he said.

7-YEAR AGREEMENT

On 2 March, GlobalSantaFe announced it had entered into a letter of intent to provide a new ultra-deepwater semisubmersible under a 7-year agreement valued at approximately \$1 billion.

The rig, to be named the GSF Development Driller III, will be built by **Keppel FELS** in Singapore and is scheduled for delivery in early 2009. Approximate cost is \$590 million.

“Recently announced contracts such as ours indicate that there’s still strong demand for ultra-deepwater rigs. If our customers were fully confident that they could wait for the capacity additions and still have access to them, why would they

book a newbuild now?" Mr Hunt said. "They would wait until closer to delivery, with the view that there's going to be an oversupply and hence the dayrates will be lower. But we haven't seen that yet."

GlobalSantaFe's 3 ultra-deepwater drillships are each already backed up to at least 2009, and some semis are committed out to 2010.

"That's all evidence that there's uncertainty among the customer base, that they still prefer to book now even though the dayrates are relatively high," he said. "This is a good sign, but of course, it's tough to tell what's actually going to unfold once all the newbuilds come onto the market, because, like I said, 60% of the floaters and 85% of the jackups are uncontracted."

AN INDUSTRY FIRST

The Development Driller III is currently the only new rig that GlobalSantaFe is building. Its 7-year agreement is the longest-term initial rig contract that the industry has seen. "As far as we can tell, it's a first," Mr Hunt said.

The operator, who remains unnamed, clearly has a preference for doing business with its preferred contractors, he said.

"The stakes are so high in deepwater projects, I think the operators are going to stay with contractors they have experience with," he noted. "The is good news for the established drilling contracting companies. But for the new entrants who are now building rigs on spec, it's going to be difficult for them to establish their credentials."

DELIVERY DELAYS

Despite what the numbers say in terms of published newbuilds and delivery schedules, Mr Hunt said, he does not believe all deliveries will be made on-time as promised.

"There are very few manufacturers of the equipment we all need, and they are going to have a tough time meeting their commitments," he said. "Then there's the commissioning of the rigs, which is extremely complex. I think people have grossly underestimated what it takes to actually commission a rig and prove that it's capable prior to commencement of operations, and that's going to add more time. So I really don't think there will be as many new rigs added in 2008 and '09 as being published," he said. "On one

hand, this is bad news for contractors waiting for their rigs, but on the other, it will take some pressure off of the rate of additions."

Looking more to the near term, Mr Hunt said, visible demand isn't causing any concern. If you compare the capacity additions with the rate of demand increases and the level of planning and commitment that operators have shown, the market is still in balance.

Mr Hunt also noted that the macro situation of the current up-cycle is fundamentally stronger than it's been in previous cycles, meaning demand is robust and predictable. "Looks like this one will be longer and stronger than the others," he said.

RIG DESIGNS

Although Mr Hunt said he hasn't seen much change in jackup design, other than marginal increases in capacity, in more than a decade, it is possible that success in the ultra-deep gas plays in the Gulf of Mexico could stimulate jackup upgrades to accommodate casing strings and to increase hoisting capacity to about 2.5 million pounds.

On the floater side, Mr Hunt said, more than a third of the newbuilds are being advertised as dual-activity floaters, which have 2 principal hoists on the rig. "That might be noted as a response to the needs of ultra-deepwater operations, where time is critically important," he said. "We also are going into slightly deeper waters with these rigs, with most of the newbuilds capable of drilling in 10,000 ft to 12,000 ft of water."

PRICE CEILING

Although current dayrates are significantly higher than they were a year ago, Mr Hunt said, he doesn't see rates going considerably higher in the near term.

"People are already pricing these new ultra-deepwater rigs being built, with 11 of the 27 already having contracts. The pricing on the capital cost of the rigs and the dayrates will likely set a ceiling on the pricing of existing rigs," he said.

There are signs that there may be more room for increases on the jackup side, however. "Recent fixtures on 300 ft jackups internationally have been in the range of \$175,000 to \$200,000. Speculative builders are asking for more than \$200 million per rig. To get a return greater than the cost of capital, you

would probably need a starting dayrate of at least \$200,000," he said.

In terms of operator response to the kind of dayrate increases the industry's seeing, Mr Hunt said he hasn't seen prices drive any operators away.

"In this kind of commodity price environment, they are going ahead with commitments. Multiple long-term contracts on the construction of deepwater rigs have been made at today's pricing. Even for jackups, there's been long-term commitments in the Mediterranean, Saudi Arabia, the North Sea and Southeast Asia. Customers are booking well into 2007 and beyond," he said.

Mr Hunt does question whether rates in the Gulf of Mexico will hold. Since it's a gas market with short-term commitments and short turnaround on well development, there may be more sensitivity to commodity prices, he said.

CONTROLLING QUALITY

Looking into the future, Mr Hunt cited equipment manufacturing and delivery and quality control as upcoming challenges for the industry. "When you have this kind of boom in construction and manufacturing, quality will suffer, which may lead to issues with commissioning. With all these new rigs coming onto the market, there are going to be some train wrecks," he said. "They're avoidable, but I'm not sure that the new entrants will know what to avoid."

Asked to give a piece of advice to his fellow drilling contractors to help the industry sustain the current boom, Mr Hunt replied, "Don't build."

He continued, "However, if you look closely, most of the speculative new construction is not by established contractors. There's not as much discipline among the speculative investors, and that's the scary part of our industry's cycle."

Even on the established contractors' side, Mr Hunt would like to see more discipline as far as newbuilds. "At a managers' meeting about this time last year when there were 23 rigs under construction, I put up a flyer that said, 'Oh dear Lord! Give me one more boom and I promise not to screw it up — again!' Here we are, a year later, with 84 new rigs under construction, and the world is quite different." ■