US Gulf is one of the most puzzling markets

THE US GULF of Mexico is one of the most puzzling offshore drilling regions due to its lack of drilling activity in light of sustained high commodity prices and various royalty relief incentives implemented by the Minerals Management Service (MMS). Drilling activity in terms of rigs contracted continued to decrease steadily since December 2003, and few believe there will be any significant increase in drilling thoughout most or all of 2004 and possibly into 2005.

GlobalSantaFe's GSF Explorer is pictured here-working for BHP Petroleum in the ultra-deep-water Gulf of Mexico.

While **ODS-Petrodata** predicts that worldwide demand for jackups, semi-submersibles and drillships will increase by 26 rig years in 2004, US Gulf activity will contribute little to that increase. The company says US Gulf drilling activity could increase slightly this summer but will remain essentially flat throughout 2004. The company believes deep shelf gas drilling and deepwater initiatives will help support US Gulf activity levels but will not result in a surge in drilling activity.

Dayrates in the region for large premium jackup rigs in excess of 300 ft of water took a hit late last year and early this year due primarily to one operator releasing eight jackups in about a two-month period. For other jackups, dayrates have held rather steady despite a generally lower drilling level.

Semisubmersibles rated for less than 5,000 ft of water is one of the largest problem areas in the US Gulf. That is not the case for ultra-deepwater units: there was a record number of rigs drilling in 5,000 ft of water or greater in March, according to MMS figures.

Still, drilling contractors that can are looking elsewhere for potential opportunities. While more than 20 rigs have exited the Gulf during the past couple of years, mostly jackups moving further south to Mexico, there still are several more jackups that are moving to other areas between early April and summer.

DRILLING PLANS, PERMITS

Drilling plans and drilling permits are trending upward for the past two years, according to figures from ODS-Petrodata. So are the number of wells being drilled of all types.

Additionally, the number of drilling plans filed indicates that more operators are planning activity in shallow waters of less than 300 ft during the first quarter 2004. As a result, drilling permits approved by the MMS also reflect that trend toward shallow water drilling activity.

During the first quarter 2004, the MMS received 149 drilling plans, including 101 for water depths 300 ft and less. The MMS approved 228 drilling permits, including 157 in less than 300 ft of water. There were 144 development permits and 84 exploration permits issued.

BEFUDDLED MARKET

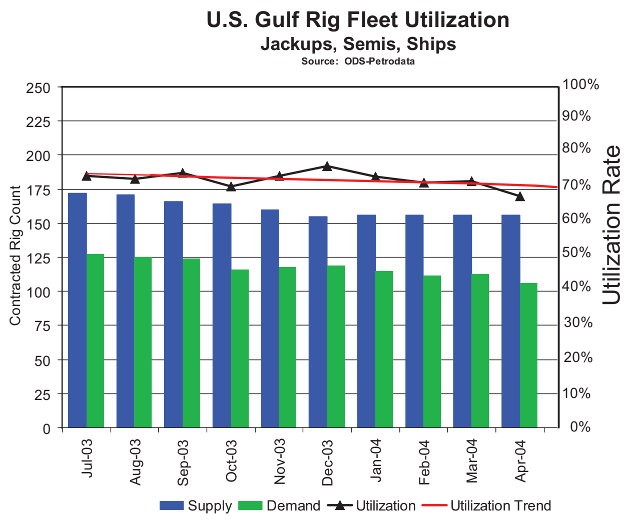
"There are a dozen reasons given (for dismal Gulf of Mexico activity)," said **Gary Krenek**, Vice President and CFO for **Diamond Offshore**, "anywhere from lack of prospects to the mergers of the majors, the majors unwilling to sell off acreage to the independents who would be willing to drill prospects, oil companies concentrating on return on investment rather than just adding reserves, the lack of conviction that product prices are going to stay high, there are probably five or six more.

"Others include the general malaise due to 9/11," Mr Krenek continued, "the future of the economy, the oil companies' desire to pay down debt.

