Is the water bluer on the other side of the Gulf?

By Jerry Greenberg, contributing editor

Parker Drilling’s Rig 77B is its newest inland water drill barge, delivered in December 2006. Including the cost of this rig, Parker will have spent approximately $100 million to upgrade its fleet of inland water drill barges in the US Gulf when the final rig is upgraded in 2009.
US GULF OF MEXICO rig activity at the end of September 2007 was at its lowest level since late 1992 in terms of contracted rigs. This is primarily a result of low natural gas prices but also a result of an industry affected by a hurricane season that runs from June through November. Much of the low activity level is attributable to idle jackups, which are most affected by low gas prices and hurricanes, while the deepwater and ultra-deepwater market is still booming and will expand with 13 newbuild semisubmersibles and drillships entering the region between 2008 and 2010, all with long-term drilling contracts.
As far as shallow water activity, drilling contractors still seek to move jackups out of the US Gulf to more lucrative regions, including the Middle East, Southeast Asia and Mexico, the latter of which has been an extremely good market for US jackups. Mexican E&P activity is expected to strengthen in the future as Pemex struggles with declining oil reserves. Several jackups mobilized to Mexico from the US Gulf during 2006 and 2007, and more are expected to go in 2008.

Pemex is preparing to expand its deepwater E&P efforts. By 2010, four deepwater semisubmersibles (5,000 ft or greater) will have arrived in Mexican waters. The first will be the Noble Max Smith, rated to 6,000 ft of water, due in mid-2008. Additionally, four mid-water semis will arrive between 2007 and 2010 to join the two already working there.

One market segment sometimes overlooked in the US Gulf is inland water drill barge activity, which had seen record-high dayrates until recently. Dayrates for deep-drilling posted barges were close to $70,000 in 2006 and earlier 2007 but have dropped 10%-15% to the mid- to low-$50s. Still, it’s an extremely good market with high activity levels of marketed units. Parker Drilling has invested significantly in upgrades to its inland drill barge fleet and at least one newbuild unit.

US GULF COMPLEXION

The complexion of the US Gulf has changed significantly in the past two years, a combination of low gas prices, hurricanes and a widening chasm between shelf and deepwater activity. Bottom-supported rigs are taking the brunt of low gas prices and new operating criteria when drilling during hurricane season. The deepwater and ultra-deepwater market is going strong and will continue to strengthen in the foreseeable future, which is now out to 2010 or so. Newbuild drillships and semisubmersibles set to be delivered near the end of this decade will work, at least initially, in the US Gulf.

Overall rig activity in the US Gulf trended downward dramatically last September when a net of 11 rigs were idled between late August and late September. September ended with 92 rigs contracted, compared with 103 units contracted in late August, according to ODS-Petrodata. The utilization rate plummeted from 77.4% to 70.8% in that month.

While an idle mid-water semisubmersible or two contributed to the decline in contracted rigs, the jackup fleet was by far the most affected. ODS-Petrodata reported that utilization dropped to just below 60% for the marketed jackup fleet in late September, compared with 72% earlier that month.

Year-on-year figures tell a big piece of the story. In mid-September 2006, according to ODS-Petrodata, 121 rigs were contracted out of a total fleet of 145, and 104 of the contracted rigs were actually working. The fleet contained eight cold-stacked rigs at that time. A year later, in mid-September 2007, there were 96 rigs contracted out of a total fleet of 132, and only 80 were actually working. The number of cold-stacked rigs had risen to 11.

The most telling number in September 2007 is the 15 hot-stacked rigs compared with zero hot-stacked rigs a year earlier. Of those 15, 14 were jackups and one was a submersible, all bottom-supported, shelf-type rigs.

As noted earlier, lower natural gas pricing and concerns surrounding hurricane season are the two most often cited reasons for slack jackup activity. Revised criteria are calling for about a 20-ft larger air gap for jackups and submersibles in some areas of the US Gulf during hurricane season means that those rigs are effectively relegated to work in shallower water depths than they are capable. This makes some operators unable to drill certain wells. As a result, many drilling

Rowan Companies’ Gorilla II jackup is under contract to Devon Energy in the US Gulf until second quarter 2008. This rig could be a candidate to mobilize for work outside the Gulf, possibly in the North Sea, where the jackup market is still tight.
contractors now view the US Gulf shelf as a “seasonal” market.

“I don’t think there is any question, at least over the last three years, that the Gulf has become somewhat of a seasonal (drilling) market,” said Jeff Chastain, vice president, investor relations for Pride International. “In some cases, (operators) have decided to slow their activity during the more active months of the (hurricane) season and then pick up again as the season ends.

“The majors have generally exited the shelf with a few exceptions,” Mr Chastain continued, “and you have smaller names that generally don’t want to take on the risks of downtime as a result of storms.”

Bill Provine, vice president, investor relations for Rowan Companies, agrees. “A lot of customers don’t want to drill in hurricane season. So if they can postpone their well, they usually do. Then in November we get a little bump (in activity).”

