

2007

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I postponed putting this article together, looking for any excuse to move on to another project - or inventing one if I did not have a project handy. The first hurdle was the title. I had no problem with "2007". That was easy, since I want to use this article to gather my own thoughts together and figure out what we here at Marcon can expect in 2007 and 2008. The hard part was finding words to complete the title. Most words I thought of started with the letter "P"- "petroleum", "plateau", "peak", "profit" plus the word that brings me to chuckle when I see it in print about the economy - "paradigm" - especially when referring to a "paradigm shift" or "new era". Maybe I just started with "P" words because 2007 is the Chinese Year of the Pig. I decided to stick with what I knew - the year, and ask readers fill in their own words as they interpret "the signs" - and more importantly basic supply and demand for 2007 and 2008. I recommend though using words that suggest "Precaution". Global growth is slowing, a 9% growth in worldwide E&P spending for 2007 is nothing to get excited about, costs are rising, announced offshore oil & gas discoveries are declining and 508 OSV's of various types are on order through 2010. Is 2007 going to keep on charging, just be a "pause" or "breather" before continuing onwards and upwards, a "peak" or a "plateau?" Here are more numbers than anyone wants to wade through, but hopefully some of it may be of use. At the end, you will still probably want to purchase a "Magic Eight-Ball" to forecast the future.



Looking back at 2006 is easy. With 74 vessels and barges brokered in 2006, this was a very, very good year for Marcon - as it was for many offshore petroleum and marine related companies. We expect '07 to be equally good or better for brokers. Strong global growth trickled down through levels of energy and maritime corporations worldwide. Every quarter we read press release after press release trumpeting record or near-record earnings, escalating dayrates and utilization from oil companies to drillers, OSV operators and shipyards. Trade journal articles were headlined by "Riding High", "Gulf Bustles with Work", "Can Oil Reach \$150" or similar. Sound familiar? I admit though that I enjoy writing about positive earnings and records, after too many years grumbling about the opposite, wondering if we were yet at the bottom of whichever slump we were then surviving. Money is now flowing. ExxonMobil's 3Q'06 net earnings were at a near record \$10,490 million, up 26% from 3Q'05 and net income for their first nine months was at a record at \$29,250 million, up 15%. Chevron's 3Q'06 net income was \$5 billion, up 40% from 3Q'05. Hess' net income was \$297 million for their last third quarter compared with \$272 million for 3Q'05 - even though 3Q'06 included a \$105 million tax-related charge. Their 3Q'06 worldwide average crude oil selling price was \$58.81/bbl, an increase of \$23.07/bbl from 3Q'05. Only eight years ago we would have been happy to see that \$23.07 increase as the actual price of oil. Most drillers also enjoyed excellent results. GlobalSantaFe's worldwide SCORE for December '06 was up 26.7% for the year and 187.7% over the last five years, although down 1.7% from November. Transocean reported near-record net income for their third quarter of \$309.0 million on record quarterly revenues of \$1,025.7 million. Some of this naturally trickled down to boat operators.

AHTSs performing rig moves in the North Sea were at times earning GBP100,000+/day with ODS-Petrodata reporting one large AHTS in December enjoying a record GBP140,000/d (\$273,937) for a rig move and large AHTS averaging GBP90,616 (\$177,308) for the month. Although we are now seeing a softening, spot rates for some AHTS in the Gulf of Mexico even reached previously unheard of levels of \$100-150,000/d. Seacor's overall fleet utilization may have only been slightly higher 3Q '06 at 87.7% compared to 86.8% the preceding quarter, but there was a 10.4% increase in average dayrates from \$8,663 to \$9,564. Hornbeck enjoyed record results for 3Q'06 with revenues increasing 66.7% compared to 3Q'05. Revenues from their OSVs increased 41.9% over the same period in '05. Their average OSV dayrate for 3Q'06 improved 51.4%, or \$7,012/day, to \$20,650 compared to \$13,638 for the same '05 period. Hornbeck though in



