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OILFIELD EQUIPMENT: Analysts have high hopes for the deepwater rig segment

By Brian Dunn Published: Mar 1 2008

While soaring oil prices are driving some new money into the sector, the outlook for demand is split, prompting analysts to question whether corporate investments in new equipment are truly warranted. The dividing factors appear to be onshore vs. offshore drilling and whether the activity is within North America or on the international scene.

Offshore rig activity is expected to remain strong, but demand for onshore oil drilling rigs is a different story. Despite oil prices hovering near $100 a barrel, onshore demand for rigs is expected to decline across North America after peaking during the past 12 months, according to industry analysts.

"The consumption for rigs should slow down after 150 were added in the last year," said Kevin Lo, an analyst at First Energy Capital Corp. in Calgary, Alberta, "which begs the question, why do we need more rigs? By contrast, the offshore rig market should remain strong."

Drilling activity in Canada is expected to be off 15 percent in 2008 compared with 2007, according to Simmons & Co. International, Houston, while activity in the United States is expected to inch up about 3 percent, with overall North American activity essentially stagnant.

And while some companies servicing the sector are pumping up capital investments, overall expenditures are expected to be flat or down from 2007, resulting in declines in both pricing and margins. Cash margins for land rigs are expected to decline 15 percent this year, following a similar decrease in 2007, according to Simmons analyst Bill Herbert, while average Gulf of Mexico day rates were off by 10 percent in 2007 and look to be flattish this year.

The international story looks much different with "a continuation of reasonably commendable growth, with the land rig count growing by 10 percent and the offshore rig count growing by 6 percent, or b y about 25 to 30 rigs on average," Herbert said. As a result, he predicts international revenue growth of between 15 and 35 percent for the larger service companies. Offshore rig rates should be flat to slightly up, marine seismic contract pricing up by 10 to 20 percent, offshore construction pricing up 10 percent and international offshore day rates also should register "methodical gains as well."

While the next few quarters overall will be flat, 2009 is looking positive due to an anticipated influx of new offshore oil rigs during the next two years, including 70 jackup rigs and 50 deepwater rigs. "Accordingly, earnings growth for the next two years should continue to be brisk for those well exposed to the bigger themes governing oil service, but between here and there is a bit of a slog," Herbert said.

Douglas Becker, senior analyst at Bank of America Corp., suggests international- and deepwater-focused service and equipment companies are riding a high tide, but the North American market, particularly the natural gas sector, is going through a slow period.

"With marine seismic spending (a leading indicator of exploration activity) forecast to increase over 65 percent between 2006 and 2008, we expect exploration activity to increase and reverse the slide of the last four years in the number of deepwater discoveries," Becker said. And while rig availability might limit the increase in deepwater spending this year to just 10 percent, pent-up demand should propel the market higher in 2009 and beyond.

"As virtually every deepwater and ultra-deepwater class rig is contracted through 2009, deepwater fundamentals remain among the strongest in any oil service segment and we expect the market to remain tight," Becker said. "Recent contract awards extending into the next decade and new build delivery schedules continue to suggest that the deepwater market will remain undersupplied through at least 2012."

BRIAN DUNN