Wall Street Outlook:

Drilling business looks healthy for next 5 years

MARSHALL ADKINS, MANAGING director of **Raymond James & Associates**, spoke with Drilling Contractor recently on the outlook of the drilling business to provide an analyst's perspective on the drilling outlook.

DC: Rig rates have reached record levels over the past year. Drilling contractors were awarded contracts with high rates for as many as 3, 5 and even 7 years. Do you think we'll see this trend continue in 2007?

Marshall Adkins

Mr Adkins: Certainly on the offshore side. We're not adding capacity at a pace that will keep up with demand, so there will be an ongoing trend of operators booking long-term contracts. On the land side, we are adding some capacity. They have also been going towards longer-term contracts, but oil and gas prices have to recover before demand for longer-term contracts really resumes.

DC: How does the capacity side look?

Mr Adkins: The land fleet — particularly in North America and the US — has been growing 10% to 12% a year, net of fleet attrition, which is 200-250 a year. We think that will continue for at least the next year and probably the next 3 years. On the offshore side, it's a much slower growth pace. We think you can increase the size of your fleet — on average over the next 5 years — 2% to 3% a year. That does not assume any fleet attrition, and obviously last year we lost several rigs. Looking at a 5-year annual growth rate for offshore jackup rigs, I would say there will probably be a 2% a year growth. That will continue for the next 5 years.

DC: How do dayrates look by the end of 2007?

Mr Adkins: Assuming as we do that commodity prices, particularly natural gas prices in the US, bounce back up to that 6-to-1 or 7-to-1 ratio of crude, or about $10, then demand for rigs will continue to outpace supply.

DC: What areas will see more activity in the next year?

Mr Adkins: Rigs will continue to migrate out of the Gulf of Mexico to work in West Africa and the Middle East. Demand for oil projects is clearly taking rigs from conventional and gas areas. The Chevron Jack discovery may keep a few deepwater rigs in the GOM, but jackups will continue to leave.

DC: What's driving the recent drop in oil prices and are you concerned about it?

Mr Adkins: It's a broader sell-off in all commodities. There are several fundamental issues at play. We've had large oil inventories in the US, concerns over an economic slowdown, but really what's going on is a technical-driven sell-off in all commodities.

I actually think mid-$60 oil is a very healthy thing for the economy and for our business. I don't think prices will fall much further, and I don't think the recent fall implies that we're going back to $35 crude.

DC: Some analysts had been concerned that oil prices would become so high it would slow demand and therefore slow the economy. Has that happened?

Mr Adkins: It doesn't appear that's creating as big a problem as everyone thought. We all thought $50 oil was going to slow the economy, and the economy blew right through that. A lot of reasons for that – the devaluation of the dollar, we're more of a service-driven economy than a manufacturing-driven economy, and the global economy has become a bigger factor, more so than the US economy used to be. It's hard to pinpoint one exact cause, but clearly we're more resilient to higher energy prices than most people thought.

DC: What does the next year to 18 months look like for the global drilling market?

Mr Adkins: It's going to be pretty healthy for the next 5 years. The onshore market is a little more sensitive to natural gas prices, and gas prices have been weak going on 9 months now. If gas prices don't recover, then we could be in for a rough spot. But if they do recover as I think they will, then demand will continue to outpace supply.