Hercules Drilling's Rig 30 is currently working in the Gulf of Mexico for Helis. A confluence of dynamics over the past few years has left it as one of only about 90 jackup units remaining in the GOM.

A new Gulf of Mexico

As jackups leave for longer-term, higher-rate contracts elsewhere and major operators leave for lucrative deepwater projects, GOM shelf activity shifts into new paradigm

By Linda Hsieh, associate editor

THE NUMBERS ARE striking: In June 2001, there were 156 jackups in the Gulf of Mexico. As of April 2007, the jackup rig count stands at approximately 90, with 9 of those cold-stacked. Moreover, only 63 of the approximately 80 actively marketed fleet are under contract and working.

"One would have to go back quite a long time in history to the last time when the Gulf of Mexico had about 80 actively marketed jackups and about 60 working jackups," said **Steve Gangelhoff**, **GlobalSantaFe** vice president of sales, contracts GOM, shelf and deepwater.

One key factor driving rigs out is slow activity. Shelf activity in the GOM has been low since hurricanes Katrina and Rita in 2005, Mr Gangelhoff said. "The main driver of that slow pace is soft natural gas prices, as perceived by our customers over the past several months. Secondly, major operators are increasingly shifting their budgets to deepwater plays that carry a higher risk but a richer reward. So, we have to consider, who are the companies seeking natural gas on the shelf? How capable are they of sustaining their projects at these natural gas prices? And that's partly dependent on the size and strength of the reservoir."

On the flip side, jackup markets outside the GOM are going strong and continue to draw rigs out of the Gulf of Mexico. The Middle East market is currently driving global demand, and West Africa coast, the North Sea, Southeast Asia, the Mediterranean and India remain strong and are currently forecasting supply deficits throughout 2007 and into 2008. Compared with the GOM's well-to-well drilling programs and softening dayrates, other markets around the world are offering 3-5 year contracts with a much higher dayrate structure, said **Mark Keller**, **Rowan Companies** executive vice president of business development. "Jackup migration will continue until the US Gulf of Mexico offers a more stable work environment," he added.

THE X FACTOR

And let's not forget the hurricanes. Ivan in 2004 and Katrina and Rita in 2005 didn't just damage and destroy drilling

contractors' rigs — they also significantly kicked up operating costs.

"The hurricanes recalibrated the basis on which rigs can be positioned offshore and approved for work locations," Mr Gangelhoff said of the industry's increased mooring requirements. "The result is that virtually all jackups have been downgraded in terms of locations they can access during the hurricane season."

Mr Keller added that major challenges facing US Gulf of Mexico drilling contractors today are short-term contracts, unstable natural gas prices, increased insurance premiums and fleet risk associated with hurricane season.

A confluence of these dynamics — natural gas prices, majors' budget shifts, reservoir sizes, stability and higher dayrates in other markets, weather — over the past few years have taken its toll on the Gulf of Mexico with both opportunistic mobilizations and deliberate relocations.

"Any business person could see that the better business prospect is to put your

GlobalSantaFe moved the GSF High Island IV to Saudi Arabia from the Gulf of Mexico for long-term work at higher rates.

rigs to work outside the Gulf, and I think most drilling contractors will continue to evaluate overseas relocations as long as this uncertainty continues," Mr Gangelhoff said.

The GlobalSantaFe fleet is a case in point, he continued. Eighteen months ago, the company had 10 jackups in the Gulf; today, it has 3. What happened to those 7 jackups? "Two were virtually destroyed by Hurricane Rita, and 5 left on long-term contracts with much higher rates than could be found in the Gulf," Mr Gangelhoff said. One of those 5 went to the Mediterranean, and 4 went to Saudi Arabia.

GlobalSantaFe also has 4 semisubmersibles in the Gulf, and 2 will be departing this year. The GSF Arctic I is leaving later this year for a 36-month contract with **Shell** in Brazil. The GSF Celtic Sea will be mobilized in mid-2007 to Brazil for 6 months with **Eni**. "That's a deliberate relocation to place the rig outside the Gulf of Mexico during the hurricane season. Afterwards, we'll bring it back to drill in the Gulf until June 2008, then we'll be locating it elsewhere again," Mr Gangelhoff said. "It's a temporary strategy. Ultimately we see the better place for the Celtic Sea is overseas."

