Drilling rig market **set to change**

Market drivers point to a slowdown in new project activity, Ian Simpson and James Graf of ABS report.

Changes in the drilling rig market are indicators of industry ups and downs. A look at today's numbers indicates that the most recent upswing is about to change direction.

There is fairly good agreement among the organizations that track drilling rig day rates and utilization numbers. Rigzone's RigLogix numbers provide a snapshot of the market, offering a good starting point from which to begin drilling rig sector analysis.

In February 2014, Rigzone reported drillship utilization at 86.7%, with 85 of 98 vessels working. Jackups were at 85% utilization, with 367 of 431 on contract. And the semisubmersible sector was even higher, with 89% of the units – 168 of 189 – on contract.

While day rates have fluctuated somewhat, they have remained relatively strong. Drillships capable of working in more than 4000ft water depth are averaging US$500,000/day, while high-spec semis are bringing in more than $400,000/day. Jackups vary broadly, of course, based on water depth and drilling capability, but over all, these units are averaging approximately $90,000/day.

At present, the Middle East has the most rigs working offshore, followed by the Asia-Pacific region and Europe. And while the distribution of working rigs is likely to remain more or less the same, the number of rigs working most likely will not.

The utilization numbers are high, but it is worth noting that they have all dropped slightly from January, when 91% of the drillships, 87% of the jackups, and 90% of the semis were on contract.

Because ABS classes jackups, semisubmersibles, and drillships, the organization follows activity in these sectors closely. Globally, 84% of jackups, 57% of semis, and 55% of drillships are ABS classed.

Jackups

The jackup market currently stands at around 530 units. There are 120 additional units contacted or under negotiation, not including options. About 470 units make up the operational fleet, but nearly 300 of these units are more than 30 years old. Some have passed middle age, with 45 years or more under their belts since originally being delivered.

Worldwide demand appears to be somewhere between 450 and 480 units. Not surprisingly, the preference is toward higher-spec units; so the demand for these units will continue to grow, with steady ordering at a somewhat lesser level than currently seen for the remainder of the decade.

Drilling contractors are well aware of the bifurcation of the market. Asset owners realize that to maintain a healthy balance between utilization and day rates, they will have to scrap or find alternative uses (other than drilling) for at least 200 of the aging units in the fleet as higher-spec newbuilds come in and displace older units.

Drillships

The drillship fleet has grown from less than 40 units in 2005 to more than 100 units at the beginning of 2014. The profile of the fleet is young, with approximately 75% of the vessels less than 15 years old. A further 76 or so units are on order, and steady ordering is expected for the remainder of the decade. A fleet of 200 units would appear to be sustainable with some removals from the older end of the fleet. Drillships will continue to be the asset of choice for extending industry frontiers – deeper targets in deeper water and further from logistic base support.

Semisubmersibles

The semisubmersible fleet of around 240 units is one where 65% of the rigs are more than 20 years old. But unlike the drillship and jackup sectors, the semi sector has not seen a sustained newbuilding program over the last 10 years. Today, there are only about 25 newbuilds under way, and the majority of those are being built specifically to work offshore Brazil and Norway.

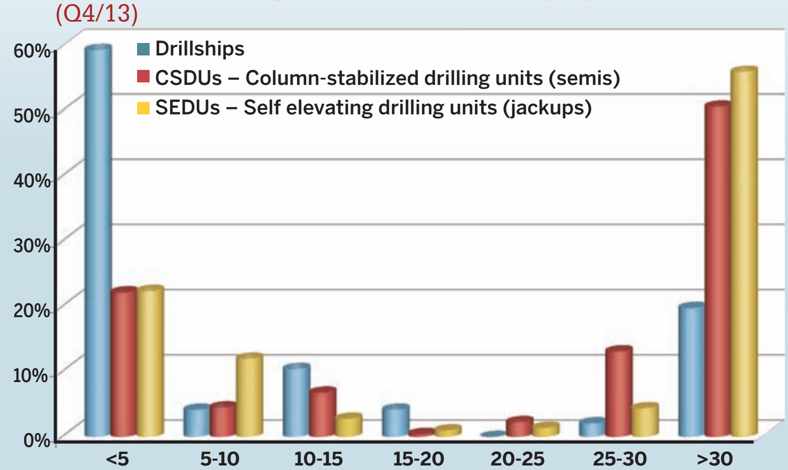
There certainly still is a place for semisubmersibles, but the newbuilds will be constructed for focused mission type operations, where they can compete with drillships. Fleet replacement will happen, and the semi will reinvent itself to compete in a bifurcated floater market.

