As Pemex looks to projects in deeper waters, it must vie with tight floater demand worldwide

By Jerry Greenberg, contributing editor

THE MEXICAN GULF of Mexico has been a lucrative market for offshore drilling contractors for a number of years, and for a number of reasons. First, it is very close to the presently lackluster US Gulf (the same body of water, actually) so it is not overly expensive to mobilize a jackup to the region. Second, it is lucrative in terms of dayrates compared with the US Gulf, and it is about to become even more profitable for contractors that operate the few semisubmersibles there as contracts will potentially roll over to new and dramatically higher-paying drilling contracts.

Another reason is the contract terms. Where the US side of the Gulf has been a well-to-well market since most people can remember, **Pemex** offers drilling contracts ranging generally from 2 to 4 years. However, that could change in the next round of contracting.

There have been some issues, however. The most recent issue facing offshore contractors, the vast majority of which are US-based companies, is that Pemex, noting the softening jackup market in the US Gulf, wants to index dayrates for its rigs under contract to dayrates in the US. That won't be the case for semisubmersibles, where dayrates are tied to the globally tight demand.

Pemex itself has other issues to resolve, not the least of which is the dramatically declining reserves of its huge Cantarell oil field and its efforts to increase production in other fields to offset that decline.

The Pride Mexico is working offshore Mexico at a dayrate of less than $50,000/day, a contract that began before the floater market began experiencing significant tightening. The contract expired in mid-April. "We will have an initial opportunity to re-price the rig to the stronger market that has developed since mid-2004," said Jeff Chastain, Pride International vice president of investor relations.

OIL WOES

Mexico is the world's fifth-largest oil producer, according to the US Energy Information Administration (EIA), with average production in 2006 of 3.74 million bbl/day. However, that figure is down 1.2% from 2005 and 2.5% compared with 2004 production. EIA predicts that Mexico will produce 3.6 million bbl/day this year, down from 3.8 million bbl/day in 2005 and 3.7 million bbl/day in 2006. Additionally, EIA noted that the country's reserves-to-production ratio declined from 20 years in 2002 to 10 years in 2006.

However, Pemex is not exactly in a situation to throw millions or billions of dollars at the problem due to the complex nature of the relationship between Pemex and the Mexican government. Pemex is a steady source of funds for the government in the forms of taxes and revenue sharing, providing an estimated 60% of its revenues to federal coffers in 2005, according to the EIA. A more recent report stated that Pemex sent more than 93% of its profits to the federal government in 2006.

But the state oil company faces a Catch-22, of sorts. The Mexican Congress approves Pemex's annual budget, which can have the affect of constraining the company's ability to fund additional exploration and production efforts. When Pemex generated above-average revenues, the government claimed a larger share of the earnings through taxes, and in years when below-average revenues were generated, Congress lowered the company's E&P budget to make up for the government's deficits.

Most of the country's oil production is derived from fields in the Gulf of Campeche off the country's southeastern coast. The area accounted for about 73% of the country's total crude production in 2005, according to the EIA. The Gulf of Campeche's Cantarell oil field is one of the largest in the world, but as noted

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above, is experiencing serious production declines.

According to the EIA, the Cantarell field produced 2.14 million bbl/day of crude during the January-September 2004 period compared with 2.06 million bbl/day and 1.85 million bbl/day during the same period in 2005 and 2006, respectively. EIA said the field will likely continue to decline by an estimated 14%/year despite any incremental gains from developing satellite fields.

There are 2 other major producing regions in the Gulf of Campeche. However, only one holds promise for increased production: The Ku-Maloob-Zaap (KMZ) field, adjacent to Cantarell, produced at more than 321,000 bbl/day in 2005. The field's production has increased by 50% over the past decade and holds promise that Pemex's continued development of the field will help offset some of Cantarell's decline.

The other production center in the Gulf of Campeche, Abkatun-Pol-Chuc, produced nearly 300,000 bbl/day in 2005. However, the production rate has decreased by about 50% since 1996.

STILL STRENGTHENING

In addition to maintaining oil production levels or even to increase production via technologies — such as nitrogen injection to boost downhole pressures — perhaps the main thing is to increase exploration efforts. The country's constitution prohibits foreign investment in Pemex, and foreign companies are only allowed to serve as outside contractors. To increases exploration activity, Pemex is continuing to seek additional offshore rigs to enhance that effort.

ODS-Petrodata notes that Pemex will likely increase its contracted jackup fleet during 2007 and 2008. The company recently received tenders for the contract renewal of 3 jackups already working offshore Mexico, plus an additional jackup to begin during the second half of 2007.

Pemex also is tendering for semisubmersibles. According to ODS-Petrodata, the company is seeking 2 semisubmersibles capable of drilling in water depths up to 7,000 ft and 10,000 ft for 5 years. That won't be an easy task given the extremely tight semisubmersible market globally where every available semisubmersible is contracted, many on multiple-year contracts with extension options. Hiring these rigs won't be inexpensive, either.

"Pemex is continuing to look for floating equipment and expressed a need for deeper water than where they have been drilling," said **Les Van Dyke**, director of investor relations for **Diamond Offshore**. "Most of the area is in a maximum of around 2,500 ft of water, with a little in up to 3,000 ft, but there is a continuing market for mid-water depth equipment."