"I don't believe any of those are the overriding factor but at the same time, all are somewhat true, and all have something to do with the lack of drilling."

DAYRATES

Dayrates for high spec jackups are down from late 2003 and early 2004, due to one operator, El Paso, releasing about eight jackups as they reined in their spending. This caused the dayrates in the high end of the market to lag



although as many of the rigs released by **El Paso Production** are beginning to return to work, those rates are again increasing.

Rates for high spec jackups before the El Paso action were about $50,000 per day with rates at around $35,000 on the low end, which remained at that level while the high end of the range dropped.

Those rates tumbled to the high $30,000

to the low $40,000 but have since worked their way back to the mid-$40,000 by early April.

There is also optimism that the high specification jackup market will soon return to its high dayrates.

"This market will tighten quickly," Mr Krenek said, "and I think we can get back to those rates fairly quickly."

Units rated for 200 ft of water are receiving rates in the mid-$20,000 while units rated for 300 ft of water are paid in the low to mid- $30,000.

With more jackups scheduled to depart the US Gulf, the reduction in the supply, even with no real increase on the demand side, could result in a gradual build up in dayrates.

Semisubmersible rates for water depths up to about 5,000 ft of water are paid in a range from the high $50,000 to mid-$60,000, while ultra deepwater rigs are looking at rates in excess of $100,000 and significantly higher than that for those ultra-deepwater rigs still on long-term contracts signed a few years ago.

MORE RIGS FROM THE GULF

About 20 rigs have departed the US Gulf for other areas, mainly to Mexico. Presently there are perhaps as many as another six jackups planning to leave the US Gulf for other areas, including two rigs owned by **ENSCO International** and two or three owned by **Diamond Offshore**. ENSCO will be mobilizing its ENSCO 93 and 95 jackups to Qatar to try to take advantage of potential opportunities related to the LNG market in the region. They are moving on speculation and will enter a shipyard upon arrival to the region for work on the ENSCO 93's cantilever and life extension work on the ENSCO 95.

"We are certainly not exiting the Gulf of Mexico," said **Richard LeBlanc**, Vice President of Investor Relations and Treasurer for ENSCO International. "Going forward, we see real opportunities drilling the more difficult wells, whether it is deep shelf or just drilling the more complicated wells such as directional or deviated drilling, which is why we are upgrading our equipment to handle that type of work."

GlobalSantaFe will be mobilizing the Adriatic II to Cabinda for a two-year contract with **ChevronTexaco** in July.

There are other potential opportunities offshore Trinidad, perhaps several in Mexico, although not nearly as many as the 10-12 rigs previously thought, and more opportunities in the Middle East and West Africa.

DEEP GAS

The MMS recently implemented royalty relief incentives for deep gas found and produced below 15,000 ft and another incentive below 18,000 ft in water depths of 200 meters or less. Depending on whom is asked, the incentives will either revive a sluggish jackup market or won't do anything to aid the level of drilling, and everything in between.

"I think there will be an uptick in the number of deep wells drilled later this year and into 2005," said **Roger Hunt**, Senior Vice President of Marketing for GlobalSantaFe. "We are positioning ourselves to take advantage with opportunities to add a third mud pump or to increase the capacity of the derrick."

Mr Hunt also said that the company's two newbuild jackups, Constellation I and II, were built to take advantage of the type of deep gas well on the shelf.

"There is some deep gas drilling going on and it will continue," said Mr Krenek. "It will be another area for us and the industry, but having said that it is not the answer to all of our problems. We believe it is going to be helpful to the industry but it is not the panacea that will solve the industry's problems.

"I don't think it is something that operators are rushing to do," Mr LeBlanc said. "They are taking their time, doing their research, reprocessing their seismic, bringing in partners where necessary to assure they have the greatest chance for success with these expensive wells.

"There has been enough success and I think there is enough opportunity there," Mr LeBlanc concluded.

ENSCO has three of the former Chiles Offshore rigs that can drill deep wells in addition to upgrades completed on three other ENSCO jackups plus an additional two jackups that will be upgraded by year end.