2001 off to good start for N American land drillers

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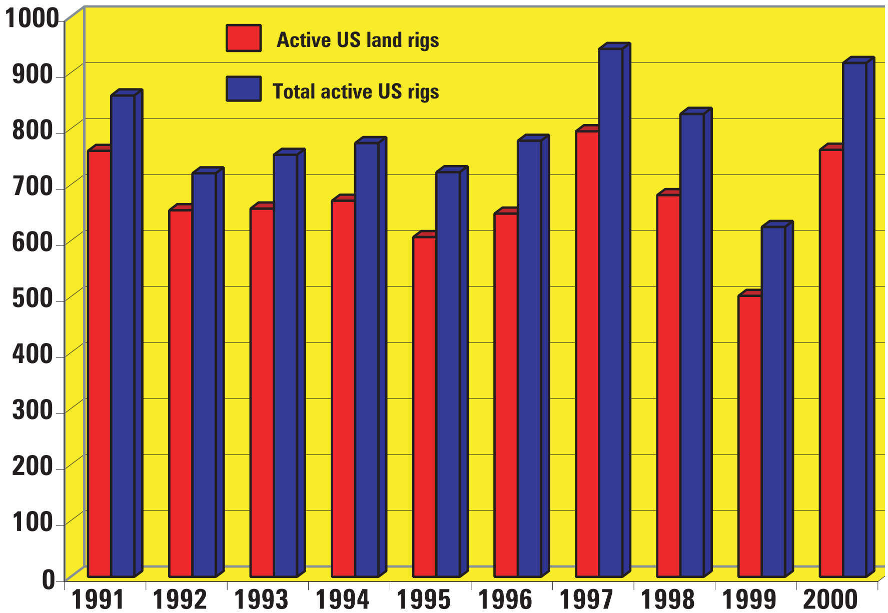
EVIDENCE OF THE STRENGTH of the land drilling market is seen in improved utilization rates, better financial performance by drilling companies and strong demand for new rigs.

There is considerable evidence that this strength will continue through 2001. But as always, oil and gas supply/demand balances are the keys.

Figure 1: US active land rigs and total active rigs



Source: Baker Hughes

With 2001 getting off to a strong start, US land drilling contractors can expect more work as demand for energy—particularly natural gas—continues to increase. And for the near term, they can expect higher rig rates.

Oil and gas prices will moderate, maybe even decline sharply from 2000 levels. But at least for the next 2 years, forecasters—including the **US Energy Information Administration**—expect natural gas prices to remain well above the average projected long-term price.

And the California power crisis of late 2000 and early 2001 has given consumers and politicians a large dose of market reality: When energy demand exceeds supply, higher prices are the inevitable result.

US land drilling contractors have an opportunity to play a large role in meeting the growing demand for energy.

But that opportunity won't be without its market, financial, technical and human challenges.

A STRONG BEGINNING

With a number of new land rigs coming into the fleet and an average 19% increase in E&P spending planned by a broad range of majors and independents, how much will drilling activity increase this year?

Or will it increase?

The answers to those questions, of course, lie in how much operators actually spend—not *plan* to spend—on drilling. Spending depends on the future price of oil and gas. And predicting oil and gas prices over a period even as short as 1 year has proven to be extremely difficult.

As the year began, projections of the average US rig count (onshore and offshore) for 2001 included both modest increases over last year's **Baker Hughes** average of 918 and aggressive forecasts of much greater increases.

If spending plans are implemented—which may happen if oil and gas prices remain in the neighborhood of $25/bbl for WTI and $3.50/Mcf—the increase in the rig count average will fall somewhere in the middle of those forecasts.

A 19% increase in E&P spending will not mean a 19% increase in the average rig count, much less a 25% increase. But that increase in spending will mean significantly more than a single digit increase in the rig count.

And the year did start in a big way. The US rig count averaged 1,182 rigs in January and Canada's January count was 539, according to Baker Hughes statistics.

LAND RIG MARKET

Land drilling activity in the US and Canada last year was at the highest level since 1997. Except for 1997—activity was only slightly higher that year in both the US and Canada than in 2000—the year just past was the best in a decade.

