US Gulf experiencing a fully employed rig market

IT'S A DRILLING contractor's dream come true. Imagine an offshore market that is in balance in every region worldwide, and in some cases is even facing a shortage of rigs in some regions. Imagine a market where dayrates are approaching historical high levels and operators are still lining up to contract rigs.

That scenario is being played out in many offshore regions of the world, but the US Gulf of Mexico best falls under this scenario.

Once called the "Dead Sea", the region is experiencing increasing dayrates in a market where the only additional capacity is from long-stacked rigs or if a rig is mobilized from other areas. Both are occurring in the US Gulf.

The market is still well-to-well with a few term contracts creeping in. However, there is virtually no rig downtime between contracts, whether for an existing customer or a new operator.

Operators are generally keeping rigs longer, anyway, with drilling programs stretching beyond their initial multiple well contracts due in large part to historically high commodity prices.

Contractors are still faced with their usual challenges and issues such as finding good qualified personnel and being confronted with higher costs and longer lead times for equipment and expendables, but this just means they have to plan better.

Operators don't appear to mind waiting for a particular rig to drill their wells and they also haven't complained about increasingly high dayrates.

FULLY EMPLOYED RIG MARKET

The US Gulf rig market, both shelf units and deepwater rigs, is essentially fully employed. The only way additional capacity would be available is to reactivate some of the handful of cold-stacked rigs or mobilize rigs from other areas. Contractors are at least mobilizing units to the US Gulf to meet some of the demand.

There presently are no rigs immediately available in the US Gulf, and the only offshore drilling rigs available for reactivation are shallow water jackups owned by **TODCO**, which was spun off from **Transocean Inc** earlier as a separate shallow water drilling contractor.

Nabors Drilling has several cold-stacked small workover jackups. However, the company took one of its units, Pool 53, out of cold-stack mode earlier this year and the rig is presumably ready for work.

GlobalSantaFe's 300 ft water depth jackup Main Pass I is working for ChevronTexaco in the Gulf of Mexico. The region's jackup market is fully employed and is commanding dayrates in the $50,000 to $60,000 range. Contractors predict dayrates could reach $70,000 or higher for large jackups.

TODCO presently markets 13 of its 23 rigs, including 12 jackups and one submersible, and all are contracted.

However, TODCO said it has received inquiries about their cold-stacked rigs.

"We've had some inquiries for additional rigs," said **Scott O'Keefe**, CFO for TODCO. "We have basically the only excess capacity in the Gulf so we are going to wait until the customer comes to us and wants to reactivate them."

All 10 of its cold-stacked rigs could be reactivated for a total of approximately $45 million, according to Mr O'Keefe.

However, typically the cost will be lower on the first few reactivations and then increase for the last few rigs, which could cost as much as $8-$9 million each.

TODCO is seeking term contracts to support the reactivation costs, at least a six-month contract, but the company would prefer a year charter.

Other contractors have already mobilized some rigs to the US Gulf and several additional units are enroute. The latter category includes two newbuild semisubmersibles, **GlobalSantaFe's** Development Driller I and II steaming from Southeast Asia to the Gulf under their own power.

Both have long-term contracts, two years with **BHP Billiton** for the Development Driller I and three years for BP for the Development Driller II.

GlobalSantaFe also mobilized its jackup GSF Adriatic VII from Trinidad to the Gulf for a contract with ChevronTexaco. Additionally, the company is bringing its semisubmersible GSF Arctic I from Venezuela to the Gulf for a one-year contract with Spinnaker.

GlobalSantaFe is also mobilizing its drillship GSF Explorer from the US Gulf to the Black Sea off Turkey for BP. The rig will then return to the Gulf to continue work for BP under a contract that will carry it through at least the first quarter of 2007.

Diamond Offshore will mobilize its semisubmersible Ocean Baroness from Southeast Asia to the US Gulf for a one-year contract with Amerada Hess. However, the company doesn't expect a lot of rigs moving to different areas.

"Some rebalancing of the GOM is to be expected given the tight market," said **Les Van Dyke**, Director, Investor Relations for Diamond Offshore Drilling, "but I would be surprised to see a major reshuffling of the deck.

"Diamond Offshore has the Ocean New Era, a cold-stacked mid-water unit that could possibly be reactivated this year if pulled out by market demand," he said.

"Other than that rig, there is very little idle semisubmersible equipment in the GOM that could enter the market."

STRONG JACKUP MARKET

"The Gulf of Mexico is now about a 94-95 jackup rig market," said **Roger Hunt**, Senior Vice President or Marketing for GlobalSantaFe.

"Our view is that it appears to be at the level at which the market has settled and for all intents and purposes it is a fully employed market.

"There is no spare capacity in the 250 ft and deeper cantilever rigs," he continued.

Mr Hunt expects to see more of the same for jackups, noting that high commodity prices have obviously been very good for the contract drilling industry and that he doesn't see any sign of weakness in the market.

