Seadrill confident in growth, believes modern fleet will pay off, says CEO Thorkildsen

By Jeremy Crosswell, contributing editor

In Q2 2008, Seadrill landed one of the most spectacular contracts ever awarded in offshore drilling. The client is Petrobras, the revenue potential is $4.1 billion across 18 rig years, and the rigs to be used comprise a trio of sixth-generation semisubmersibles currently in build.

Moreover, strategically, Brazil is set to become one of the most important areas of operation for this Bermuda-registered group whose fleet numbers 43 semi-submersibles, jackups and tender rigs, including the many new units on order but not options held at the time of writing.

Seadrill is one of the fastest-growing, and may in fact be the fastest-growing, company of any engaged in offshore drilling. Of the 43 rigs, 25 are newbuilds, of which nine have entered service, including two sixth-generation semis delivered during the first five months of 2008.

The delivery schedule is 11 newbuilds in 2008 and eight in 2010, including the latest order for four jackups that was placed in June and one semi-tender in 2011. The gross capital commitment of rigs in build and just signed is more than $6 billion (see newbuild table on Page 38). Moreover, it is largely being achieved off the back of long-term contracts and is therefore entirely fungible.

It is useful to note that, at present, the average contract length of Seadrill’s deepwater capacity is 51 months and that the first available unit will be the newbuild deepwater drillship West Gemini, with scheduled delivery in Q2 2010.

It is thought that this market will tighten further in the near- to medium-term, with Brazil acting as a powerful driver. Basically, the availability of deepwater rig capacity continues to shrink, and there is very limited availability for 2009 or 2010.

Dayrates for term contracts are now well established in the mid $500,000 range and, as signaled by the Petrobras deals, Seadrill has successfully set the bar significantly higher at $600,000-plus.

As for shallow water capacity, tender rigs have an average contract length of 46 months, with the first unit becoming available during Q2 2009. While for jackups the average contract length is 14 months, it is reckoned that the new units will soon build backlogs.

This is a company that is both new and yet has been around for a long time. It was established in 2005 but has at its heart Smedvig, which dates from the early 1970s, when the North Sea was a new energy province and which was merged into Seadrill.

Growth since the 2005 merger has been meteoric, with the result that the group has become a top-five player in the drilling elite, perhaps jostling with Ensco and Noble for second slot behind Transocean that, according to Seadrill’s newly in post CEO Alf Thorkildsen, is “in a league of its own.”

Moreover, by the time the current build programme is complete, this will be the youngest of the leading fleets by some margin – in the range of 5-7 years versus 20-plus years, according to the company.

“When this investment and building programme is completed, we will have 43 rigs. The difference between us and more or less all the other key players is that we will have only very modern units, and we think it will pay off,” said Mr Thorkildsen, who took up as Seadrill’s CEO on 1 June following Kjell Jacobsen’s decision to stand down for personal reasons. He remains on the board, however, to focus “specific tasks linked to organizational development, client relationships and communication with the financial markets.”

“We have taken delivery of five jackups so far of the original orders, also three tender rigs and two deepwater units. I would argue that most of these rigs have been on time, schedule and within budget. We have had a small delay on one of the deepwater units, but that’s partly due to some changes requested by the client.”
Mr Thorkildsen, who has served in a variety of roles at Smedvig/Seadrill, is primarily referring to the three- to four-month delays in delivery of the semi-submersibles West Herculus and West Aquarius from Daewoo of South Korea.

He is confident that, in terms of sustaining its high level of investment, Seadrill can be kept firmly on course despite the high level of cost inflation impacting upstream petroleum, especially offshore. This encouraging position is in large part thanks to careful structuring of build contracts and solid investor confidence in a company that is clearly going places.

A measure of this confidence is surely the early June 2008 announcement that the company had decided to order two Baker Marine Pacific Class 375 deep-drilling jackups rated to 375-ft operational water depth and drilling capability to 30,000 ft, plus a pair of KFELS Mod V ‘B’ design units rated 400 ft and 30,000 ft.

The price tag for the four is $850 million, though the total bill would climb past $1 billion should option agreements be exercised for further jackup newbuilds in 2011.

However, this is emphatically not about spend, spend, spend. As Mr Thorkildsen said when the latest jackup orders were announced early June 2008: “These new-build orders are the best way to increase Seadrill’s near-term earnings potential in the offshore drilling market. We are convinced that the market for offshore drilling units in general will remain tight in the years to come.

“Furthermore, the combination of deliveries, pricing and expected return is attractive compared to other investment...
alternatives within the offshore asset market as well as corporate opportunities."

By corporate opportunities, he was referring to stake building in other companies, notably increasing the bid for Scorpion Offshore and the fact that, on 23 April 2008, Seadrill disclosed that it had acquired 200,000 Pride International common shares and that it had entered into forward agreements to acquire a further 16.3 million shares in this corporation, whose early 2006 market capitalization was some $7.5 billion.

Switching to semisubmersibles and the possibility that the price tag of an advanced deepwater semisubmersible might soon reach $1 billion, Mr Thorkildsen cautiously acknowledged that prices have risen sharply over the past few years, but suggested that the pressure might ease from 2012-13 onwards, when the current rush to build new tonnage may slacken.

“We started ordering the Jurong rigs some years ago at $400 million to $420 million each; one year ago it was $530 million, and now the same rig is costing $640 million,” Mr Thorkildsen said.

“There are pressures … to some extent at the fabrication yards but more so the key equipment suppliers,” he said. “They are not that easy to replace … nor is it easy for them to expand in terms of output.

“There are other factors. Steel has gone up dramatically; the dollar is down versus other currencies, and this is a significant contributing factor. And of course margins from some of the key vendors have gone up dramatically.

“So it’s a mix of higher demand, very much higher raw material prices and vendors seeking better margins.”

Mr Thorkildsen is absolutely correct with regard to raw materials. Over the past 12 months alone, the price of iron ore has risen by 60% and coking coal some 200%. The largest steel users can expect to pay as much as $1.200 a ton for hot-rolled steel and $1.300 for cold-rolled by July 2008, about twice the cost in January.

Such factors can potentially have a negative impact on newbuilds, but Mr Thorkildsen and his board are “of the opinion that the strategy to enter into fixed-price turnkey newbuild contracts, combined with heavy back-loaded yard installments schedules at the most experienced yards in the offshore industry has served the company well.”

At the same time as growing its fleet rapidly, Seadrill’s top team says it has been able to engineer and build on the kind of strong organisation that will be required to underpin the massive investment program.

Thus far, they have been successful in recruiting more than 1,500 experienced and skilled offshore workers that have grown the workforce to more than 6,700 people. Many more will be required, but Mr Thorkildsen and Mr Jacobsen are clearly confident that Seadrill’s approach is working well.

Hosting the media Q&A session at the 2008 Q1 results, Mr Jacobsen said of recruitment progress to that point, including the training aspect: “We’re very fortunate in that a lot of people have joined us, and they have found their place in this company.”

Concurrent with fleet and workforce expansion is the creation of onshore infrastructure to match and, in that regard, it seems that Seadrill has also been on the ball.

There seems little doubt that Seadrill is doing an excellent job of carrying the standard for Europe as it grows a world-class capability, not just in drilling but throughout the upstream supply chain.