The other 2 semis, the newly built ultra-deepwater Development Drillers I and II (see Page 56) were built to withstand the Gulf's challenging weather. The Development Driller I's original 2-year contract with **BHP** has been extended for 4 more years, taking it to 2012. The Development Driller II is working for **BP** on a 3-year contract ending in late 2008.

GlobalSantaFe's 2 ultra-deepwater drillships, the **GSF C.R. Luigs** and the **GSF Explorer**, also will stay. Contrary to the uncertainty of the jackup market, the Gulf of Mexico sits pretty in the deepwater and ultra-deepwater market.

"Based on exploration and development successes under way that prove oil can be produced in the deeper water, the future for that market in the Gulf of Mexico is very bright. It's an attractive market, quite competitive with other deepwater markets, and characterized by lack of supply, long-term work, high demand and strong dayrates," Mr Gangelhoff said.

LOOKING AT THE LONG TERM

If jackup rig migrations continue as they're expected to, the US Gulf of Mexico rig fleet will suffer in the long run, Mr Keller said. "The larger, independent-leg, higher-spec rigs will have greater opportunities if they depart the Gulf. One day US producers could wake up and find themselves with a fleet of operationally limited jackups that may not be able to drill some of the deeper wells in their program," he said.

From the operator's side — another perspective

Drilling Contractor spoke with **Dave Gibbs**, president of **Medco Energi**, an Indonesia-based oil and gas E&P company active in the Gulf of Mexico.

Q: From an operator's perspective, how attractive is the GOM shelf market to you now?

A: We're very active in the Gulf, and it absolutely is still an attractive market. We will continue to stay busy with jackups in the Gulf of Mexico. I have 2 on contract right now.

Q: What are the biggest challenges for you to working on the GOM shelf?

A: The biggest challenges are cost of operations versus the size of the prospects. We're drilling smaller and smaller targets, and over the last few years, rig rates, boat rates, service company rates and materials have gone up significantly. It's a juggling act to keep the economics favorable.

Q: Do you see the ratio of one to the other as being in an imbalance?

A: I would say so. I would say the prospects are getting smaller and the prices are getting higher. It's getting tougher to find the right things to drill.

Q: How does that impact your projects?

A: It makes me be more selective. Over the last few months, however, we've seen the service prices subside. I think we're getting that back into better balance. Last winter, prices got very high, and we did back off and slow down. We're starting to pick back up

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Rowan currently has 9 jackups in the US Gulf of Mexico. Over the past couple of years, Rowan has mobilized 11 jackups to other markets — 8 jackups in the Middle East, 1 to Trinidad and 2 to the North Sea. The 2 most recent moves were in January 2007, when the Hank Boswell and the Scooter Yeargain mobilized out to work for **Saudi Aramco** on 4-year contracts.

THE MEXICAN ANOMALY

One anomaly in the Gulf of Mexico shelf trend is Mexico, Mr Gangelhoff pointed out. While activity on the US Gulf shelf is declining, “right next door in the Mexican waters of the Gulf, activity has increased and continues to increase,” he said. In fact, there’s a surprising new paradigm in play now: When you look across the entire Gulf of Mexico, he said, about a third of the total jackup rigs are working in Mexican waters. (For more on the Mexican GOM market, please see Page 30.)

1ST QUARTER 2007

With natural gas prices appearing to stay solid in the $7-$8 range, Mr Gangelhoff said, he’s surprised by the

The Bob Keller is one of 9 jackups Rowan Companies has left in the US Gulf of Mexico. Eleven others have been mobilized out of the market over the last couple of years.

recent lack of shelf activity in the US Gulf — particularly in this off-hurricane season.

"We would've thought our customers would have taken the time before the hurricane season to seize the opportunity provided by these historically strong natural gas prices and declining dayrates to get some work done. However, the reality is that utilization has drifted downward," he said. "So there is uncertainty as to what the rest of the year holds."

John Rynd, president of **Hercules Drilling**, agreed that activity has slowed down from the 2006 pace, but he said he remains optimistic that the remainder of 2007 will improve.