Diamond operates 3 of the 5 semisubmersibles offshore Mexico. The contractor will send 2 additional mid-water depth semisubmersibles to Mexico this year.

Diamond's semisubmersibles already offshore Mexico are expected to see dramatically higher dayrates if they are rolled over into new contracts. "All of the floater contracts are going to be at dayrates that are significantly higher than they were previously," Mr Van Dyke said. "They are going to have to be competitive with international rates, or Pemex is going to have to offer extended terms to get a bit of a discount, but they are not going to be at the (lower rates) they had before."

Diamond's recent contracts bear that out. The Ocean New Era and Ocean Voyager will mobilize to Mexico during the third quarter for 2 ½-year contracts extending to early 2010. The Ocean New Era will work for a dayrate of $265,000/day while the Ocean Voyager will receive $335,000/day.

Jeff Chastain, vice president of investor relations for **Pride International**, agrees with Mr Van Dyke. Pride has its semisubmersible Pride Mexico working offshore Mexico at a dayrate of less than $50,000/day, which began in late 2003 before the floater market began experiencing significant tightening and subsequent higher dayrates. The contract expired in mid-April.

"We will have an initial opportunity to re-price the rig to the stronger market that has developed since mid-2004," Mr Chastain said. "The rig today is probably in the range of a $200,000 to $250,000 per day opportunity.

"The rate will be driven by the very tight supply and demand for floating rigs whether they are deepwater-capable or the more standard water depths," he continued. "It's a very tight market around the world."

Reportedly, Pemex tried to index floater dayrates to the US Gulf as well but received no bids for several semisubmersible tenders. "They revised their contract language to reflect that the first 2 years of a contract (assuming it is longer than a 2-year contract) would have a fixed rate," Mr Van Dyke explained. "Subsequent to that, if the rate moved more than 30% in either direction, they would adjust the rate accordingly."

Those are acceptable terms to drilling contractors, he noted, because most semisubmersible contracts in Mexico are not much longer than 2 years. However, more recent semisubmersible tenders from Pemex have asked contractors to bid on terms of up to 5 years. Pemex recently awarded a 5-year contract for the semisubmersible Petrolia, subject to final approvals.

JACKUP MARKET

Much of the Mexican exploration and production activity has been in water depths that could be accommodated by jackup rigs, and that is likely what will continue to occur. There have been several contracts signed for jackups that have recently mobilized to Mexico from the US Gulf, and there are still outstanding tenders for additional jackups.

However, despite the very lucrative jackup market offshore Mexico, there have been some issues that need to be resolved. Foremost is the fact that Pemex wants to index the dayrates it pays for jackups to the dayrates that drilling contractors are able to command in the US Gulf. Those rates are lower than for jackups presently offshore Mexico, in some cases significantly lower.

"Pemex is continuing to seek additional equipment into their side (of the Gulf)," Mr Chastain said, "including independent-leg cantilever and mat-supported units. There has been some discussion regarding an indexing mechanism that would tie back to the US Gulf rate levels for similar equipment.

"That created a bit of concern from the contracting community and is an issue that we are attempting to work out."

Still, Pemex is said to require 4-6 additional jackups in the near term, and as has been the case for most jackups offshore Mexico, they were mobilized from the US Gulf. For example, all 3 of Pride's jackups in Mexico were mobilized from the US Gulf, including one that was recently mobilized for a 2-year contract at around $100,000/day. The strong Mexican market enabled **Noble Drilling** to move all of its available jackups to Mexico, and the contractor now has the second-largest fleet of rigs in the region, with 10 jackups.

The average contract duration for jackups in the US Gulf has eroded again, Mr Chastain noted. "We were seeing some backlog build on the contracts, but now there is some erosion to that backlog," he said.

Additional jackups could become available following completion of the merger of **TODCO** with **Hercules Offshore**. TODCO recently contracted it's THE 205 jackup to Pemex for 2 years.

Jackup dayrates in the US Gulf range from around $65,000/day for the smaller units up to around $150,000 for the deeper water jackups. Dayrates have decreased significantly in recent months. In 2005, Mr Chastain said, mat-supported jackup rates were around $120,000/day. Most contracts signed recently for the same type and size of rig range between $70,000 and $80,000 presently.

For jackups offshore Mexico, according to Mr Chastain, contracts negotiated during 2006 saw dayrates from $120,000 to $150,000. Like the semisubmersibles, jackup contracts negotiated in 2003, before the market uptick of 2004, are paid around $50,000/day. The vast majority of the jackups under contract to Pemex expire during 2007, thus the seriousness on Pemex's part to try to index rates to lower levels.

Pemex may also be offering shorter terms for their contracts if they can index dayrates to US Gulf figures. "The dayrate market is changed," Mr Chastain said. "I think Pemex is reluctant to contract rigs on longer terms with the market environment potentially pulling back and Pemex being locked into higher rates.

"As a drilling contractor, we can understand that, but we also want a mechanism that allows us to participate if rates should reverse and move up again."