DRILLING CONTRACTOR

DRILLING AHEAD

‘Stopping the insanity’: Toward better management of cycles

Mike Killalea, Editor & Publisher

INSANITY, QUOTH THE sage, is doing the same thing over and over again, expecting a different result. So reads signs posted around **National-Oilwell**, remarked **Jerry Gauche**, Vice President with the firm and moderator of a panel discussion at the 2002 IADC/SPE Drilling Conference. Yet that too often seems the fate of our roller-coaster industry, and, in fact, determined the theme for both the plenary and the conference itself: Meeting the Challenges of our Cyclical Industry. The goal of the panel, said Mr Gauche, was to provide the audience “with a plan for stopping the insanity”.

One signal of strengthening sanity is that companies today recognize and accept that cycles are inevitable. This marks a distinct change from just a few years ago. Remember ’96-’98, when conventional dogma had it that strong oil prices and would drive a bullish rig market for half a decade or more? As that economic spring turned to $12-oil winter in ’99, oil wizards forecast low oil stretching well into the 21st Century. That worm also turned, and has now flipped again.

Now, companies like **Grey Wolf** take cycles in their stride, remarked Senior VP-Marketing **Ed Jacob III**. One of the company’s central tenets in its business strategy is a Janus-like review of the past to prepare for the future—evaluate the last cycle and prepare for the next, he said.

Much of this depends not only on the key issues of personnel, equipment and technology, but also on business relationships. Mr Jacob observed that partnerships are the norm in many other industries, but rarely in drilling services.

“The only way we’re going to go forward is if we commit to trust each other,” he observed.

MANAGING THE RIDE

Meanwhile, Grey Wolf is “managing the ride”, as Mr Jacob aptly puts it, through market diversification. By focusing on key markets, Grey Wolf is running 10% more rigs during this downturn than during the last.

The company aggressively sought out turnkey jobs. From 1999-2001, Grey Wolf drilled 288 turnkey wells. This ranks the Houston-based drilling contractor as the sixth most active operator in the US among its customer base, led only by **Anadarko**, **Conoco**, **El Paso**, **EOG** and **Texaco**, Mr Jacob said.

RELATIVITY

Still, omnipresent commodity volatility overhangs the industry like a dark cloud. Sometimes the price of the commodity itself little gibes with activity levels. After a bellwether winter in 2000-2001, when natural gas prices soared to double digits, the industry began foundering as prices fell to the $3.50 level. Two years before, we would have salivated over $3.50 gas.

It’s all relative.

Or, as **Andy Szescilla**, Senior VP/COO at **Baker Hughes**, put it during the Plenary, “It’s not just the price of the commodity. It’s the *expectation* of what that price will be.”

The resulting volatility is the enemy of stability and profitability, Mr Szescilla argues, the evil genie that hinders steady employment, distorting demographics (with 60% of petroleum engineers eligible to retire over the next 15 years) and, most fundamentally, destroying value.

“This industry has not returned its cost of capital over two full [4-year] cycles,” he said.

CASH IS KING

Ours is not the only cyclical industry, to be sure. **Roger Simons**, for example, as President/CEO of **Simons Petroleum**, a highly successful distributor of diesel and other fuels to, among others, the drilling industry, has ridden out good times and bad for decades. What are his secrets? First, says Mr Simons, “Cash is king.” During good times, build cash reserves

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CAPITAL WIRELINES

MMS should suspend subsalt leases only in certain situations

Brian T Petty, Senior Vice President-Government Affairs

GOM Subsalt Lease Suspensions (Washington)—IADC submitted comments to the US Minerals Management Service addressing its proposed rule which would under limited circumstances consider requests by lessees for lease term suspensions in subsalt areas of the western planning area of the Gulf of Mexico. IADC has broadly opposed lease suspensions or extensions in the US and in the UK where operators sought to avoid drilling commitments for reasons driven primarily by their own internal financial considerations. However, certain leaseholders in this area have argued that the very difficult seismic interpretation of subsalt formations has made it difficult, if not impossible, to fulfill their drilling commitments under existing lease terms. IADC reluctantly agreed not to oppose this rule, which would require those leaseholders to demonstrate very strictly that their requests for lease suspensions are justified. IADC's comment to the record on the proposed rule is as follows:

"MMS expressed a desire in its draft proposed 5-Year OCS Program (2002-2007) to provide a reasonable level of certainty for lessees, and by inference the contractors who support their activities. For drilling contractors, the most critical element of that objective lies in assuring that leases are drilled as agreed under the terms of lease sales, and if lessees fail to do so, those fallow leases be returned to the federal inventory for offering again in a later sale. The offshore drilling industry has embarked on a vast and expensive program to improve and expand the drilling fleet available to explore for new sources of oil and gas vital to this nation's security. That financial commitment in the most substantial way depends on the resolve of MMS to insist that lessees abide by the terms of their lease obligations to the federal government. Waivers and extensions of drilling commitments operate to unsettle the drilling market and its sources of financing.

"IADC accepts the intention of MMS to insist that applicants for subsalt lease suspensions meet various rigorous tests before consideration is given to any request for lease suspension. We ask that MMS dedicate resources to vigorously scrutinize such requests, and that every element set forth under the proposed rule for justifying such suspensions be fully satisfied. Moreover, we ask that MMS regard this as a unique circumstance requiring a unique response, and not a precedent for other lease suspension requests that are essentially motivated by the financial or strategic priorities of a given lessee."

WTO Energy Services (Geneva)—World Trade Organization (WTO) Secretary-General designate **Dr Supachai Panitchpakdi** on a recent visit to Washington met privately with Energy Services Coalition (ESC) chairman **Brian Petty** and members of the ESC Executive Committee, including **ExxonMobil** and **Halliburton**, to discuss the way forward at the WTO for expanding trade in energy services, including drilling services, and a parallel process of making government procurement and customs levies transparent and consistent. Dr Supachai expressed enthusiastic support for ESC's agenda, and he noted particularly his interest in bringing investment to his home country of Thailand. The seven countries (including the European Union) that have thus far tabled requests for negotiations in energy services met late March in Geneva to consider ways to attract more countries to embrace the cause of energy trade liberalization. Brian Raggett of the Brussels office of the International Association of Oil and Gas Producers (OGP), participated in that meeting on behalf of the ESC. Also, IADC's Mr Petty addressed an Extraordinary General Meeting of the OGP in Kuala Lumpur on the subject at the same time. OGP operator members have expressed growing interest in the developments at the WTO as the producers have come to understand the benefits to them of broadly liberalizing energy trade, and in removing bureaucratic barriers to contractors serving them around the world.

and decrease debt to help weather bad times. Second, provide managers with the tools they need to perform their best, particularly solid and current financial information.

Mr Simons said his company is consistently on the look out for new, related services it can provide its existing customers and use to attract new buyers.

Finally—one of my personal favorites—avoid "over meeting". Communication among peers, direct reports and upper management is critical. But if at the end of the day, one realizes his or he entire day has been chewed up in meetings, something's wrong.

The consumer industry also faces cycles, of course, and a stalwart of Houston's retail establishment shared some secrets of his success. **Jim MacIngvale**, fondly known to Houstonians as "Mattress Mac" for his high-energy television commercials, owns **Gallery Furniture,** arguably the world's most successful furniture store. But Mr MacIngvale insisted he isn't really in the furniture business at all: "We're in the customer business", he proclaimed.

Put the customer first, second and third, said Mr MacInvale. And "innovate or die."

How relevant is your company, he suggested we all ask ourselves. "Who would miss you if you went out of business today?"

That's a question we can't ask too often. ■

SPE/IADC AMSTERDAM IN '03

Planning is already under way for the 2003 SPE/IADC Drilling Conference, 19-21 March in Amsterdam. Under the leadership of Conference Chairman **John Willis** of **Halliburton Energy Services**, the event's Advisory Committee has set forth a bold theme emphasizing the borderless nature of our global industry: "People and Technology: The Future Sans Frontiers". The Advisory Committee has also begun development of the 3 conference Plenary Sessions, always high-interest and thought-provoking events.

Meanwhile, Mr Willis and the Programme Committee have thought through a number of themes of particular interest to form the core of the technical sessions, which is the heart of the conference, after all.

We will issue a Call for Abstracts very soon. The Call will also be available through the SPE website, www.spe.org.

Make your plans now to attend the premier drilling technology event of 2003 in Amsterdam. ■