“The complexion of the operators has changed from larger independents to smaller independents,” said Les Van Dyke, director of investor relations for Diamond Offshore. “They often have less money and are looking for smaller reservoirs and therefore need the gas price to be higher in order to earn the return to justify the well.

“That, coupled with the hurricane season, seems to have retarded the demand for equipment.”

Most drilling contractors with equipment on the shelf are optimistic that drilling activity will pick up again in November or December. Several contractors report that operators are already inquiring about jackup availability for programs that begin in November and beyond.

BRIGHTER MARKETS

Although drilling contractors see shelf activity rising again late in the year, they do continue to seek better markets elsewhere. Numerous jackups have exited the US Gulf during the past couple of years, primarily for long-term contracts elsewhere. US Gulf dayrates were in the mid- to upper-$100,000s for larger, high-specification jackups, but contractors were still facing a well-to-well market. The Middle East and elsewhere offered 3-4 year contracts — sometimes even longer — while paying the same rates.
Global Outlook

Now that dayrates in the Gulf have slipped due to lower utilization, drilling contractors are looking outside the US Gulf for higher rates as well as long-term charters. Mr Provine believes 10 more jackups could leave the US Gulf by late 2008. He notes that there are around 17 bids working just in the Middle East that would require rigs beginning in first quarter 2008. He also said that several of Rowan’s larger Gorilla Class units could work in the North Sea’s tight jackup market.

There still is work to be had on the shelf, however. “With the combination of rigs leaving the Gulf and as operators decide to spend year-end money or get new budgets going into the new year,” Mr Van Dyke said, “activity will be sufficient to keep most of the equipment working.”

Deepwater Drilling

According to the US Minerals Management Service (MMS), a record-high number of rigs were working in ultra-deepwater in mid-August, when 15 units were drilling in 5,000 ft of water or greater. At the time, the rigs were working in water depths up to 8,694 ft.

As expected, most of the wells were operated by major oil and gas companies, with a couple of large independents sprinkled in. Operators have major investments in deepwater and ultra-deepwater leases and recently increased their portfolio as a result of the Central Gulf lease sale in October.

Approximately 40% of the 723 tracts that received bids in Central Gulf lease sale #205 are in water depths of more than 5,200 ft. One partial tract is in more than 11,000 ft of water. Oil and gas companies were spending near-record amounts to obtain those leases.

The sale attracted $2.9 billion in high bids, the second-highest total of high bids in US leasing history, including a bid of more than $90 million by Shell for a deepwater block.

Shell submitted high bids totaling $554 million, and Chevron submitted $283 million. At year end 2006, Chevron was the largest leaseholder in the Gulf, with 973 leases, 587 of which were in water depths greater than 1,000 ft. The operator completed four exploratory wells, including two wildcats and two appraisal wells in 2006.

On the shelf, Chevron drilled 70 development and delineation wells in 2006 and participated with partners in five deep
gas exploration wells. However, the number of wells drilled by Chevron during 2007 is expected to be lower.

In September 2007, Chevron was contracting five jackups and three ultra-deepwater rigs, two semisubmersibles and one drillship. Two additional Transocean drillships currently under construction are contracted by Chevron and will work in the US Gulf beginning in 2009 and 2010 under five-year contracts.

Apparently, not only the results of the latest OCS lease sale show the bullishness among operators for future deepwater, so do the length of contracts. Additionally, with dayrates for ultra-deepwater rigs beyond the half-million dollar mark, operators also appear to believe they have enough prospects to keep rigs busy as long as oil prices remain strong, although none are making drilling plans anywhere near the $80-per-barrel price today.

“We have plenty of prospects, plus we have made discoveries where we need to do (more) drilling,” said Chevron spokesman Mickey Driver. “The Cajun Express is drilling the third well at our Jack prospect, which we are calling a combination appraisal/delineation well.”

Ultra-deepwater wells are not for the faint of heart, nor for those with shallow pockets. Ultra-deepwater wells can cost $100 million and take several months to drill. The risk can be extremely high. Chevron is drilling its third well at the Bob North prospect in more than 5,600 ft of water. “The first two attempts there we ran into great difficulty, one above the salt and one below the salt,” Mr Driver explained. “But we think we’ve figured out a way to do that now.”

INLAND BARGES

Although the inland water drill barge market has seen some softness, this market segment had experienced record-high dayrates and nearly full rig employment during 2006 and the first half of this year. Dayrates were reported as high as $67,000 by ODS-Petrodata. Hercules Offshore, which owns the largest fleet of inland water drill barges in the Gulf, noted that one of its barge rigs was receiving around $68,000 per day.

Parker Drilling, which operates 16 inland water drill barges in the US Gulf and one in Mexico, had 14 working in the US in September with dayrates for their deep-drilling units in the high $40s to low $50s. That’s about 10% lower than peak rates in the first quarter 2007, according to Dave Mannon, Parker president and COO.

