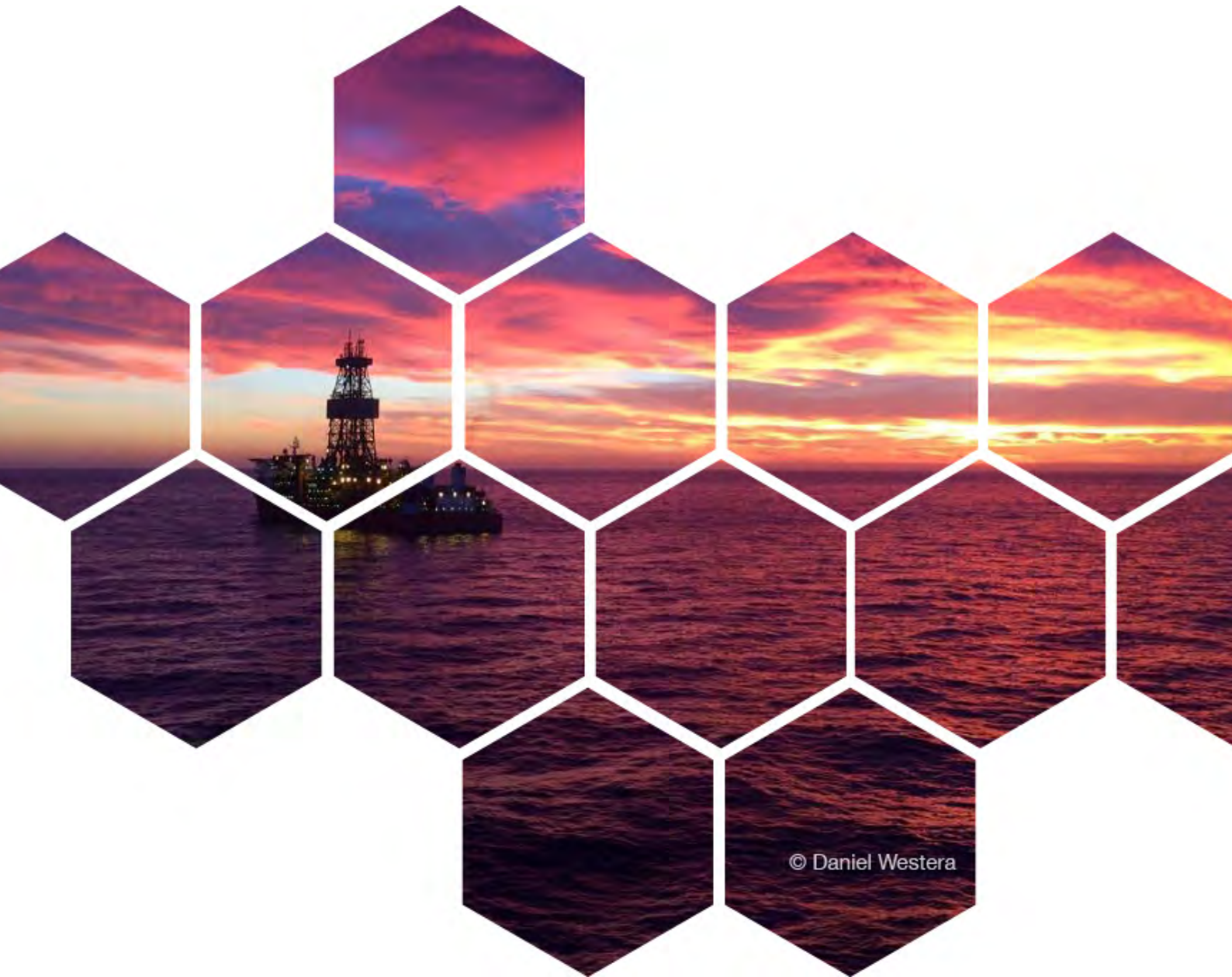


Drillship Day Rates - New Dawn or False Dawn?



