

Rig production figures to be taken with pinch of pre-salt

Talk about BG selling stakes in the Santos Basin has proved to be untrue, but production delays are increasing



BARRY PARKER — NEW YORK

BG Group, a holder of large positions in the Santos Basin, has denied rumours in the Brazilian press it is selling down its stakes in the pre-salt oil fields.

By its own recent estimates, its share of oil reserves could reach 8bn barrels. Its holdings include a 25% stake in the BM-S-11 block, where the well-known Lula field, now producing oil and gas in a pilot project, is located — and a 30% share in BM-S-9 block, where the Carioca field sits. Petrobras holds 65% and 45% respectively in these two fields.

Recent market reports show Petrobras employing Seadrill's West Orion, Schahin's Vitoria 10,000 and Petroserv's SSV Victoria in BM-S-9, all at depths exceeding 2,000 m. In BM-S-11, Transocean's Cajun Express and Diamond Offshore's Ocean Valor are on contract at similar depths.

At Lula, roughly 40,000 barrels per day is produced after processing at the Modco-owned floating production, storage and offloading unit Cidade de Angra dos Reis.



In BM-S-11, Transocean's Cajun Express is on contract at depths over 2,000 metres. Bloomberg News

Gas is now being fed through a new underwater transmission line to a platform in a shallow part of the Santos Basin and then into onshore processing.

The resource nationalism is part of a bigger story with enormous promise for the offshore energy sector of the business. Petrobras, the country's major producer, has plans to produce up to 5.5 m bpd of gross liquids by 2020, up from approximately 2m bpd at present.

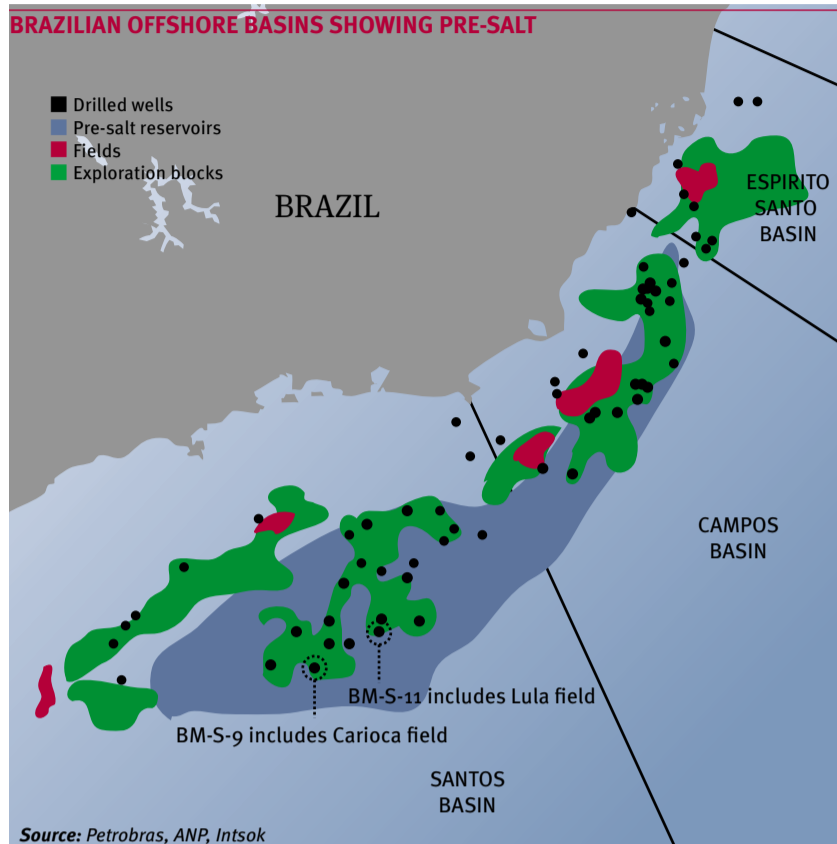
Brazil has planned to build drilling rigs domestically to support oil production that is being ramped upward at compound annual rate exceeding 12%, compared with 4% in the decade through 2010.

