Panel: There are challenges in an up market, too

MORE CONSOLIDATION is ahead for drilling contractor firms. Finding, training and retaining competent rig crews will continue to be a major concern. And safety remains a top priority among drilling contractors and their clients.

Executives on a panel that discussed the 48th Annual **Reed-Hycalog** Rig Census and related issues at the 2000 IADC Annual Meeting 27-29 Sept in Houston were in fundamental agreement on these trends for the future.

Other important issues cited in the panel discussion were the availability of equipment and parts, and increasing rig rates.

Details of the latest Rig Census are included in another article in this issue.

Participating in the panel discussion were **Randall Kubota**, General Manager-International Drilling for **Texaco**; **John G O'Leary**, Vice President Worldwide Marketing, **Pride International Inc**; and **James W Linn**, Executive Vice President and CEO, **Parker Drilling Co**.

OPERATOR'S VIEW

Mr Kubota said the consolidation of oil companies—as well as drilling companies—will continue.

"We will see a lot of 1, 2 and 3 well programs; long term drilling contracts will be increasingly less common."

—Randall Kubota

Texaco

Randall Kubota

This consolidation is driven in large part by the fact that stocks of companies in the industry are underperforming in the market.

Oil company earnings and return on capital employed (ROCE) are not keeping pace with other investment opportunities.

He suggested companies assess how each performance measure impacts its strategy.

Reserve additions are a traditional measure of oil company performance, but investors are valuing that criterion less than in the past.

Evidence of this shift in the value of reserve replacement as a performance measure is the fact that producers typically increase reserves each year but recently their stock price has not followed suit.

Contractor financial performance in the past year has been much better than that of oil companies, said Mr Kubota, and better than the gains made by the S&P 500 Index.

He said oil companies that are not performing financially will be focused internally to improve their performance.

A sign that this effort has top priority is a recent round of layoffs by some companies despite the fact that oil prices are at record levels.

The focus on ROCE means, said Mr Kubota, that "we will see a lot of 1, 2 and 3 well programs; long term drilling contracts will be increasingly less common."

What will operators want from drilling contractors in the future?

"Safety is first," said Mr Kubota. He noted that international safety performance among drilling contractors is better than performance in the US. That is an opportunity for improvement, he said.

Operators also want to avoid downtime, said Mr Kubota. "It (downtime) is not good for the industry, the contractor, or the oil company."

UP MARKET CHALLENGES

Noting that words of optimism are found throughout the 48th Annual Reed-Hycalog Rig Census, Mr Linn cautioned that "it is when, not if, another downturn comes. It's just a matter of time." However, this up cycle will be longer than many expected, he said.

Industry should use the good times, said Mr Linn, to maximize profit to maintain a healthy service sector, improve safety and improve operating performance.

In particular, he said, it is important to keep the focus on safety in an up market. "A goal of the drilling industry in the new millennium should be to have an accident-free work place."

Noting that offshore rig utilization was 85% at the end of August, he said utilization could reach 90% by next year.

"A goal of the drilling industry in the new millennium should be to have an accident-free work place."

—James W Linn

Parker Drilling Co

James W Linn

It's going to take an "infusion of bright, young" people to meet the high levels of activity and the increased expectations of operators, said Mr Linn.

More alliances may also be needed to satisfy the increasing demands of clients. "Customers want more service and they want it delivered on time."

Crew availability will be a major concern in the near term if expected activity levels hold firm. Another key concern, he said, is the aging rig fleet. "More new builds are on the way," he said.

Advancing communication technology and the Internet will soon link customers, partners and shareholders, said Mr Linn.

OTHER VIEWS OF THE FUTURE

"If the present trend continues, all US land rigs will be owned by one company by 2004," said Mr O'Leary in tongue-in-cheek emphasis on the extent of consolidation in the drilling industry.

And by 2005 there will be 4 or 5 offshore drilling companies.

There are several reasons companies have the urge to merge, he said. First, it increases access to capital. There are also the benefits of operating scale and the ability to field the equipment needed for large projects.

A portfolio approach also makes it possible for large companies to offer a mix of rig types and a geographical spread of capability that is often difficult for smaller companies to provide.

Finally, there is a range of cost savings that can accrue to larger organizations.

Mr O'Leary cited two examples of recent consolidation. What were 10 companies in 1990—and 11 in 1992—now comprise **Transocean Sedco Forex**. **Pride International** is the result of 17 companies put together in the past 8 years.

As consolidation continues to shrink the number of oil companies and ROCE rather than reserve additions becomes the key performance criterion, megaprojects will become the focus of the large operators, said Mr O'Leary.

"But despite this focus on big projects, there will still be opportunities for contractors that develop niche markets with smaller oil companies," he said.

E-commerce will change the business, Mr O'Leary predicted. It already is possible to use the Internet to monitor equipment and operations, locate equipment or

"But despite a focus on big projects, there will still be opportunities for contractors that develop niche markets with smaller oil companies."

—John G O'Leary

Pride International Inc


John G O'Leary

buy and sell an exploration block in the North Sea. As an example of the use of the Internet, he noted that Shell has said it will spend $22 billion of its total procurement budget of $29 billion over the Internet this year.

It's easy to see that in the future rigs may be bid over the Internet. There may even be a "rig time" market in which third parties buy up rig time and resell it, he said.

Looking ahead to rig demand, the market for semisubmersibles appears strong, said Mr O'Leary and there is particularly good upside potential in the intermediate water depth range for all types of rigs.

He also expects a "return to land," a significant increase in land drilling activity in North America, Argentina and Venezuela. Land activity is also expected to pick up in Chad, the CIS and China.

"The key is what happens in the North Sea. And the key to what happens in the North Sea depends on oil prices remaining above $20/bbl," said Mr O'Leary.

There also are several challenges facing contractors, he said. A large share of the jackup fleet, for example, will be 25 years old in 2004-05 and must be renewed.

Emphasizing the comments of other industry analysts, he said, "There also has been a depletion of brain power and manpower."

But the outlook is positive, said Mr O'Leary. "There is a strong indication that we are in the early stages of a growth cycle," he said.