- Drillship utilization rates are increasing but day rates are still low
- The demand for the UDW (ultra deepwater) drillships is increasing
- Given the high number of drillships ready (warm/ hot) stacked and under construction drillships it is likely that most of the cold stacked would be permanently retired.
- It's probable that drillship day rates could double in 2020.

Introduction

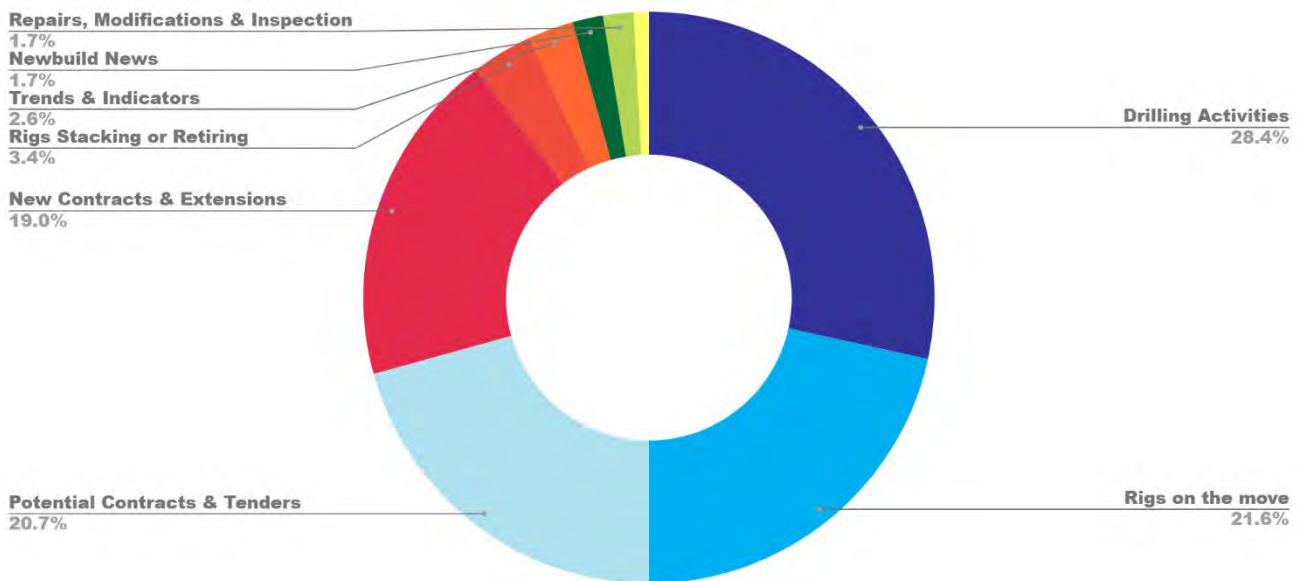
Last time we commented on the drillship market ([May 2018 insight paper](#)), one of our observations made – was no signs of a rebound in the drillship utilization rate. There was a downward slope. However, we concluded that things could quickly change. And, indeed things have quickly changed. Since the end of last year there has been an uptick in the drillship utilization rate.

What has triggered this pick-up of activities? And what are the future trends? This is what we are covering in this month’s paper. The paper gives a holistic view of the current rig market and highlights the risks associated with uncertainty of the market.