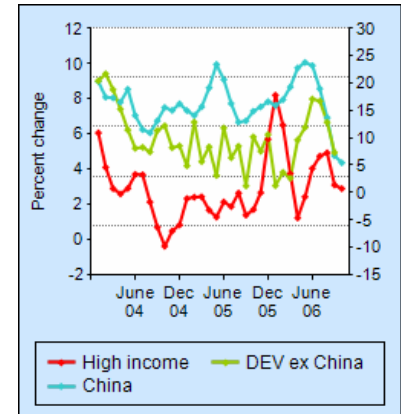
4Q'06 experienced more volatility and after taking in account a utilization averaging in the mid-80's, their effective dayrates ended up roughly \$2,000 less than the previous quarter. This was partially due to softer market demand and partially to shipyard delays for regulatory drydockings and unscheduled repairs. Farstad enjoyed close to full utilization in the North Sea with improved rates in all markets. The strong price for crude also led to a sustained increase in global exploration and higher rates and utilization for Swire Pacific with their fleet's forward coverage reaching a 5-year high. DOF's operating profit for 3Q'06 totaled NOK 260.5 million compared with NOK 135.5 million last year. I could keep reporting numbers after numbers, but all that is in the past. As one Owner keeps

telling me - "what have you done for us lately" (I hope that he recognizes the quote and the humor and truth in it). We need to figure out what to expect in '07 and '08. I always try to simplify things and start from basic building blocks which

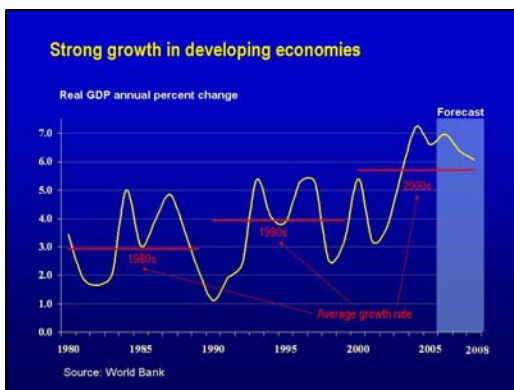
sometimes get buried and forgotten even here at Marcon in all the “buzz”. The two most important words to remember are “supply” and “demand” and track these words through the various levels, starting with a “Reader’s Digest” compilation of reports on global economy and its hoped for growth, working down to the individual vessel operator.

Global Growth According to the World Bank

Global growth is the first stepping stone to figure out energy demand for the next couple of years. I started with what the World Bank says about “**Prospects for the Global Economy**” in their December 2006 report (www.worldbank.org). Despite oil prices topping \$75/bbl during 2006, the World Bank reported that world gross domestic product growth strengthened, coming in at 3.9% compared with 3.5% in 2005. This reflects rapid expansion in developing economies, which grew by 7.0% - more than twice as fast as high-income countries. Even excluding China and India, developing countries grew 5.5%. Most of the acceleration in global growth was concentrated in the first half of the year though. World industrial production grew 6.7% in the first six months of 2006, compared with 4.3% in 2005. Among developing countries, rates of growth of industrial production eased in second and third quarters, although this was partially offset by stronger growth among high-income countries. Order books and business sector confidence are strong in both Europe and Japan, suggesting robust industrial activity, while in the U.S. there are signs that industrial production is slowing. In the U.S., acceleration in industrial output was mirrored by GDP, which began 2006 expanding by a torrid 5.6%. However, responding to higher short-term interest rates, residential investment spending fell sharply and a cooling housing market moderated consumer demand. As a result, the economy slowed the third quarter to a 1.6% annualized growth, with most of the slowdown restricted to housing. Importantly profits, non-residential investment and consumption remained robust and inflation and unemployment low. As a consequence, although growth was expected to remain subdued, the World Bank believed that it should not decline in the fourth quarter and the strong first quarter means that output for the year as a whole is expected to increase 3.2%. (The U.S. Commerce Department actually announced on 21st December that the American economy grew at 2% the third quarter of 2006, less than the 2.2% estimated and the lowest growth since fourth quarter 2005).



While growth in developing countries may slow over the next two years, it is expected to remain robust - at more than 6% in 2007 and 2008, more than twice the rate in high-income countries, which is expected to be 2.6%. Increases in supplies of key commodities, in combination with demand-side substitution and conservation measures, should allow for some easing of prices, including oil, but continuing strong global growth is expected to keep commodity prices high by historical standards. Even though a tapering down of growth to a sustainable but robust rate remains most likely, this is subject to risks. Efforts to temper expansion in some faster-growing developing countries may not succeed, leading to stronger short-term growth, but a sharper slowdown later. A faster-than-expected weakening of housing markets in high-income countries could brake the economy much more abruptly than expected, thus weakening global demand.

