Rig fleet changes to respond to market demands

ACCESS IS THE KEY to meeting the US gas supply challenge. That's the view expressed by **John Schiller**, Executive Vice President, Operations, **Ocean Energy Inc**, during a panel discussion at the 2001 IADC Annual Meeting in New Orleans, 27 Sept.

The discussion followed presentation of the 49th Annual **Schlumberger Reed-Hycalog** Rig Census.

"We must open areas such as the Rocky Mountains and the eastern Gulf of Mexico in order to have an adequate exploration inventory," Mr Schiller said.

"We're not going to solve the supply problem unless we get more access."

The very small increases in production that have marked the past few years will continue unless prospective areas are opened, he said.

It's important that enough rigs be available to drill the wells needed to meet expected healthy growth in demand, said Mr Schiller.

Consolidation—among energy companies, contractors, and elsewhere—will continue, he said.

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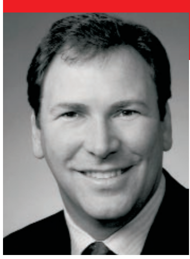
Ocean Energy



"But increasingly, mergers are not about cost savings," he said.

"A shortage of capital, people or expertise is now the cause of much consolidation."

During the first half of 2001, operators "drilled for value" to get gas worth $5-6/MMBTU and exploration was delayed. Finding and development costs were up significantly.

Bullish on the world economy in the long term, Mr Schiller expects the US natural gas price to average in the $3/MMBTU range.

Current low prices are caused by "demand going away," he said. When prices bounce, increased demand will be the cause.

RIG FLEET CHANGES

It is important to remember that even though the number of offshore rig operators is small—currently only 9—contractors cannot control prices.

Rather, they will still be subject to market control, said **Lawrence R Dickerson**, President & COO, **Diamond Offshore Drilling Inc.**

The drilling market resembles the Biblical 7-year cycles of "lean" and "fat," said Mr Dickerson. "And things are looking a bit lean now."

He said industry did "a lot of construction" in recent years, noting that deepwater capabilities have been an area of rapid growth.

From 1995 to 2001, the fleet of drillships increased from 23 to 38 and the average water depth capacity of the drillship fleet jumped from 2,495 ft in 1995 to 5,785 ft this year.

The industry's global fleet of semisubmersibles increased from 145 to 176 during the period. The number of 4th generation units jumped from 13 to 40 and 16 fifth generation units were built, a category that did not exist in 1995.

The fifth generation class has not been completely defined, said Mr Dickerson. But he noted that an important goal to shoot for in building a vessel with these capabilities is to deliver the unit for under $300 million.

"The same is true for drillships," he said. Companies that come in under $300 million have a much better chance of being successful.

The jackup rig fleet remained almost flat from 1995 to 2001, said Mr Dickerson, adding only 4 units to 399.

The deepwater fleet, those units able to drill in water depths greater than 5,000 ft, ballooned from 6 in 1995 to 57.

Technologies such as dual activity have been important in making deepwater operations viable, he said.

He cited preset mooring capability and freestanding risers as important future developments.

The move to deepwater will continue. But it is important to keep supply demand relationships in mind, said Mr Dickerson.

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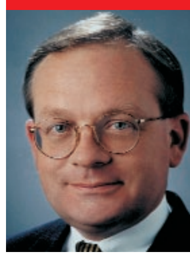

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Oil company mergers have an effect on the drilling market, said Mr Dickerson. "Some prospects get high-graded out after a merger," he said, "so 2+2 may only equal 3."

He cited these challenges facing offshore drilling contractors in the future:

- Roll newbuilds from initial contracts (Diamond Offshore's have rolled at higher prices, he said);
- Technology that has been delivered and implemented will now require maintenance attention, and costs and downtime may increase;
- Define the long term role of drillships;
- Be careful not to overbuild.

LAND CHALLENGES

US contractors have "answered the call" to meet growing demand for energy, especially natural gas.

But continuing to rebuild an industry that has suffered from 20 years of neglect will be a challenge. That's how **Steven A Richards**, Vice President Drilling Operations, **Key Energy Services**, described US land drilling capability.

As the number of players in the industry continues to shrink, the 2001 land rig fleet gains are due primarily to refurbishment, he said. The increasing age of the fleet is a critical issue.

"But new build prospects are uneconomical," said Mr Richards. "Rates are still below that needed to build new rigs."

About 200 rigs have been refurbished since the first of 2000, he said. Rebuilding the industry will require major investments in technology, safety and training. Mr Richards cited lessons learned from industry consolidation, including:

- Market leadership is value leadership;
- Stable rates allow reinvestment in rigs and people;

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- Service providers must grow in scale along with customers;
- Customers value a one-stop service;
- Consolidation allows efficiencies and economies of scale;
- The concentration of idle capacity will decrease new building activity.

"Drilling levels have to be sustained to meet demand," said Mr Richards.

"Even with aggressive drilling, we have barely kept pace with depletion. A decrease in drilling today exacerbates future supply shortages."

A continuing challenge for contractors is to operate safely and efficiently, said Mr Richards.

They not only must understand operator economics, but also must educate operators about the cost of building and refurbishing rigs, he said.

Keys to success are to leverage the benefits of consolidation and offer a full range of services. Contractors must also provide the best-maintained equipment and the best-trained employees.

Finally, they must invest in technology and reinvest cash flow to reactivate idle equipment.

He also advised contractors to "think long term and price rationally."

The terrorist attack on the US has heightened near-term uncertainty, said Mr Richards.

"But the long term outlook is good." ■