Status of the Global Drillship Market

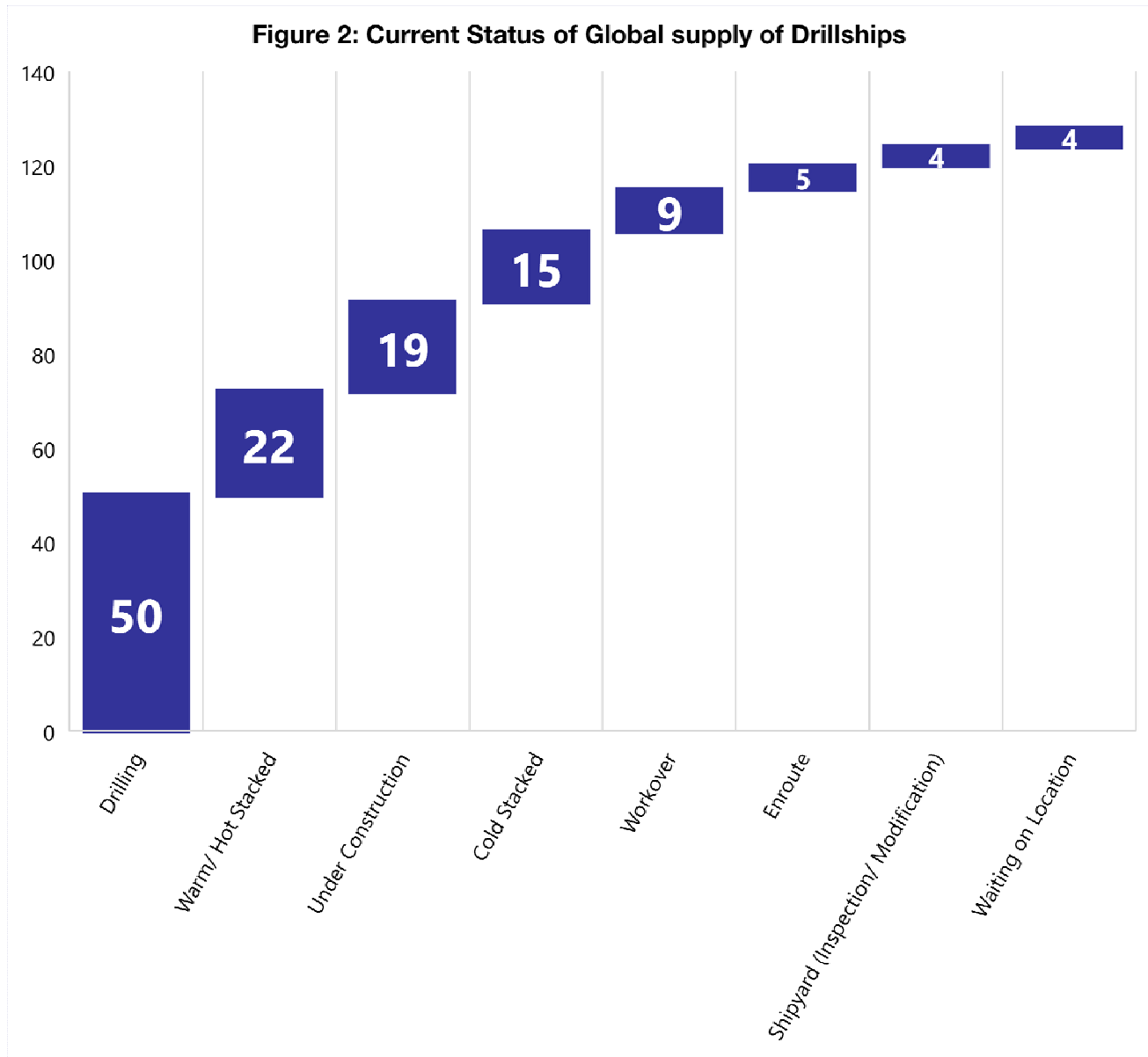
The first four months of 2019 started on a positive note for the drillship market and from our extensive research, we found 124 individual drillship focused articles. As shown in figure 1 below, over 96% of drillship news in the last three months were highlighting a slight uptick of the drillship market.

Figure 1: Headline News per Activity Type (1st January – 8th April 2019)



Source: DailyLogix Data, Epeus Analysis (8th April 2019)

Currently there are about 128 drillships globally. Figure 2 below shows the status of all the global supply of drillships, whereby 39% of them are currently drilling.



Source: RigLogix Data, Epeus Analysis (8th April 2019)

Spanish waters have become home to 41% of the warm or hot stacked drillships.