"The thing that is different this time than in previous times is that the commodity prices are much higher so the economics to the customer are much better," TODCO's Mr O'Keefe said.

"As long as commodity prices stay at the current level I think we will continue to see tight demand, and if demand stays tight, dayrates will continue to rise."

"In our view, this market has more legs than prior markets like latter half of the 1990s and then in 2001," said **Richard LeBlanc**, Vice President, Investor Relations for **ENSCO International**.

"We think for a number of reasons that this market has further to go," Mr LeBlanc continued.

"It is always difficult to predict how far that is, but it is looking very strong to us now."

DEEP GAS EXPLORATION

A lot of interest has been focused on deep and ultra-deep gas plays in shallow water in recent months as three deep gas wells are presently being drilled with several additional wells to perhaps be drilled in the future.

The wells the industry is focusing on presently are the Blackbeard prospect by **ExxonMobil** and **ChevronTexaco's** Cadillac prospect.

TODCO's jackup THE 203 is one of the contractor's 12 jackups in the shallow water Gulf. Activity and dayrates for this class of rig have increased along with other classes of jackups. TODCO's average fleet dayrate is around $44,000 today compared with approximately $27,600 a year ago.

The Blackbeard well is being drilled by **Rowan Drilling's** first Tarzan Class jackup, Scooter Yeargain in about 70 ft of water.

The well was spud 16 February and could take nearly a year to drill to its permitted 32,000 ft.

However, according to Rowan, the well could go well beyond that depth, to as deep as 38,000 ft depending upon results.

Rowan's second Tarzan Class rig, the Bob Keller, will begin a contract with McMoRan when it is delivered this September for an ultra-deep well, approximately 26,000 ft, according to **Bill Provine**, Vice President, Investor Relations for Rowan Companies.

Additionally, Rowan is drilling the Joseph well for Shell with its Gorilla Class rig, the Bob Palmer. This rig, rated to drill in up to 550 ft of water, is working in 33 ft of water for this particular well.

Diamond Offshore is drilling the Cadillac prospect for ChevronTexaco, a 25,000 ft test in 122 ft of water.

More operators have expressed interest in deep and ultra-deep wells, according to Mr Provine, including BP, BHP, El Paso, and McMoRan, which has already contracted the Bob Keller for a deep test, as mentioned above.

Most of the Gulf of Mexico gas production is from the upper Miocene formation, Mr Provine noted. The deep and ultra-deep tests are aimed at the lower Miocene, between 22,000 and 25,000 ft deep.

TIGHT FLOATER MARKET

"The (Gulf) deepwater market is fully employed and there will be a shortage of capacity through 2006," GlobalSantaFe's Mr Hunt prognosticated. "It really is a worldwide market, you can't just talk about the Gulf of Mexico."

The deepwater market comprises two types of work. The ultra-deepwater market (7,500 ft and deeper) is driven by large development projects discovered five years ago that have since been in the planning cycle.

These are the projects that attract long-term contracts for rigs like GlobalSantaFe's two new semisubmersibles Development Driller I and II, with two and three-year term contracts.

"I think the three-year contracts we have seen recently are probably going to be the longest," Mr Hunt noted. "No one has stepped up like the last boom and offered five-year contracts."

Mr Hunt noted that the only way a long-term contract would evolve is if the current capacity squeeze would frighten a customer or two who didn't want to risk not having a rig for its drilling programs.

If an operator did sign a long-term contract beyond two or three years, it would probably try to get the dayrate on some form of index so the rate could be adjusted to the market.

Much of the deepwater equipment is contracted out 6-9 months, according to Mr Van Dyke. “As operators contract into 2006 you may begin to see more 9-12 month fixtures, with a few longer-term agreements,” he said.

“The operators are going to contract to fit their program, and they are not likely to commit themselves beyond the block of work that they can see.

“Roughly 25 floaters are currently working in the GOM, with a handful on the sidelines,” Mr Van Dyke noted.

“We have the Ocean New Era that the market may potentially pull out sometime this year, but other than that, there are only a couple of cold-stacked semisubmersibles in the GOM that could enter the market.

“The market is extremely tight for rigs right now,” he concluded.

The mid-water and deepwater floaters as well as the ultra-deepwater rigs have been the strongest in the present rally, according to Mr Van Dyke.

The 4th generation rigs have moved with less momentum but are gaining ground.

JACKUP TERMS STILL SHORT

Despite an essentially fully employed rig market, the US Gulf jackup market is also still essentially a short-term or well-to-well market, although there have been a smattering of term contracts.

“It is still a short-cycle, high turnover market but operators that have the rigs tend to keep them longer, so there is less turnover between customer to customer,” said Mr Hunt with GlobalSantaFe.

He has seen a few term contracts creep into the market, some six and 12-month charters, but he doesn’t think that will continue strongly even as dayrates continue to move up.

