- HE semisubs market segment is picking up
- There are not enough HE semisubs to meet the growing demand and this will translate into higher day rates and potentially, long-term contracts
- Stringent rules for using sustainable and effective HE rigs will force drilling contractors to upgrade their fleet
- More and more independent field operators are entering the HE market, specifically in the North Sea.

Is the Environment Harsh for HE Semisubs?

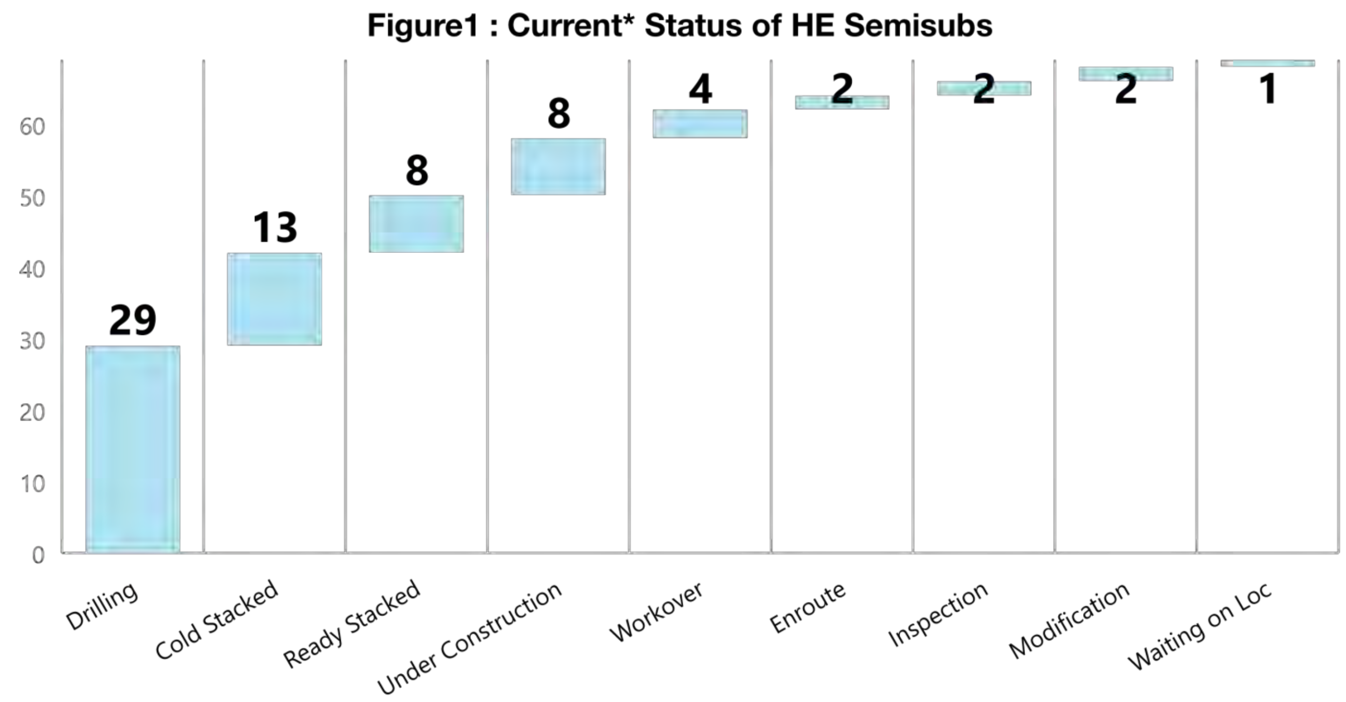
Introduction

In our [May 2018 insight paper](), we briefly touched on the harsh-environment (HE) semi-submersibles (semisubs) market. We mentioned that there was an undersupply in the Norwegian HE semisubs market. Some drillers were reactivating cold-stacked units due to a lack of available ready-stacked units.

In this month paper, we are drilling further into the global HE semisubs market. We have Analysed past and current data to understand the market risk profile faced by those looking for HE Semisubs.

Current Snapshot of the HE Semisubs Market

Currently, 69 HE semisubs exist globally. *Figure 1* below shows the status of these. Over 50% of the HE semisubs are in the North Sea region making it, by far, the biggest market for this type of rig. In numbers, this translates to 21 out of 29 of the rigs presently drilling, are in the North Sea (sixteen in Norway and five in the UK). The demand for more rigs in the region is increasing and in line with this demand the 2 "*enroute*" rigs shown below, are heading to the North Sea.