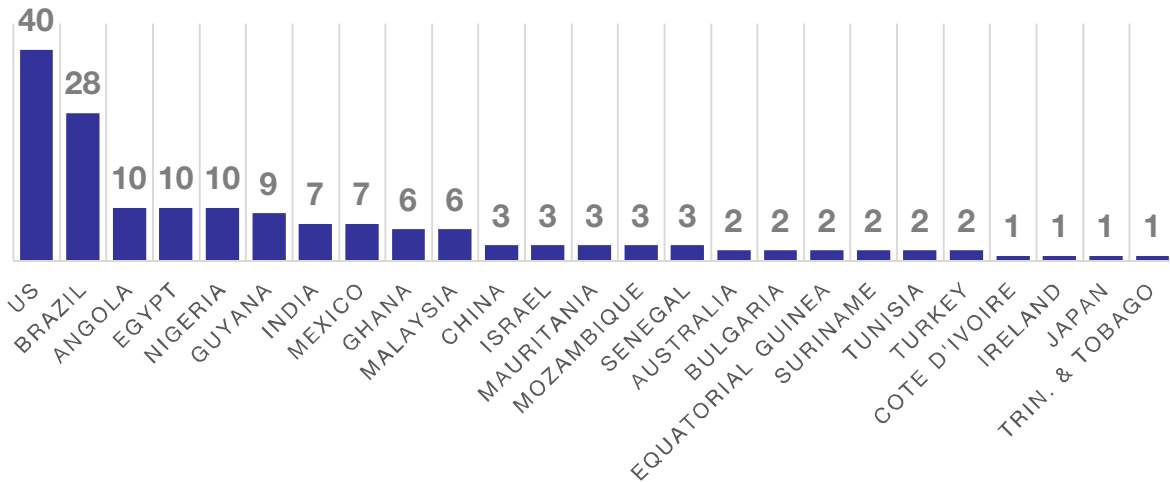
All nineteen drillships under construction were ordered prior to the current oil crisis when the market was buoyant. Out of the nineteen under construction drillships, only three have firm contracts. *Arpoador*, which was ordered in 2011, has a firm contract with Petrobras starting November 2019. *Guarapari* which was ordered in 2012, has a contract with Petrobras starting January 2021. And finally, *Transocean Espadon Drillship Tbn2* has a contract with Chevron starting May 2021.

Transocean owns 67% of the current cold stacked rigs. From the fifteen-cold stacked drillships, only one is over 40 years old, namely, *SC Lancer*. It's possible the SC Lancer drillship is facing permanent retirement, while the remaining drillships are aged up to 20 years old. How many of these will ever see the market? Are they perhaps going to end up in scrapyards?

Given the high number of drillships ready (warm/ hot) stacked and under construction, it is likely that most of the cold stacked would never see daylight again. They are most likely to be permanently retired.

Most of the drilling is currently being done in the US and Brazil. Both countries have the most fixed contracts globally, as shown in the figure 3, below.