ABS MODU outlook – Spring 2014

Mobile Drilling Units	2014	2015	2016	2017
Demand Growth	1.3%	1.1%	1.4%	2.3%
New Construction				
Orderbook Fleet %	19.2%	17.0%	16.4%	16.2%
Delivery Slippage1	12.7%	13.0%	10.7%	8.7%
Newbuilds Fleet %	7.0%	7.2%	6.4%	6.4%
New Orders Fleet %	5.2%	5.8%	6.2%	6.6%
Fleet Growth	4.0%	4.2%	3.0%	2.6%
Idle Rate	5.2%	5.0%	4.9%	4.9%
Removals Fleet %	0.4%	0.5%	0.8%	1.2%
1- Projected estimate				
Key:	High	Moderate		Low

MODU fleet age distribution by type of unit

(Q4/13)



Forecast

Over all, the market appears to be taking a breather from the surge the past few years. There are 31 drillships and semisubmersibles slated to leave the yards by year-end, and nearly half are not contracted. Demand has begun to drop off, in part as a result of a number of international operating companies cutting back on their exploration programs.

Those watching the international market began to recognize toward the middle of 2013 that the market was beginning to soften. Rig supply is somewhat outpacing demand. And the large number of drilling rigs due to come out of the yard by the end of this year is compounding that problem. A slowdown in the market is shaping up, and with stagnant oil prices, it could last a few years.

ABS has framed its forecast based on macro industry demand drivers, and using a supply vs. demand approach to project future supply needs. Oil price and oil demand are closely correlated to offshore industry activity on a longer term trend basis, and consequently represent a primary base demand indicator used for longer-term activity projections.

Barring any major geopolitical event or natural disaster, oil prices should remain relatively flat for the next few years; in part dampened by weak oil demand growth, the growing shale oil contribution, and the growing demand for natural gas. Oil demand is projected to grow at only a modest 1-2% per year over the next four years. As a result of a series of factors – which includes dampened demand, stagnant oil prices, recent large inflow of new supply, large current orderbook, and a short term backlog in vendor equipment – new supply demand will likely be weaker for the next year or two.

While the near-term market is less than rosy, the longer-term outlook is still strong. Regulatory and environmental requirements, technology-driven expansion to deeper water, and other short-term drivers will generate new orders to meet both new demand and to replace existing units.

Construction, Industry Outlook

New construction activity will remain high but will not reach the peaks witnessed over the past few years. The MODU orderbook is projected to decline for the next year or two as deliveries outpace new orders, leveling off at about the same level seen by the industry in mid-2011. High-specification jackups will make up the lion's share of exploration unit activity.

The correction in the market is likely to take a year or more, but the industry will emerge on the other side of the decline with a much more capable drilling fleet to meet the more demanding operating environments that operators are targeting. The upgraded fleet will be much better placed to meet their exploration needs. **OE**

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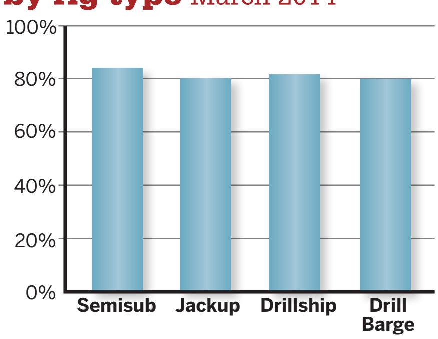
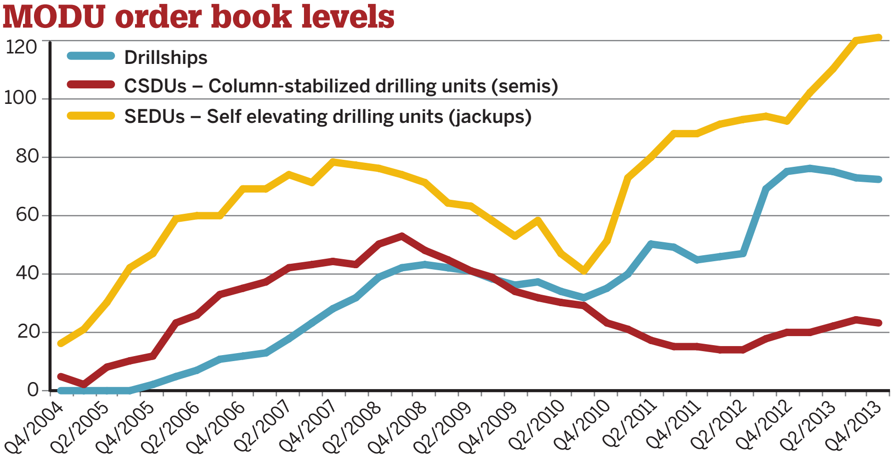
Current competitive offshore rig utilization by rig type March 2014



Drillships	80.6%	(79/98)
Jackups	79.8%	(343/430)
Semisubmersibles	84.1%	(159/189)

Source: RigLogix, www.Rigzone.com

MODU order book levels



The rise in newbuilds in recent years is evident in this chart. The drillship fleet has grown from less than 40 units in 2005 to more than 100 units at the beginning of 2014.

Deliveries/removals from the MODU fleet to 2020