After 3 years of building and billions invested, effective offshore rig count is up by only 19

Drilling industry must brace itself as a new era descends

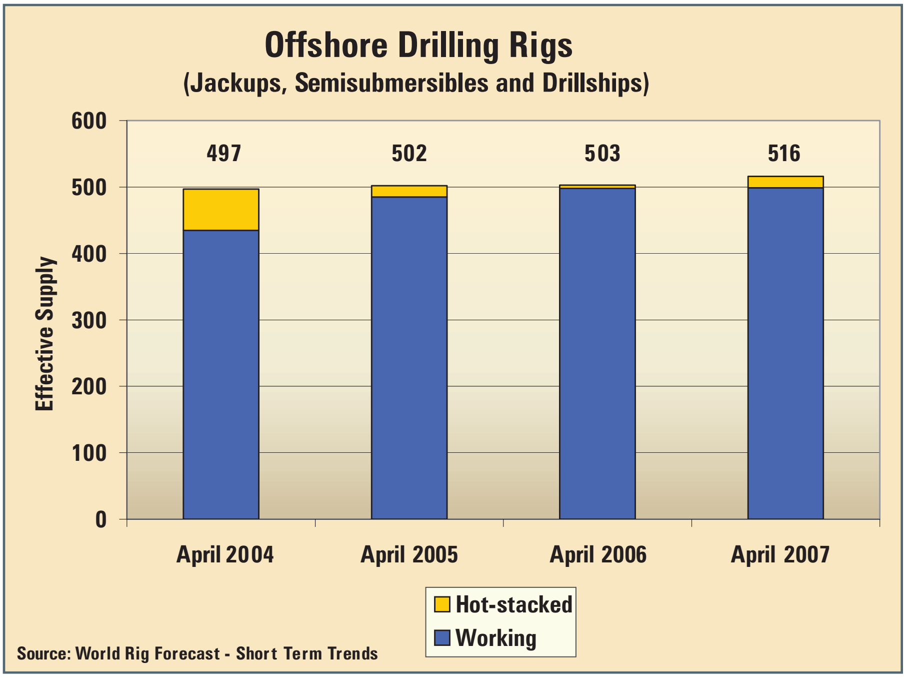
By Tom Kellock, ODS-Petrodata

IS THE INDUSTRY ready for the "perfect storm" that is fast approaching?

The offshore drilling industry is poised to enter a new era. The past 3 years have, in a sense, been a period of preparation, marked by dramatic increases in dayrates and a spate of orders for new rigs. However, so far at least, the industry has failed to provide a meaningful increase in the number of rigs ready, willing and able to work.

In April 2004, the effective supply of jackups, semisubmersibles and drillships, i.e. the number at work and those able to go to work within a few days, stood at 497 units. As shown in Figure 1, 3 years later, this number has risen by a paltry 19 to a total of 516, despite the billions — yes, billions — of dollars being spent on refurbishment, reactivations, upgrades and brand-new rigs.

In fact, virtually the only thing to have changed as far as available rigs is concerned is that the supply of idle rigs has almost dried up.



Source: ODS-Petrodata

Figure 1: There has been only a small increase in the effective supply of offshore drilling rigs over the past 3 years, going from 497 in April 2004 to just 516 in April 2007.

CHANGE ON THE WAY

But this will change, and probably very soon. As of early April 2007, in addition to 17 idle rigs (mostly Gulf of Mexico jackups), there were 12 rigs in the process of moving to new regions around the world to start new contracts, 21 rigs with contracts in hand that are due to complete short-term yard work within 6 months and a further 21 that are undergoing yard stays totaling more than 6 months but again have contracts in place. On top of this, 17 new rigs are due to join the fleet this year, and 48 more will follow next year.

Obviously some rigs now working will need maintenance, and some may undergo periods of inactivity. However, the next 18 months could see a net increase in working rigs of 100 or even more. This will put an enormous strain on drilling contractors' resources, both human and material, not to mention the impact on service companies and suppliers, and lastly, but definitely not least, on the operators who will be using these rigs.

An increase of this magnitude is not entirely unprecedented. It has happened just once before — in 1982 when the rig count rose by 112 in a space of 12 months.

But that was in a different era.

Since then, rigs have become much more sophisticated, the importance of safety and the need for care for the environment have been universally recognized, and government oversight has grown more stringent almost everywhere. However, during this period, the industry has not been noticeably successful at improving its image. Finding the required number of people with the appropriate skill sets will be hard, persuading them that the oil patch is where they should be working will be harder, but integrating them safely into the operating fleet could be the most difficult task of all.

