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OILFIELD EQUIPMENT: Home-grown growth prospects are lukewarm at best

By Brian Dunn Published: Mar 1 2008

The outlook for global drilling activity is somewhat hazy, clouded by a combination of factors, including questions over the state of the U.S. economy, the weak greenback and soaring costs.

The outlook remains strong in some parts of the world, like Russia and Mexico, while it's weaker in others, according to service providers at the forefront of the oil and gas industries.

Canada falls into the latter category for a number of reasons, Gene Shiels, assistant director of investor relations at Baker Hughes Inc., Houston, said. "The economics, particularly for natural gas producers, will be very difficult due to the weakness of the U.S. dollar vs. the Canadian dollar, relatively high service costs (due to a labor shortage, which boosts salaries), lower gas prices and the higher royalties in Alberta for oil and natural gas, which will take an additional $1.4 billion out of the pockets of producers."

Despite major oil drilling activity in Canada, overall rig counts were down last year from 2006 levels, and Shiels doesn't see any indication the situation will improve anytime soon. The drill rig count averaged 343 in Canada last year, down 27 percent from an average of 470 rigs in 2006 and a sharp reversal from the 2.6-percent gain from 458 rigs in 2005 and the 24.1-percent jump from 369 rigs in 2004, according to data compiled by Baker Hughes.

Compared with Canada, drilling activity in the United States is booming, although the rate of growth is slowing, Shiels said. The U.S. rig count averaged 1,768 in 2007, up 7.3 percent from 1,648 rigs the previous year, continuing the 19.4-percent growth from 1,380 rigs in 2005 and the 16-percent jump from 1,190 rigs in 2004, the Baker Hughes data shows.

While the average rig count in North America last year was slightly more than 2,100, the rig count overseas was less than half that at about 1,000. The difference, Shiels said, is that outside North America much larger projects are under way that don't appear to be influenced by commodity prices or the seasonality of projects in Canada, and thus show more stability. "A lot of them are being conducted by national oil companies whose primary motive isn't necessarily profit, so international projects are much more steady."

In terms of offshore drilling, the shallow water shelf of the Gulf of Mexico will continue to be a challenging environment, with several rigs pulling out to more attractive areas that offer better contract terms for the rigs and don't have to pay hurricane premiums, Shiels said. But deepwater projects-which cost upward of $100 million just to drill a well-are a growth area requiring the latest technologies of service companies.

Deepwater drilling in Mexico will likely strengthen this year, "and Mexico itself could be a good potential market with some very big projects, which could drive a lot of (equipment) growth," Shiels said. However, Russia has the potential to be the world's biggest growth market over the next couple of years. "It's a huge, huge market. The big difference in Russia is that activity is moving from a traditional brownfield play into more exploration play and a growing willingness to adopt and pay for Western technology."

Like many players in the oil patch, Tesco Corp., Houston, designs, manufactures, sells, operates and services oilfield equipment used in drilling oil, gas and geothermal wells around the world. The company's North American business depends on the state of the economy, but oil prices don't drive Tesco's North American activities, said Nigel Lakey, senior vice president of marketing and business development.

"In other parts of the world, and especially in areas where the local economy is driven by petro-dollars, oil prices do drive drilling activity to a degree," he said. "However, it is interesting to note that even with very high oil prices, drilling activity has not increased recently as oil production remains strong."

During the next two years, Lakey sees drilling activity increasing in the Eastern hemisphere-led by Russia, North Africa, the Middle East and Asia-while activity is expected to slow in North America amid signs of an economic slowdown. "Twelve months ago, there were 120 rigs drilling offshore of the Gulf of Mexico. Today, there are only 56."

Natural gas drilling in the United States isn't expected to vary greatly from recent levels, oilfield services company Schlumberger Ltd., Houston, said, adding that land activity outside North America is expected to remain strong, as is global seismic exploration.

"Within this context, technology that assists our customers in mitigating risk in exploration and development projects, increasing recovery factors and improving operational efficiency will remain at a premium," Andrew Gould, Schlumberger's chief executive officer, said.

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