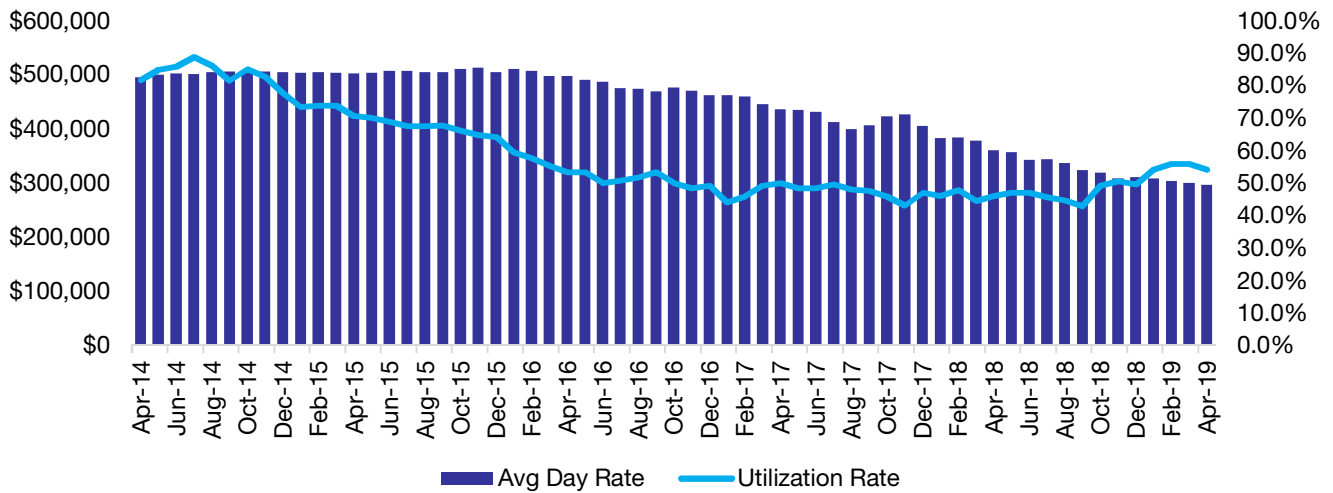
Figure 3: Current Contracts per Country
 Source: RigLogix data, Epeus Analysis (8th April 2019)



The utilization rates started picking up from October 2018, as shown in figure 4. However, the average day rates have done the opposite, they have gone on a downward slope. 2019 has had the lowest average day rates since the market crash. Last month, Offshore Energy Today posted an article, stating that the *Pacific Sharav* drillship which currently has a day rate of \$551,000 has signed a two-month firm contract starting in October 2019 with an estimated day rate of \$175,000.

Figure 4: Average day rates & utilization rates of drillships between 2014 and 2019

Source: RigLogix data, Epeus Analysis

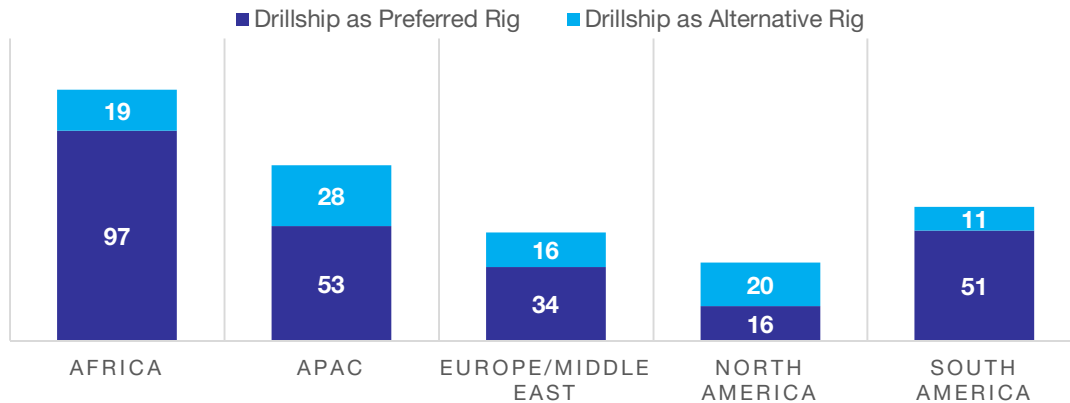


Future Demand

Which region will lead the future demand?

The African region was most affected by the 2014 oil price slump, and to date it's still recovering, as figure 6 shows below. The majors have been criticised for not sanctioning enough exploration projects in Africa – it appears that they have returned. For example, Total E&P has 14 drillship tenders, Eni (10), ExxonMobil (7), Shell (7) and BP (4). The oil majors currently lead exploration projects, in Africa, but also globally, including Guyana and Brazil.