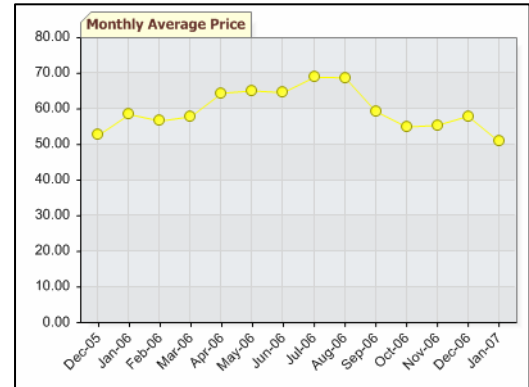


Disruptions in oil markets are also always possible - and the World Bank feels the unwinding of the U.S. current account deficit and its mirror surpluses in oil-exporting countries and East Asia could be disruptive if sudden movements in capital markets, perhaps abetted by collective policy inaction, drive rebalancing. Even so, these risks appear manageable. While developing-country growth is projected to slow over the next two years, it should remain robust at 6.1% in 2008. Mainly because of continued expansion of developing economies, global growth will remain robust, keeping commodity prices high. Nevertheless, increases in supply, combined with demand-side substitution and conservation measures, should allow for some easing of prices - including that of oil. This positive outlook though is subject to significant risks. Past episodes of fast growth and favorable financial conditions have been followed by sharp and largely

unanticipated reversals. While stronger fundamentals in most developing countries reduce the likelihood that a hard landing would be as severe as in the past, countries need to take particular care to ensure that fiscal, monetary, and structural policies are in order so as to minimize domestic consequences of external shocks—a point driven home by the financial market turbulence observed in the spring of 2006, which affected most sharply those countries whose fundamentals were most out of balance.

High oil prices and rapid global growth contributed to a gradual increase in inflation among developing countries, from about 1.7% in 2002 to 3.2% during third quarter '06. The acceleration though was not consistent across the globe. Inflation has been stable or declining in half of the developing regions, falling to an average of 5.3% the third quarter. In contrast, in high-income countries it rose from 1.3 to 2.7% before falling to 1.4% in October as oil prices declined. Most of the increase appears to reflect the higher oil prices. Until recently, core inflation in high-income countries has been relatively stable. Core inflation in the U.S. was rising much of the year, but has been easing recently and stood at 2.7% in October. In many developing countries, inflation first picked up in response to higher oil prices, but has since declined, reflecting solid productivity growth and more credible monetary policies. However, developments in a number of low and middle-income countries run counter to the general trends. In these countries, inflation is rising, reflecting several years of above-trend growth and steep increases in global commodity prices. Higher inflation appears to reflect overheating in Argentina and several countries in Europe and Central Asia, Mid-East, North Africa, and South Asia.

In the oil market, rising supply and slow demand cause prices to ease. As shown in OPEC's graph, after stabilizing in Fall '05, the price of oil shot up the first half of 2006. Prices since declined and were below \$60 late November - bringing the price below the level at which it began the year. In euros, the price declined 7% since the beginning of '06 and stands at about the same as before the hurricanes of Summer and Fall '05. High prices slowed growth in demand despite acceleration in economic activity. Demand among OECD countries actually declined and although demand in developing countries continued to increase, this was slower than in '03 and '04. Notwithstanding three years of higher prices and arrival on stream of new fields, non-OPEC supply was relatively slow to increase. Despite limited responsiveness of supply the first half of '06, growth of oil demand was weak and inventories and global spare capacity increased. However, spare capacity remains low leaving us vulnerable to a significant supply shock. That vulnerability, plus concerns about future Mid-East supplies, provides the best explanation for the increase in oil prices during spring and early summer '06 with market speculation also playing a role. Over the near term, limited spare capacity and strong global growth suggest that oil prices will remain volatile. However, high prices should continue to moderate demand growth, while investments in new capacity already in the works are projected to increase output by about 15 mbpd by 2010, implying a 3 mbpd annual increase - well above expected increases in demand of 1.5-2 mbpd annually. As a result, the World Bank projects the price of oil to decline modestly over the next two years, reaching an average of \$53 in '08.