"In summer 2006, natural gas prices fell to the \$4-\$5 per MCF range. Service costs, not just rig rates, didn't abate in lock-step with the reduction in commodity prices. Our customers were likely faced with a higher cost than they budgeted," he explained. "It takes about 90 days for companies to adjust their spending due to new commodity prices, so we started seeing a slowdown by the 4th quarter of 2006. Then, with uncertainty about natural gas underground storage and prices, they entered 2007 with a cautious approach.

"Going through the 1st quarter of 2007, it appears natural gas prices are stabilizing in the \$7-\$8 range. I think we're seeing what appears to be the first signs of a recovery, albeit modest at this point," he continued.

Hercules currently has 6 jackups in the Gulf of Mexico. A 7th rig is undergoing a \$47 million upgrade and refurbishment to increase its water depth capability to 250 ft, to expand quarters capacity and drilling depth, and to improve variable deck load.

When the upgrade is completed in July 2007, it won't be staying in the Gulf of Mexico, Mr Rynd said. "We will opportunistically bid it in markets outside the Gulf, and we anticipate having a contract in place prior to delivery."

This decision is in line with Hercules' global expansion strategy, implemented in late 2005 when the company went public. As part of that strategy, Hercules also has acquired a jackup in the Middle East, currently working on a 2-year contract with **Oxy**, and another working in India for **Cairn**, currently drilling the 4th of 7 firm wells.

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again now that rig rates have mitigated fairly significantly.

Q: Can drilling contractors expect activity levels to pick back up for the rest of 2007?

A: I think so. If we can keep these rig rates to the \$70,000-\$90,000 range, I think you will see more activity. When the jackups were above \$100,000, it was choking a lot of projects.

We just picked up 2 rigs coming off of jobs that were significantly higher-priced than the price they're bringing to us. That was in late February, so that was probably the turning point, with people coming off winter contracts. Starting with contracts in the spring, we're seeing much better rates.

Q: Do you expect strong rig demand in the GOM for the next 5 years?

A: With respect to our business plan, we expect to maintain a very active presence in the Gulf of Mexico over the 5-year horizon.

Q: How big a concern for you are the hurricanes?

A: Hurricanes are always an element of our business. We have to plan for them, plan around them. One thing I'm doing is shifting my operations to focus much more heavily on the Western Gulf than the Eastern Gulf. We used to be concentrated in the Main Pass area, and now most of our new activity is going to be in Brazos, Mustang Island. The storm paths was a deciding factor.

Q: What's your view of drilling contractors intentionally moving their jackups out of the US GOM, and what do you think the long-term impact will be on your business?

A: I can't blame them. The Gulf of Mexico always has been and always will be a spot market. We get an idea, we get a rig, we drill that idea, and we let that rig back down again; whereas overseas they can get 3-5 year contracts, locked-in prices, long-term stability. Why wouldn't they do that?

How does it affect me? Obviously, the fewer rigs in the Gulf of Mexico, the tougher it is for me to drive prices down. But there's a balance in there.

Q: Does your overall view of the Gulf of Mexico remain optimistic then?

A: For me, it is. It's a tough place to make a living, but if you know what you're doing, it's a place where I've found a lot of success, and I intend to stay there.

OUTLOOK IS UP

According to Mr Rynd, he sees the potential for an undersupply of jackup rigs in the Gulf of Mexico soon: 4 to 5 of the approximately 80 actively marketed jackups are already scheduled to leave with contracts. Robust jackup markets around the world may draw 3-5 more away in 2007, leaving approximately 70 units for the US Gulf of Mexico. "Compare that with the 76 jackup rig demand in January 2007, and you can see the potential that the jackup market will be undersupplied," he said. "I think rigs could get very tight."

For Mr Gangelhoff, however, "the pivotal issue remains what natural gas prices will do. "And that's very difficult to predict beyond 6-12 months."

As for GlobalSantaFe's remaining 3 jackups in the US Gulf of Mexico, he said they're not rushing to relocate. "We're not being indiscriminate about opportunities to move them out. We're being deliberate and taking our time."

Migration out of the US Gulf of Mexico, whether now or in the near future, should prove to be a wise strategic move for US drilling contractors, Mr Keller pointed out. "We've developed strong relationships with customers here in the US Gulf. However, in the long term, I believe it's prudent for US contractors to diversify their jackup fleets on a global basis," he said. "The US Gulf of Mexico is no longer the largest or most active jackup market in the world. We are now operating in an expanded global market."