However, Mr Hunt said the question of term contracts is a portfolio management philosophy as far as GlobalSantaFe is concerned, and probably other large contractors as well.

Any time dayrates approach historical highs, one has to ask if there is an opportunity to lock in that rate for a longer period. If the company has a large asset base, why not put a few rigs long because the company also has a lot of rigs to go short.

“I think you will see some contractors go long in this kind of a market just as they would at any time,” Mr Hunt explained, “but that’s a function of the operator.”

“The Gulf will probably always be a short-term market,” ENSCO International’s Mr LeBlanc said.

“There are cases where an operator may be drilling a deeper well or have a series of wells to drill and they want to make sure they have the equipment available to do the work.

“I don’t think the nature of drilling in the Gulf has changed in that most of it is still short-term contracts, but with the rig supply more limited now there is more concern about rig availability.

TODCO, which operates jackups and inland drill barges in the Gulf, and essentially controls all of the overhang of cold-stacked drilling jackups, said it has received some term inquiries.

“We have had some inquiries for term

work," O'Keefe with TODCO said, 'but we're not really willing to enter into a term contract without getting a little bit of premium because (dayrates) continue to rise.

"We are waiting for the scarcity psychology to filter through the market and sooner or later operators will say they better lock up a rig or I'm not going to have one," Mr O'Keefe continued."I think that will happen if the market continues the way it is."

don't think we will see a lot of term in the Gulf."

RECORD DAYRATES?

The US Gulf jackup and floater markets are experiencing close to record dayrates as a result of the extremely tight market.

Other regions of the world are experiencing similar high rates that are close to record levels. Virtually every Gulf of Mexico contractor believes there is still

Rowan Drilling's Scooter Yeargain is drilling an ultra-deep well for ExxonMobil on the Blackbeard prospect. The well is permitted to 32,000 ft but could be drilled to as deep as 38,000 ft depending upon the results. Additional wells on the prospect may follow. Several other operators are planning deep and ultra-deep wells in the US Gulf of Mexico.

Mr Van Dyke has another view of term contracts. "Historically, shorter term is much more the norm," he said.

"Operators generally prefer to match the term of the contract to the work program, and they are going to be reluctant to get into the ultra long-term agreements of the late 1990s that left them with equipment to sublet in a down market.

"However," he continued, "historically in periods of tight rig supply, high demand and rising rates, operators migrate toward longer term agreements to assure their work programs and lock in price.

"We would like to see some additional backlog on our jackups as well, but I

room for additional growth in rates.

TODCO says that its current average rate for its 12 jackups and one submersible that are marketed and working is about $44,000. That compares to an average of approximately $27,600 just a year ago. "I think we could easily see those rigs go to $60,000," Mr O'Keefe said.

ENSCO International's Gulf of Mexico jackups are also experiencing high rates. The company said its 250 ft units are now paid rates in the low to mid-$50,000. That compares with rates in the low $30,000s a year ago.

The larger rigs, the 350-400 ft jackups, are "comfortably in the $70,000s," said Mr Le Blanc with ENSCO International.

Mr Van Dyke with Diamond Offshore agrees. "We have a couple of 350 ft rigs that are moving toward the $70,000 mark on their dayrates," he noted.

Those rigs are in the $50,000 area presently but will move to around $70,000 with new contracts that become effective at mid-year.

He also said the company has 200 ft mat-supported jackups that are receiving dayrates in the low to mid-$40,000s, confirming the rates that TODCO is experiencing.

GlobalSantaFe's Adriatic VII, which is moving from Trinidad to the Gulf for a contract with ChevronTexaco, will be paid $70,000 daily during its initial 90-day contract.

Rowan Drilling's Gorilla IV jackup will be receiving $100,000 per day when it begins its contract with W&T Offshore, the first jackup to receive that rate in the Gulf of Mexico.

The rig will be drilling over the Mahogany platform and requires a long cantilever reach to drill the wells to approximately 20,000 ft.

Floaters are receiving correspondingly high dayrates, with some commanding rates nearly twice as high as they were receiving under previous contracts in other areas.

For example, GlobalSantaFe's GSF Arctic I, which is mobilizing from Venezuela, will receive more than $160,000 per day, according to Mr Hunt. The rig was paid $80,000 while it was working offshore Venezuela.

The contractor's two new semisubmersibles, Development Driller I and II, will both be receiving around $200,000 per day. The Development Driller I, contracted to BP for three years, will receive a rate of $210,000 while the Development Driller II, contracted to BHP Billiton for three years, will be paid $185,000.

Both units likely could have received higher rates depending upon the timing of the contract signings. The contract with BP was signed about 18 months ago while the contract with BHP Billiton was signed last August.

The rate for the BHP contract was an industry high at the time, according to Mr Hunt, but he noted that it was just a matter of weeks if not days when the rates began to move up.