Figure 6: current drillship tenders



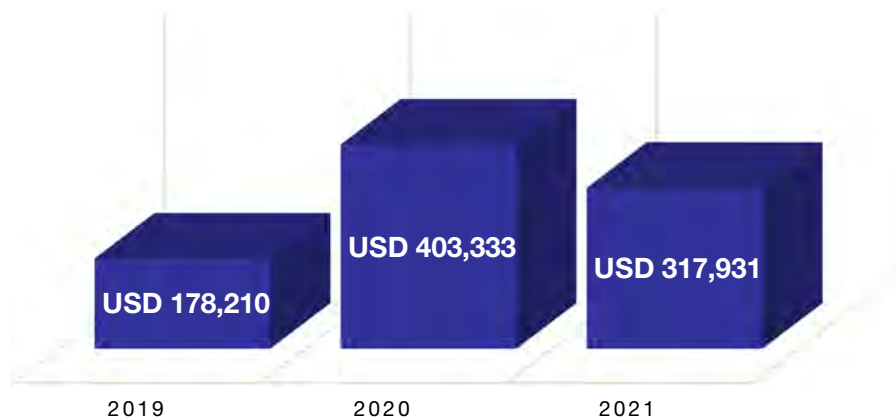
Source: RigLogix Data, Epeus Analysis (10th April 2019)

The ultra deepwater (UDW) market segment is recovering. From 345 drillship tenders, 117 require UDW drillships. From the outset of the downturn, the ultra deepwater operations were among the first projects to be cut-off due to their relatively high field development costs. Over the last four years however, the industry has managed to reduce their costs significantly and the operators are receiving a record cash flow. The combination of these two factors are giving field operators an extra impetus to re-enter the ultra deepwater space. According to Upstream Online, the number of final investment decisions (FID) for offshore field projects is expected to increase to 119 this year, close to a peak of 120 in 2013.

Are day rates going to increase anytime soon? We looked at the average day rates for awarded contracts this year, 2020 and 2021; and as figure 5 shows, improved day rates look set for 2020. It's possible day rates could double next year. This is in line with what the CEO of Transocean, Jeremy D. Thigpen said in February 2019 that *“they anticipate a rapid acceleration of day rates also in the ultra deepwater market going forward and a doubling of day rates within the next few years”*. Field operators are aware of this and they are currently trying to lock in the best rig assets at current low day rates for as long as possible. However, it's highly unlikely drilling contractors will agree to sign long-term contracts at present day rates.

Figure 5: average day rates for awarded contracts

Source: riglogix data, epeus analysis



The limited supply of modern specialised UDW drillships or floaters in general might trigger a similar trend that in the harsh-environment (HE) market we observed last year in the North Sea; where utilization and day rates increased due to limited supply of modern HE rigs.

Conclusion

Overall, the outlook for the drillship market looks brighter for drilling contractors and next year could be the year, where drillship day rates start to increase. In turn, field operators who move first will benefit from the low day rates and better selection of rigs.

As we have seen 41% of the warm/ hot stacked drillships are currently in Spanish waters. It's probable they will be some of the first of the fleet to be reactivated. This raises some questions, do the rig owners or the drilling contractors have reactivation strategies? And as demand for the drillships increases, would they be able to simultaneously and successfully handle multiple reactivation projects? Rig reactivation and redelivery are projects which require a range of management skills and competencies. Unfortunately, due to the massive downsizing in the downturn market, it is going to be harder for drilling contractors and field operators to find key and experienced personnel.

However, if demand for drillships and day rates do not increase this year and next as anticipated, there's a risk most of the cold stacked drillships could be permanently retired due to the high cost of reactivating cold stacked units. Have drilling contractors started developing a scrapping approach for their cold stacked rigs for this likely eventuality? Readiness is all.

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For more details visit our website at www.epeusconsulting.com

Contacts



Mark Thompson
+44 7734 874749
mthompson@epeusconsulting.com



Andrea Petrone
+44 7702 518339
apetrone@epeusconsulting.com



Claudette Gaius
+44 7519 116339
cgaius@epeusconsulting.com

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