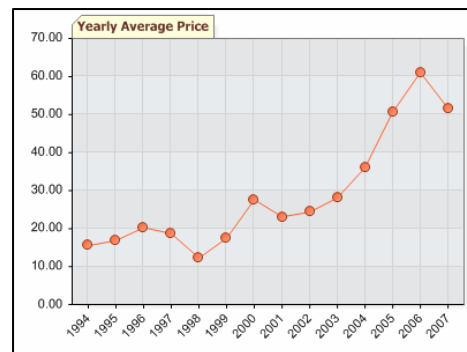
A soft-landing scenario as outlined above is the most likely outcome. Tight monetary policy in high income and a number of developing countries is slowing growth and should alleviate inflation. Meanwhile, low long-term interest rates and emerging-market spreads are expected to maintain favorable conditions for developing countries, allowing them to grow at a slower but still robust pace of 6%. While a soft landing is likely, the global economy is at a turning point following several years of very strong growth - and such periods are fraught with risk. The last century began under similarly auspicious circumstances, characterized by an extended period of strong growth buoyed by technological change and ample liquidity. Rather than continuing forward as anticipated by leading economists at that time, the world plunged into the Great Depression. Thus, while much in the current environment is reassuring, a note of caution is merited.

Overheating could provoke a sharper slowdown though. The world economy and, in particular, developing countries have been expanding at near record pace. So far, inflationary effects of fast growth have been largely confined to markets for global goods, such as commodity markets. Inflation at the national level has been muted. Given projected levels of demand, further price hikes in commodity markets cannot be ruled out. Moreover, should measures to slow growth in several key developing economies fail, as they have to varying degrees in recent years, inflation could pick up. That could lead to a marked slowdown later, either because of sharper tightening of policy or loss of external competitiveness.

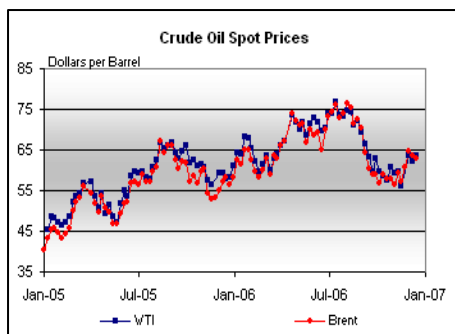
An oil-sector supply shock could also disrupt growth. With spare production capacity at only 3 mbpd, the world oil market remains vulnerable to a supply shock. Because no country can easily ramp up production, if output in a producing country were to fall significantly, world supply would fall, provoking a decline in economic activity. Simulations last year suggest that a negative supply shock of 2mbpd that cause oil prices to double for three months and then remain at \$80 for nine further months would cause global output to shrink initially by about 1.5% of GDP. Inflation would pick up rapidly, and on average the current account position of oil-importing countries would deteriorate by about 1.1% of GDP. The impact would be more severe in large low-income and middle-income countries. While the impact in terms of GDP for current-account-constrained low-income countries is smaller, it is more severe in terms of domestic consumption and investment. Such countries have limited access to capital markets and capacity to pay higher oil prices is limited by export revenues.

The Demand and Cost of Energy

Now that we are looking for 6%+ growth in developing countries and 2.6% in high-income countries for 2007-8, what will be the demand for oil and gas – and at what price. Reviewing **OPEC's "Monthly Oil Market Report"**, 2006 will be remembered for strong upward prices for oil, with OPEC basket prices at previously uncharted heights over \$72/bbl in August, although far behind absolute real peaks reached in 1980. Prices were volatile with fluctuations of almost \$20/bbl. Continued robust global growth, especially the first half of '06, was not matched by a growth in oil demand. A mild winter, rising prices and removal of subsidies in some developing countries dampened demand. OPEC predicts world oil demand growth for '07 to grow at a moderate rate of 1.57%. With expectation of "normal winter weather", especially in OECD countries, first quarter '07 should experience upward oil consumption growing at 1.6%. The report though highlights that global economic uncertainties, decelerating demand growth and strong incremental non-OPEC supply point to weakening fundamentals in '07, with the strongest imbalance expected the second quarter. OPEC reduced production by 1.2mb/d in November and decided to cut an additional 500,000bpd in February. This latest reduction was scheduled after winter to ensure sufficient supplies during this strong demand period while addressing looming market imbalances forthcoming.