Yet, in spite of this optimism, with major oil companies and their state-owned brethren poised to fight for Brazil's oil resources, observers are asking more difficult questions about the timing of the path from exploration to real production.

Rosy forecasts are now abutting real delays. In a recent interview, chief executive of Petrobras José Sergio Gabrielli acknowledged deliveries of newly-constructed drilling rigs have been fewer than hoped for.

The impacts may add tightness to the semisubmersible, drillship and for hire segment of the FPSO markets that all exceed current expectations as the activity in Brazil begins a shift from exploration to development.

In their just-released Strategic Review of the Brazilian Drilling Market, analysts at Morgan Stanley caution the combination of a tight worldwide rig market, described as a "looming 2012/2013 shortage of deepwater drilling rigs



globally", and delays with rig construction in Brazil, could delay the country's ability to meet its "ambitious deepwater production goal".

Morgan Stanley's energy services analyst Ole Slorer, in the firm's Offshore Exploration Outlook call, told investors: "If you take the production goals of Petrobras and you back into what that means, in our view, on rig requirements in order to achieve their 2020 production numbers, they will be short upwards of 40 rigs."

As detailed in the report, Brazil may also find its ability to build FPSOs, used in offshore production beyond the reach of pipelines, also coming up short. Depending on the true magnitude of oil reserves, Morgan Stanley sees a demand for an additional 40 to 60 FPSOs in the next six years.

In the "Bird's Eye View" section of the Brazil report, the region is described as the world's largest and most prominent market for floating drilling equipment.

The report concludes with a discussion of two continuing tenders to charter in midwater rigs, capable of working in depths of 3,000 ft to 5,000 ft.

The tenders are indicative of a nearby

trend noted by Morgan Stanley and other analysts: the potential for demand to spill over from the deepwater sector into midwater rigs.

Morgan Stanley, in discussing Brazil, says: "While Petrobras may prefer newer technology for all its fields, it is happy to save on costs by contracting older, lower-spec floating equipment at rates that are as much as 40% lower than those of the newest ultra-deepwater rigs."

In the country-specific report, a far more nuanced situation is revealed. Specifications for equipment specify technological requirements that would significantly restrict the field of potential bidders for the Petrobras contracts, which vary between three and five years' duration.

The analysts conclude with a simple message: "We believe Petrobras would have to be willing to contract a rig at a market price, if it wants to meet its drilling demand."

However, as pre-salt predominates exploration, the same message would apply to rigs working in the ultra-deepwater depths down to 12,000 ft. ■

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Report model features wide range of scenarios

THE Morgan Stanley report on Brazilian drilling presents a detailed model of future supply and demand for floating drilling equipment — semi-submersibles and drillships — to the year 2020, writes Barry Parker.

This type of model looks at the requirements for both exploratory and appraisal drilling, as well as floating production equipment, all against historical performance baselines.

An important reference point is that 30 floating rigs were needed to bring Brazil's offshore production from zero to 1.5m barrels per day (with similar requirements in the US Gulf) in fields far less complex than Brazil's pre-salt.

The model encompasses a range of cases in which scenarios for 2018 are compared with the present 70 floating rigs operating in Brazilian waters.

Petrobras and others will need 135 rigs in total — some 65 additional units — in the base case. This implies more than three dozen rigs above Petrobras' stated production target of 28 drillships.

In May this year, construction contracts for seven of these drillships were awarded to the Estaleiro Atlântico Sul (EAS) yard.

In the extreme bull case, some 180 rigs are needed, 145 to be operated by Petrobras, based on lengthy drilling times — 90 days to drill in pre-salt versus 65 days in the base case — and quicker depletion of fields.

Added into the mix are oil prices above \$120 per barrel, with the impact of "incentivising" Petrobras to meet production goals.

At the opposite end of the spectrum, in the extreme bear case, 90 rigs are needed offshore Brazil, an increase of only 20 beyond the anticipated complement, based on relative ease — 55 days — in penetrating the pre-salt.