The average number of active land rigs in the US jumped by 52% last year over 1999 as total rig activity in the US climbed 46%. Canadian drilling activity jumped by 42% in 2000. Based on the Baker Hughes rig count, the average number of active land rigs in the US was 763 in 2000, up from 502 in 1999. The total of onshore and offshore active rigs averaged 918 last year, up from 625 the year before.

The percentage increases are impressive. But it's important to remember that the increases in 2000 were from a record low level.

Throughout the late 1990s, land rigs accounted for 80-84% of total active US rigs. In the early part of the decade, when offshore activity was in a slump, that share climbed to near 90%.

This year will see continued increases in land drilling, according to most projections. But much depends on what happens to oil and gas prices. It's likely that prices will decline. The key questions are: how much, and what effect will the decline have on drilling activity.

In the **Lehman Brothers** Original E&P

Spending Survey released in December, independents and majors together planned to spend an average of 19% more on E&P in the US than in 2000. Those expectations are based on an average oil price expectation of about $25/bbl for WTI and $3.75/Mcf for natural gas.

Now that 2001 is underway, that oil price could prove to be an optimistic view; the gas price could turn out to be conservative.

On balance, though, strong gas prices could mean increased spending and drilling because of the continued emphasis on natural gas development. Drilling for natural gas continues to involve roughly three fourths of active rigs in the US.

An example of the strength of the land drilling market in the months just past is shown by financial and operating results reported by **Grey Wolf Inc**.

In early February, it reported that demand for its land drilling services increased 41% for the fourth quarter of 2000 compared with a year earlier. Grey Wolf had 83 rigs working in the quarter compared with 59 during the fourth quarter of 1999. Average daywork revenue per rig increased by 40% to $9,900 for the last quarter of 2000, reported Grey Wolf.

"We experienced higher daily margins reflecting the benefit of a premium rig fleet with a deep-drilling bias," said **Tom Richards**, Chairman, President and CEO. "Current bid rates are between $11,500 and $14,500 per day without fuel or a top drive."

Grey Wolf reported in early February that it had signed 13 term contracts ranging in length from 6 months to 2 years.

The contracts are expected to generate a total revenue of $72 million, including $3.2 million in 2000.

Grey Wolf's reactivation of 4 rigs is expected to be complete in the first quarter, bringing the total marketable fleet to 94 rigs.

The company expects to reactivate between 8-12 rigs in 2001, depending on demand.

Each of the company's rigs can be brought into service for a capital investment of $1.5-4.5 million, including tubulars, depending upon upgrades.

CANADA STRONG, TOO

Drilling activity in Canada surged last year, and a further increase is expected in 2000, according to projections by the Canadian Association of Oilwell Drilling Contractors.

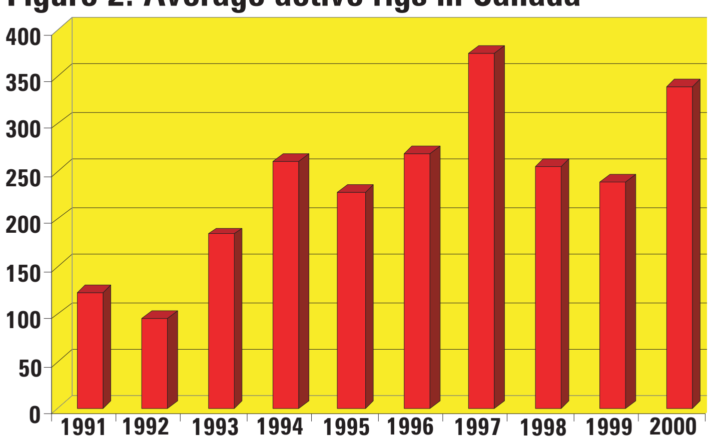
After a recent peak in 1997 when an average of 419 active rigs brought the utilization rate to 82%, utilization rate slumped in 1998-1999 to around the 50% level.

Utilization rebounded to 64% in 2000 and CAODC projects a further increase this year to 73%.

Average active rigs dropped to 272 in 1999, but returned to 382 last year. The CAODC forecast for 2001 is an average active rig count of 461. Its assumptions for this forecast include the drilling of 18,542 wells that require an average of 7.9 days/well.