1

Source: RigLogix Data, Epeus Analysis

For drilling contractors to remain competitive, the rig ownership landscape has undergone and is still undergoing change. Currently, the top 5 HE semisub drilling contractors are Transocean (12), Seadrill (10), Diamond (7), Odfjell (6) and China Oilfield Services (COSL) (6).

* Snapshot of the 25th September 2018

Last month, Transocean strengthened its market share in the HE semisubs segment by acquiring Ocean Rig and its two HE semisubs. Reports in August 2018 appear to suggest that Odfjell Drilling, is actively seeking to expand its HE rigs fleet, either through newbuilds or acquisition of existing rigs.

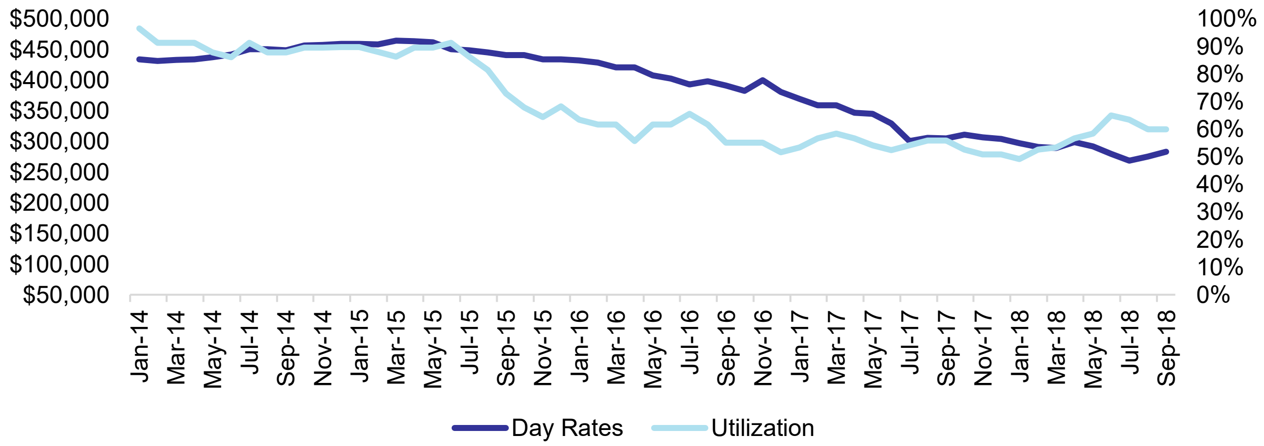
The market demand leaders for HE semisubs (i.e. Equinor), are pressuring drilling contractors to use more modern rigs, which have a lower environmental impact and a higher efficiency capability. This policy will encourage more drilling contractors, interested in this market, to order new rigs and retire the old ones.

Five of the thirteen cold stacked HE semisubs are over 30 years old meaning that about 30% of the total stacked HE rigs are more than likely to be permanently retired. A few others may be used for workover or decommissioning projects in less harsh work areas. Leaving the younger rigs (comprising about 54% of the cold stacked HE semisubs) to be reactivated once demand picks up. This, of course, remains to be seen and rig owners with older rigs may well choose to speculatively reactivate their rigs to secure any future work ahead of those, which remain stacked.

Efficient and sustainable rigs are generally more expensive to hire, and since Norway is requiring them for their waters, does this mean the UK will follow suit? If the answer is yes then the pressure on the supply side will increase and if the market is true to form, so will rig day rates.

Figure2: Day Rates and Utilization of HE Semisubs between 2014 and 2018

Source: RigLogix Data, Epeus Analysis



Day rates have had a downward spiral since January 2014, with average day rate dropping by almost US$160,000, representing a 36% reduction, as shown in *figure 2*. The average day rate for the 21 HE semisubs currently drilling in the North Sea, is around US$267,000. The utilization graph portrays a more positive outlook. Since February 2018, the utilization rate of HE semisubs has increased on average. It is early days, but this may be a positive sign of market recovery.

So, are day rates going to increase anytime soon? We looked at the already awarded HE semisubs contracts, with start dates ranging from 2018 to 2021, and averaged out the operating day rates. As *figure 3* shows, the trend is for day rates to increase from next year onwards, which points to a more optimistic future compared to day rates of *figure 2* and in line with current utilization and market supply challenges. The data suggests demand for HE semisubs is increasing and that there will be more contracts awarded next year. For instance, some of the operators who have been rumoured to be looking for HE semisubs to commence drilling in 2019 are: INEOS, Siccar Point, Total, and Shell.