The Morgan Stanley forecast is skewed to the bullish side of the base case, with an expectation that 40-50 floating rigs will need to be contracted from the outside market in the coming years.

The implication for the listed rig owners is quite positive: "This should help offset the pressure of a large number of uncontracted rigs to be delivered in 2014."

Included are deliveries slated for late 2013, which Morgan Stanley expects to slip into 2014. ■

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Petrobras rig-building looks set to encounter delays

THERE is ample evidence contracting will continue to be delayed, increasing the likelihood Petrobras must continue to rely on the outside market, writes Barry Parker.

In their Brazil report, analysts at Morgan Stanley lay out a case that, historically, "inexperienced yards" have experienced multi-year teething pains when gearing up to build rigs.

After noting that plans now call for Petrobras' 28-rig construction programme to stretch out beyond the original goal of 2017 to 2020, the analysts suggest the 28th unit could be delivered as late as 2025.

Looking at history, the report makes the case: "We looked at other yards around the world that decided to enter the rig business. Many of these had been world-renowned yards, yet when they attempted to build a deepwater rig, they experienced meaningful delays and cost over-runs."

Several months after its initial seven-unit award, executives from Sete Brasil — the entity that would take delivery of the seven drillships from EAS and then charter them to Petrobras — had said publicly it would be negatively impacted by local content rules, which would increase costs.

Early October reports in the Brazilian media provided a window into the tendering process. Considerable disagreement was revealed between a Sete Brasil-linked group of yards and local operators and Ocean Rig, tied to a different yard consortium, which submitted a lower bid.

According to the local reports, bids submitted by the Ocean Rig group in conjunction with the "Synergy" yards, equating to \$584,000 per day, are being challenged by the Sete Brasil group, where bids for drillships and ultra-deepwater semi-submersibles were calculated back to \$619,000 per day.

For comparison, both rates exceed the roughly \$520,000 per day inked in mid-October by Atwood Oceanic on its semi-submersible Atwood Condor (being built at Jurong), to deliver into a two-year charter to Hess next summer, working in the Gulf of Mexico.

Morgan Stanley points out the tenors of Petrobras charters are longer — typically around five years — than those in other regions, more likely to be two or three-year terms.

In return for the greater earnings visibility, the day rates, unadjusted for bonuses, are usually slightly lower than in other regions.

The Sete Brasil charters to Petrobras, in effect lengthier full payout financings, worked back before the discussions of cost over-runs to day rates between \$430,000 and \$475,000.

These fully built-up costs must be put into the context of the tightening rig charter market for floating equipment.

Morgan Stanley's Ole Slorer talked about overall rig market utilisation moving upward from 72% to 80%, where it begins to tighten. He expressed an

expectation a current round of Petrobras tendering "might get them five rigs".

Diamond Offshore's vice-president, marketing, Michael Acuff, responding to analysts on the third-quarter 2011 investor call, said: "We're seeing throughout the whole market the tightening as we go forward... We think Petrobras could take anywhere from four to six rigs, probably off the market, in this latest tender."

Delays and increased costs have implications transmitted through the system, impacting exploration and production activities beyond rig construction.

Recent news from Aker Solutions, a major producer of subsea production components, shows the economic impacts. Its stock, traded in Oslo, was hit hard by a mid-October announcement of delays in producing subsea systems — with a potential cost of Nkr400m-Nkr500m (\$72.2m-\$90.3m) to be included in Aker's third-quarter results, to be presented in the first week of November.

An Aker executive said: "Our performance is hampered by high activity in Brazil. Suppliers to the oil industry in the region are facing lack of resources."

He added Aker's problems were partly company-specific, related to a manufacturing facility at Curitiba. Aker has said it has looking at investing in additional manufacturing capacity in Rio de Janeiro and in Rio das Ostras. ■

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Petrobras chief executive José Sergio Gabrielli has acknowledged deliveries of newly-constructed drilling rigs have been fewer than hoped for. Bloomberg