The **International Energy Agency** in Paris in their mid-December "**Oil Market Report**" states that global oil product demand remained unchanged at 84.5mb/d in 2006 (+1.1% versus 2005) and 85.9mb/d in 2007 (+1.7%). Their 2007 forecast though, like OPEC's forecast, faces downside risks, due to the uncertainties in the U.S. economy and China's 2006 demand growth rate revised down to 5.6% because of weak apparent demand over the past three months. The IEA kept unchanged their global growth forecast for 2006 (+1.1% to 84.5mb/d) and 2007 (+1.7% to 85.9mb/d), as downward adjustments in OECD countries were largely offset by upward revisions in the rest of the world. A big question mark regarding the outcome of the 2007 forecast relates to U.S. economic growth.

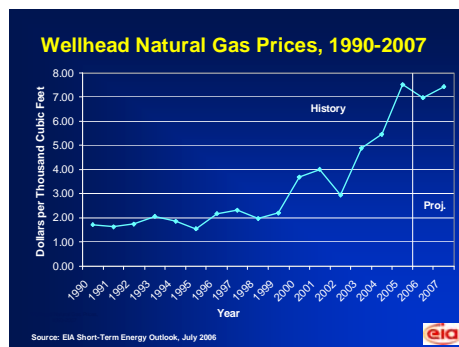


The Energy Information Administration in their "**Short-Term Energy Outlook**"

expects world oil demand to grow by 1.5 million bpd and U.S. petroleum consumption to rise by 0.3 million bpd in '07, following relatively flat consumption last year with U.S. and China are projected to account for over half world growth. Demand growth is also projected to be strong in those Mid-East oil-exporting countries benefiting from high oil revenues. New supplies from non-OPEC countries will partially meet anticipated demand growth. EIA believes surplus world crude oil production capacity should increase only slightly in '07. With continuing instability in some oil producing countries, we at Marcon would not be surprised to still see volatility in oil prices, with peaks around the 2006 high of \$78/bbl, but we would not be surprised to end up with average 2007 oil

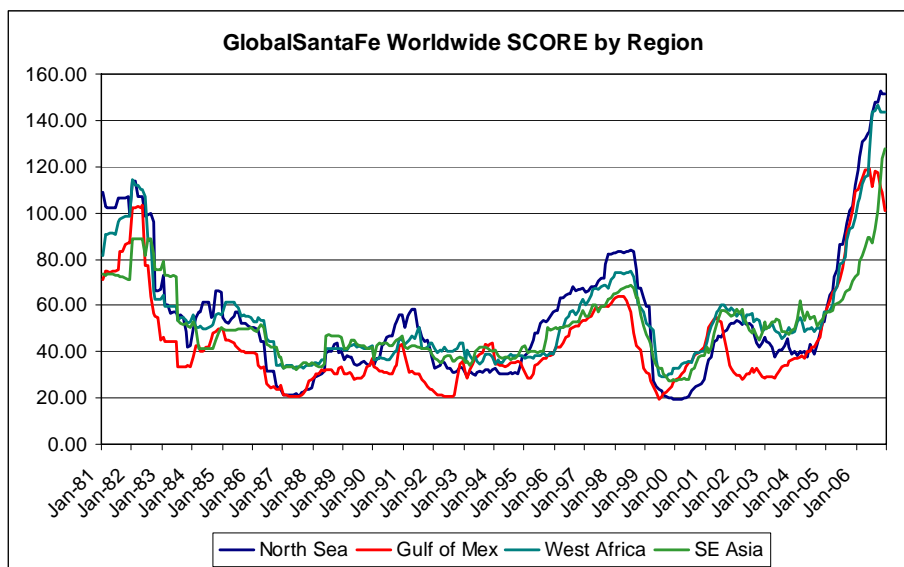
prices slightly lower than in 2006, but still at a level to attract further investment by oil companies.