Figure3: Average Day Rates and Contracted Days of Awarded Contracts
Source: RigLogix Data, Epeus Analysis

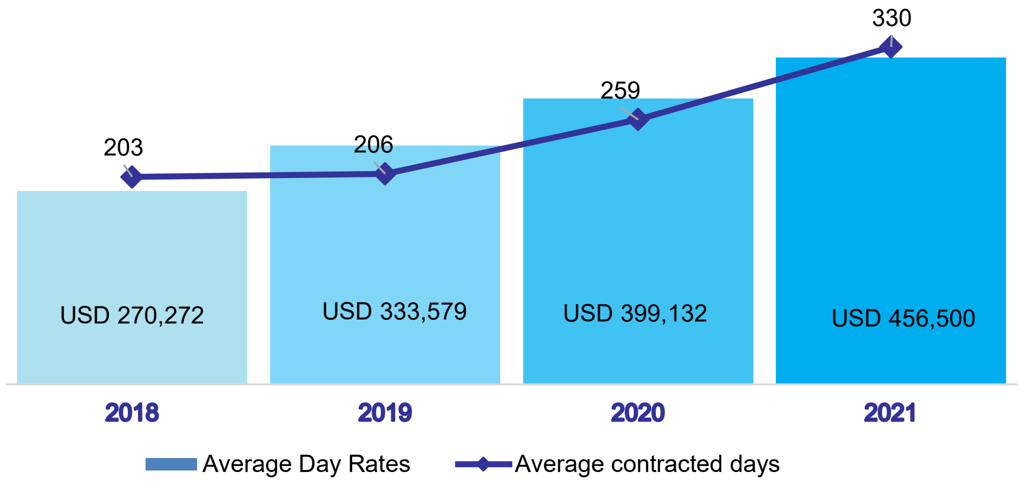


Figure 3 highlights another important factor. The average contracted days for the HE semisubs is going up. Over the past couple of years, field operators sanctioned shorter drilling projects and drilling contractors also do not usually lock their rigs in at low rates for long-term contracts. Hence, there is a correlation between average day rates and average contracted days. What does all this mean for the field operators? The higher average day rates and longer drilling projects may direct them towards contracting rigs under multi-year deals to realise value.

Future Demand

The current market demand for the HE semisubs is primarily coming from the North Sea, and it seems that the trend will continue for the next few years. *Table 1* below shows the current global tender status for HE Semisubs, 2019 through 2021. Most of the tenders are emanating from field operators in the North Sea, with almost 70% of the total demand. Noteworthy is that more and more independent field operators are entering the harsh environment market in the North Sea Region. As indicated by the data in *table 1*, 40% of the field operators are independents.

Some small independent field operators are embracing new business models with companies that provide well operatorship (outsourcing operational services). There would likely be an adverse impact on rig intake and start up if these types of business models are not properly implemented.

Table 1: Current tenders with estimated start dates of November 2019 to April 2021

Operator name	Norway	UK	Canada	Ireland	Russian Federation	Australia	Grand Total
Equinor ASA	2		2				**4**
Siccar Point		4					**4**
Chevron		1				1	**2**
Aker BP	1						**1**
ConocoPhillips	1						**1**
Eni	1						**1**
Europa Oil and Gas				1			**1**
ExxonMobil			1				**1**
INEOS		1					**1**
Nexen Petroleum			1				**1**
OMV	1						**1**
Rosneft					1		**1**
Shell	1						**1**
Spirit Energy	1						**1**
Total E&P	1						**1**
Grand Total	**9**	**6**	**4**	**1**	**1**	**1**	**22**

Source: RigLogix Data, Epeus Analysis (25th September 2018)

Conclusion

To summarize, HE semisubs market segment is picking up. There are not enough HE semisubs to meet the growing demand and this will translate into higher day rates and potentially, longer-term contracts. Finding new and efficient HE semisubs is going to be harder. Stringent rules for using sustainable and effective HE rigs will encourage those drilling contractors interested in this market to upgrade their fleets. More and more independent field operators are entering the HE market, specifically in the North Sea.

So far, in 2018 there are only two HE semisubs newbuilds ordered, with delivery dates of 2020 and 2021. It will be for the market to decide if these will be enough to meet the growing demand?

Risk Considerations:

- If demand out strips supply, there is a risk that field operators might rush into signing contracts without fully considering the contract/well requirements, the status of the rig, or the drilling contractor capabilities (people and processes). Based on our experience, these are risks that need to be assessed and if necessary mitigated with a robust rig intake/start up program.
- If the few available rigs are in other regions rather than in the desired operational location; then more time will be needed to vet, the rigs and ensure that they conform to industry standards and regional regulations. If not managed effectively, this could lead to project delays like those experienced in the HE Jack Up Market before the downturn.

The Epeus Group

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