

DRILLING AHEAD

Two trends may brighten drilling

John Kennedy, Contributing Editor

LET'S FACE REALITY. Oil and gas are commodities. Their prices will always—always—be volatile.

And when we wish for stability, we must be careful how we phrase that wish. Few producers or drilling contractors would like to see oil prices stabilize at, say, \$11/bbl for West Texas Intermediate.

The drilling business is highly vulnerable to this market volatility. But two trends could have a dampening effect on the wild swings of the oil and gas drilling market.

First, mergers among giant operators will put undrilled prospects into the hands of companies that are more likely to drill them.

Second, meeting expected demand for natural gas in North America will require stepped up drilling over an extended period of time.

Together, these trends may promise a longer-term future for drilling contractors that may be much brighter than that of the past decade.

A SLOW UPHILL CLIMB

Oil company spending—in particular, spending on drilling—did not shoot up like the price of crude over the past 12 months. There were several likely reasons for this disconnect between oil price and spending in this latest cycle, including:

- Caution borne of a memory that it was less than three years from the previous peak down to \$11/bbl crude;
- The burden of sorting out mergers between huge organizations;
- And the steady march of exploratory success and recovery improvement from new technology that allows operators to get more from fewer wells.

The good news for the short term is that the purse strings continue slowly to loosen.

Outlook for the medium and longer term is especially bright for the drilling industry. Properties coming on the market as a

result of mega mergers, coupled with robust demand for natural gas—particularly for electricity generation—promise to bring a little more stability to the drilling market.

Not complete stability, but *a little more* stability.

LARGE PROSPECT INVENTORY

Think about this for a moment: 8 of the largest oil companies in the world have recently been involved in mergers that resulted in only 3 new companies.

Putting aside for the moment a host of other mergers and acquisitions, consider only the companies included in this top-tier consolidation: **Exxon, Mobil, BP, Amoco, Arco, Elf, Total, and Fina.**

Leaders of the new companies formed by these giants faced two key challenges: Finding out what assets the new company has; and determining who will make decisions.

When decision-making is slow, spending is slow.

Even for a large team, it takes time to inventory and evaluate the drillable prospects one of these new companies has.

Once assets are evaluated, many of them will not fit the strategy of the new company and must be disposed of, particularly those that have been in inventory for some time.

These huge new companies must streamline their organizations and focus their resources if they are to realize the expected financial payoff of the merger.

Exxon Mobil couldn't possibly—and shouldn't even if it could—drill all the prospects in the combined portfolio of the two companies.

That's where the good news for other operators and drillers comes in. Many prospects that might have never been drilled when part of a very large inventory will be acquired by small or medium size companies and drilled.

It's still early in this process, but the pace



CAPITAL WIRELINES

Position of IADC with respect to new UK drilling contractors' organization is clarified

Brian T Petty, Senior Vice President-Government Affairs

NORTH SEA UNION RECOGNITION (London)—In response to pressure created by the UK Government's "Fairness at Work" White Paper, a group of drilling contractors operating on the UK shelf has organized itself as the UK Drilling Contractors Association to enter into a union recognition agreement with the **Amalgamated Engineering and Electrical Union**. IADC has no relationship with UKDCA, and did not encourage its formation. To set the record clear on that point, IADC Director - European Offshore Affairs **Dennis Krahn** wrote the following letter to the press which had reported the facts of the UKDCA/AEEU arrangement:

"On Saturday, 10 June 2000, you reported announcement of a recognition agreement between AEEU and a new body called the UK Drilling Contractors Association (UKDCA). Parts of the article are incorrect to which we would like to draw your attention.

"First of all, a clarification. Since 1940, the International Association of Drilling Contractors (IADC) has been a voluntary oil industry trade association headquartered in Houston. It is recognized as the premier organization representing drilling contractors throughout the world. The local arm is the North Sea Chapter, in existence since 1974.

"Your article incorrectly stated that 'It [UKDCA] is an offshoot of the International Association of Drilling Contractors...'. The UKDCA has neither a relationship with IADC, nor with IADC North Sea Chapter.

"IADC has no relationship with UKDCA, and did not encourage its formation. ... (However) We will continue to extensively contribute to HSE and DTI consultative documents concerned with making laws and statutes that govern our industry."

"Your article incorrectly suggests that the IADC or North Sea Chapter instigated UKDCA. While any responsible trade association would want to discuss the effect of the Fairness at Work White Paper and the follow on Employment Relations Act, IADC made it clear that there were limits to the discussions. If members chose to make collective bargaining arrangements, neither IADC nor the North Sea Chapter could participate. Members scrupulously heeded this advice.

"You correctly state that '... the IADC's constitution did not allow it to deal with elements of the Government's Fairness at Work White Paper'. IADC's Delaware charter, carefully constructed with respect to US Federal statutes governing trade association activities, prevents it from entering into collective bargaining arrangements for its members.

"In referring to '... the old IADC...', your article incorrectly implies that part of the IADC has become outmoded or has ceased to exist. On the contrary, we remain robust and will continue to respond to drilling contractors' needs on a wide variety of matters, including safety, training, standard contracts, drilling practices, environmental issues, and above all, engaging with Her Majesty's Government on behalf of drilling contractors in the UK. We will continue to extensively contribute to HSE and DTI consultative documents concerned with making laws and statutes that govern our industry.

"Notwithstanding our position, we respect and wish well to those drilling contractors who have entered into the recognition agreement." ■

will accelerate. By the time the realignment is complete, a very large number of properties and prospects will have changed hands.

The result will be a significant net addition to the future demand for oil and gas drilling.

NOT JUST FOR WINTER

US operators are currently heavily biased towards natural gas exploration and development.

For May, **Baker Hughes** reported 645 rigs out of a total of 844 operating in the US were drilling for gas. That 75% is almost flat with the ratio a year earlier, despite a 50% increase in crude prices over the period.

That ratio shows the high expectations for future gas markets.

Much of that optimism comes from the expected growth in demand for natural gas fired power generation plants.

That demand promises to make natural gas a year-round fuel, with a heavy demand for summer cooling as well as winter heating.

This summer will be instructive because of the already low level of gas storage. If growing cooling demand prevents storage buildup for the winter heating season, the market could be very tight.

And over the next 10 years, some forecasters see US natural gas demand growing from 22 tcf to 30 tcf.

The US has the natural gas resource base, but meeting that demand will take a lot of drilling over an extended period of time.

Indeed, there is some question whether industry can find enough good rigs and qualified people to do the job. Finding people may be much tougher than adding hardware.

Elsewhere in the world natural gas is also a preferred fuel. Though gas markets are still more regional than crude markets, the healthy growth in demand in the coming decade won't be limited to the US.

ONE MORE THING

New prospects available from the merged giants and robust demand for natural gas are good news for drilling contractors, both onshore and offshore in the medium term.

But energy markets will never be stable. Spending will continue to fluctuate. Drilling cycles will not disappear.

And oh yes, one more thing.

Competition will get even tougher. ■