INDUSTRY CONSOLIDATION

At the same time, further consolidation of the industry is seen as virtually inevitable. Since the last burst of activity on this front during the period from 1996 to 2001, which saw **Transocean** absorb **Sonat**, **Sedco-Forex** and **R&B Falcon**, the merger of **Global Marine** and **Santa Fe** and the acquisition of **Marine Drilling** by **Pride**, things have been fairly quiet. However **Seadrill** has made it known that **Smedvig** and the small Norwegian companies that it has already swallowed are not enough to satisfy its appetite, while many of the established contractors have recently endorsed the concept of greater industry concentration. It remains to be seen whether **Hercules**' acquisition of **TODCO**, which will create a leading player in several market niches simultaneously, is a harbinger of things to come.

However, anyone who has lived through one or more of these mergers, and that is probably almost everyone in the industry today, knows that they can be distracting, to put it mildly. Even when the companies concerned have the same national origins, "culture clash" can be extreme. Throw in an international element, and things can get really interesting.

What else might spice things up? Most observers expect that many of the rigs on order, in particular those with new designs being built in yards with little or no experience of rig-building, for start-up contractors, will fail to appear on time and on budget. If this happens — and past experience indicates that it is highly likely — it will create problems not only for the owners of the rigs but also for the operators who had been counting on them, in some cases for several years. If the latter are forced to charter rigs at any cost to meet drilling commitments, and contractors are able to insist that these are long-term deals, we might again see operators competing with contractors in their efforts to keep their contracted rigs employed.

Is this an unduly pessimistic outlook? Hopefully so — individual contractors have been working on staffing issues for some time and should not be caught short when the time comes for rigs to enter or re-enter service. If the lessons of the early '80s and the deepwater building boom of the late '90s have been taken to heart, many of the accompanying problems may be avoided this time around.

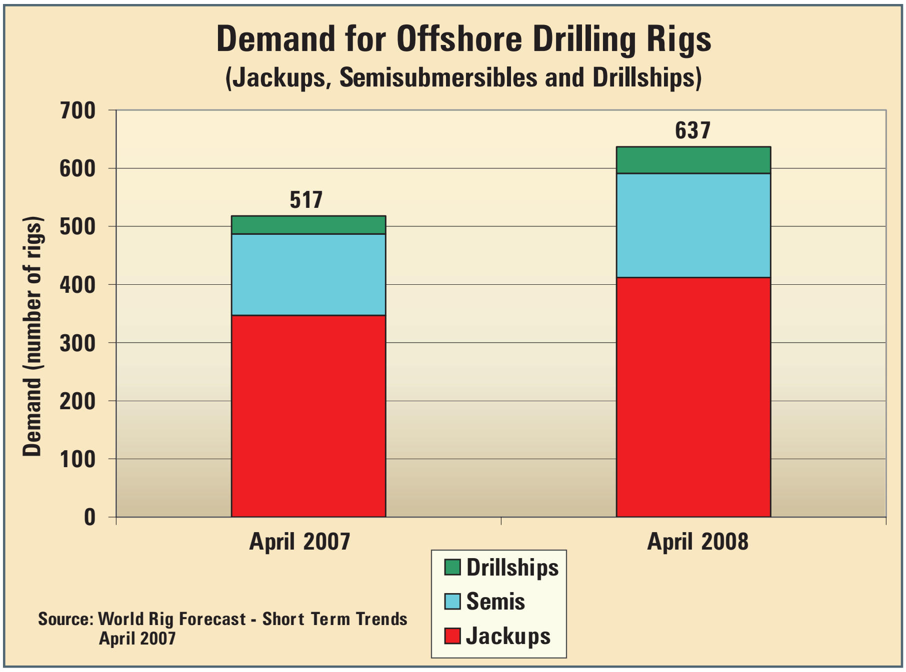


Figure 2: ODS-Petrodata's latest short-term forecast shows that there is demand for an increase of 100 working offshore rigs over the next 12 months.

However, there is little doubt that a surge in activity is just around the corner. The latest short-term forecast from **ODS-Petrodata**, shown in Figure 2, indicates that demand certainly exists for an increase of 100 working rigs over the next 12 months, although supply constraints will almost certainly mean that the actual increase will be somewhat lower. As can be seen, current demand at 517 rigs is a little higher than the 499 actually working in April 2007. The difference for the most part reflects contracted rigs that might have been delayed in the shipyard or facing weather problems while moving to their drilling locations.

Listening to the earnings announcements of the quoted contractors in recent weeks, one might feel that their biggest problem is deciding how to spend the cash pouring in. For those that have opted not to join the building boom, this might be true to some extent, but even these companies are not entirely immune to the problems of finding and retaining qualified personnel and escalating costs. For most contractors, the next few years will be a period of intense activity.

Longer term, confidence that oil and gas prices will stay "high" is apparently underpinning the willingness of operators to charter rigs years into the future. This should be of enormous benefit to the industry as a whole, as it allows the type of forward planning necessary to manage the complexities of this business that has been absent for most of its history. This will truly be a new era to be welcomed with caution and not complacency.

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