“About half of our rigs drill for oil and the other half for gas,” Mr Mannon noted. “Within the gas market, our activity is more focused on the development stages, and they are set at gas (price) hurdles that are considerably below what we are experiencing today, so it is still worthwhile to drill.”

Parker is bullish on the inland water drill barge market and has been upgrading its fleet the past couple of years. It also built a new inland water drill barge, which was delivered late last year. The company will have spent about $100 million on its fleet upgrade program, including the newbuild, when it completes upgrades on its remaining units in 2009.

Hercules Offshore has 27 units in its fleet, and 10 are cold-stacked. In mid-September, the remaining 17 units included three stacked barges and one in the shipyard that was scheduled to complete hull repairs in early October.
The company’s dayrates ranged from the mid-$40s to the mid-$50s, although a couple of its deep units were near $60,000 and higher.

**LUCRATIVE MEXICO**

Drilling activity in the Mexican Gulf has been very lucrative for US drilling contractors who have been able to move quite a few jackups south. In fact, **Noble Drilling** moved its entire jackup fleet out of the US Gulf a couple of years ago, mostly to Mexico.

Now, the contractor is preparing to mobilize one of its deepwater semisubmersibles from the US Gulf to Mexico for a three-year contract. The Noble Max Smith will be the deepest water semi in Mexico, at least temporarily, and it will be paid about $484,000 per day. Presently, only two semisubmersibles are operating offshore Mexico, one rated for 1,100 ft of water and the other capable of working in up to 1,750-ft water depths. Including the Noble Max Smith, eight semisubmersibles will join the fleet between late 2007 and mid-2010. Most will be shallower units rated to work in water depths ranging from 1,500 ft to 3,200 ft. Four are deepwater units ranging in water depth capability from 6,000 ft for the Noble Max Smith to 10,000 ft for the Oban B, a new-build semisubmersible set for delivery in 2009, and the PetroRig III, another new-build unit scheduled for delivery in 2010.

All have long-term drilling contracts.

“The most important thing about the Mexican sector is that they clearly have issues with decline rates in their existing fields,” said Lee Ahlstrom, vice president, investor relations and planning for Noble Corp. “We think the deepwater Mexican market could be one of the most exciting deepwater markets to open up anywhere in the world.”

On the jackup side, Pemex earlier this year wanted to index the dayrates it pays to rates in the US Gulf in order to take advantage of any downside in the US jackup market, which has occurred. Drilling contractors responded to that idea by no-bidding several Pemex tenders. Now, Pemex is signing one-year contracts rather than the 2-3 year charters it signed earlier.

“So rather than keep terms of 2 ½ years with some index, Pemex reduced the terms to a year with a flat rate. The last four rigs we renewed there are all at one year with a fixed rate.”

However, the one-year contract has effectively accomplished the same purpose as indexing since dayrates can now be evaluated annually rather than after several years. Still, drilling contractors view the Mexican market as one of the better global markets. **ENSCO International** recently won a contract for a jackup tender and will mobilize one of its units from the US, the first ENSCO rig in Mexico.

Pride also has received a number of lucrative contracts in Mexico. The contractor has 13 jackups there, the largest jackup fleet in the region, followed by Noble Drilling with 10 jackups. Pride is prepared to take additional units to the market. The company recently mobilized its Pride Oklahoma and Pride Mississippi jackups to Mexico from the US for one-year contracts.

“We do have additional units (in the US) that are currently outfitted with specifications required by Pemex,” said Pride’s Mr Chastain, “so they would require little to no capital investments to have them ready for work in Mexico.”
Noble’s circumstances are interesting in that it bareboat charters its jackups to Pemex. Noble provides about 9-10 crew members, and Pemex supplies the rest of the labor. “Our operating costs are significantly lower there than they are in most other places in the world,” Mr Ahlstrom said. “Certain (lower) than they would have been in the US Gulf.”

Even with bareboat charters in place, Noble is earning between $150,000 and nearly $190,000 per day, depending on the contract and rig. “Many of the US contractors have not felt comfortable taking the bareboat charter structure,” Mr Ahlstrom said. “We are very comfortable with the quality of their people and the quality of the operations there.”

The contract for the Noble Max Smith is a straight dayrate charter, not a bareboat, mainly because Pemex doesn’t have the experience level on semisubmersibles yet. That situation could change, however. “I think we would certainly be agreeable to (a bareboat arrangement) as we get more comfortable with their experience level,” Mr Ahlstrom explained.

Depending upon Pemex’s 2008 budget and Mexico’s efforts to halt its steep production decline, more jackups could be required in Mexico. While drilling contractors in the US Gulf are optimistic that shelf drilling activity will begin increasing later this year, they still view Mexico as a savior of sorts. It could increase in importance if the US Gulf shelf market continues to be a seasonal one.

This chart clearly illustrates the significant impact that natural price fluctuations have had on the US Gulf of Mexico jackup market.

![US Gulf Jackup Count vs. Natural Gas Price](chart.png)

Source: ODS-Petrodata and Natural Gas Week

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