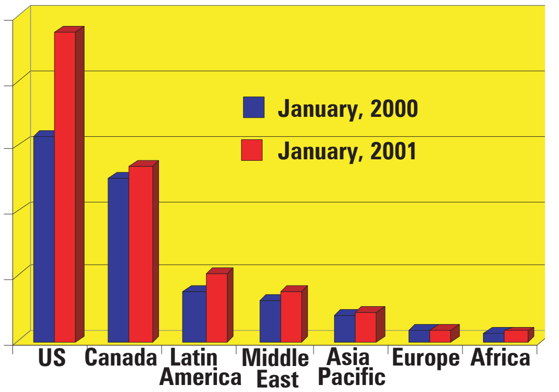
Price for WTI is assumed to average US$27.50/bbl; gas is assumed to average Cdn$5.50/Mcf.

Figure 2: Average active rigs in Canada



Source: Baker Hughes

Figure 3: Land rigs operating*



*US is at end of January; others are average for month.
Source: Baker Hughes

Those prices are higher than the US$25/bbl and Cdn$3.75 used to make the 2000 projection.

Anadarko Petroleum Corp's plans support the strong outlook for Canadian land drilling.

It plans to spend US$260 million this year through **Anadarko Canada Corp** to drill 600 wells in Western Canada.

Primary focus will be in its major operating areas in Alberta, British Columbia and Saskatchewan "where we plan to apply new advances in exploration and drilling technologies," said Mr Emme.

In the coming months, Anadarko's Canadian activity is expected to peak at 14 active rigs, 10 of which will be in Northeast British Columbia.

In 2001-2002, this is expected to increase to 22 rigs.

Anadarko has budgeted a total of $830 million for exploration in 2001; 90% will be spent in North America.

About $300 million is allocated for onshore exploration in the Lower 48.

OUTSIDE NORTH AMERICA

Most of the land drilling rigs in the world operate in the US and Canada. At the beginning of the year, those two countries accounted for three fourths of the world's total of active land rigs.

Still, an average of 511 land units were at work in January of this year outside the US and Canada, according to Baker Hughes rig statistics. And that was up a healthy 100 rigs—25%—compared with a year earlier.

Almost all regions showed at least a

modest increase in land drilling activity year to year. Latin America is the most active land drilling region, averaging 208 rigs during January, up from 150 a year earlier. And 150 rigs were operating in the Middle East region in January up from 123 in January 2000. Europe, Africa and the Asia Pacific region were up slightly year to year, but each had less than 100 rigs operating.

NEW CONSTRUCTION

Signs of strength in the land rig market, particularly the US land rig market, include a strong order book for new rigs.

National Oilwell, after consolidating a number of rig and well service unit manufacturers, now accounts for the lion's share of rig building capacity in the US. It reports its backlog for rigs and rig components climbed from $180 million at the end of September, 2000 to more than $250 million at the end of the year.

Helmerich & Payne is one of the leading customers for new rigs. It is building 12 new 1,500 hp land rigs to be delivered at a rate of 2 rigs per quarter over several quarters.

H&P also recently returned a rig from Venezuela and planned to ship 3 rigs from Colombia to the US. With these additions, H&P's US land rig fleet will total 46 by the middle of April and reach 52 by the end of this year.

The company's US land rig utilization increased from 75% during last year's first quarter to 93% during the first quarter of this year.

DRILL PIPE DEMAND

Grant Prideco recently reported a continuing improvement in market conditions and increased demand for its drilling products, including drill pipe.

"Sales of engineered connections and premium tubular products were strong for the year and that trend is expected to continue," said Grant Prideco in reporting financial results for fourth quarter 2000.

The company's sales of oilfield drill pipe during fourth quarter 2000 reached about 1.9 million ft, compared with 775,000 ft in the fourth quarter of 1999 and 1.2 million ft in the third quarter of 2000. Average price received during the quarter for drill pipe was $30.40/ft, compared to $28.00 in the fourth quarter of 1999 and $31.85/ft in the third quarter of 2000.

The decline in the average was primarily due to product mix. Of a backlog of about $170 million at 31 Jan, about $130 million was for oilfield drill pipe at an average price of around $28.75/ft, said Grant Prideco.

Grant Prideco plans to increase its drill pipe manufacturing capacity from a current run rate of 1.8 million ft per quarter to about 3 million ft per quarter by the end of this year, said **Curtis Huff**, Grant Prideco President and CEO.

"We are also immediately increasing prices for new drill pipe orders…," said Mr Huff in the early February financial report. ■