Oil is only a portion of the equation. Demand and price for **natural gas** has had a great affect on U.S. Gulf Coast drilling and consequently on OSV vessel operators – both positively and negatively. According to **Lehman Bros. "Original E&P Spending Survey"**, natural gas prices remain a prime driver of E&P spending in '07. The EIA reports that warmer-than-normal U.S. weather in November kept pressure off the natural gas spot price, which averaged \$7.63/mcf for the month. Heating degree-days in November were down 36% from normal in the East North Central region and 27% below normal in New England and Mid-Atlantic regions. While a return to "normal" weather could increase the spot price, high levels of natural gas in storage and forecast of slightly warmer-than-normal weather are expected to keep prices below \$9/mcf on average through the heating season with an expected average of \$7.06/mcf in '06 and \$7.87/mcf in '07. As a result of warmer-than-normal weather the early part of '06, total natural gas consumption is projected to decline for the year. With a return to normal weather, consumption is expected to recover in '07 and grow by 1.5% as residential and commercial consumption is expected to grow by 6.9% and 3.6% respectively in '07. Consumption in the industrial sector, which dropped 1.0% in '06, is expected to reach its highest level since '04 with a 1.8% rise in demand in '07. Due to expected moderate summer temperatures in '07 compared to '06, power sector consumption is projected to decrease by 3.6%.

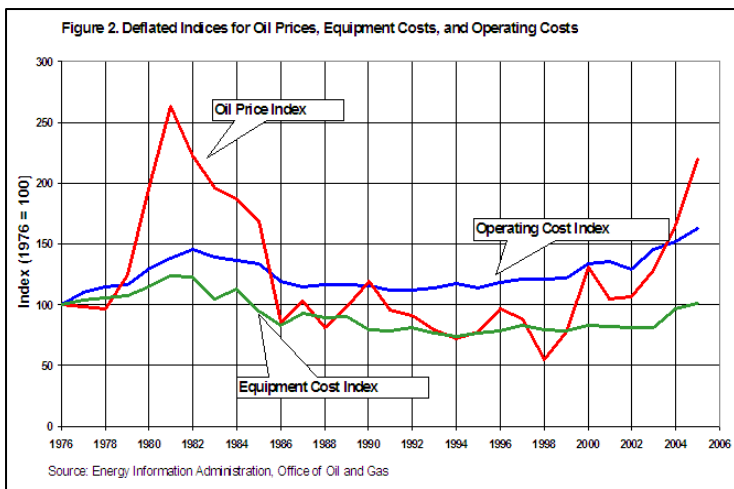


E&P

Who's going to be spending and on what? The last couple of years have been profitable for most oil companies and drilling contractors. In mid-December, worldwide oil and gas drilling contractor GlobalSantaFe Corporation reported their worldwide SCORE, or Summary of Current Offshore Rig Economics, for December 2006 decreased 1.7% to 130.5 from the previous month's SCORE of 132.5, but is still up by 26.7% over the year and 187.7% over the last five years. Breaking down the worldwide figures, over the last five years the SCORE data has increased from a low of 128.3% in Southeast Asia to a high of 225.3% in the Gulf of Mexico. GlobalSantaFe's SCORE compares profitability of current mobile offshore drilling rig dayrates to profitability of dayrates at the 1980-1981 peak of the offshore drilling cycle. In the 1980-1981 period, when SCORE averaged 100%, new contract dayrates equaled the sum of daily cash operating costs plus approx. \$700 per day per million dollars invested.



Global E&P spending for 2005 and 2006 grew by about 20% and 30% respectively, but what do we expect in 2007. Lehman Brothers Original E&P Spending Survey published December 13th reported "Worldwide E&P expenditures are estimated to grow moderately in 2007" with the 300 +/- oil and gas companies surveyed reportedly planning to increase their worldwide E&P expenditures only 9% from the \$268 billion estimated to have been spent in '06 to \$292 billion in '07. (Personally we at Marcon would describe a 9% growth as just "staying the course" rather than "moderate" growth). The greatest growth in spending will be outside North America with overall international E&P spending expected to rise by 13%. A slowdown is expected in the U.S. where companies estimate only a 5.1% rise in E&P spending – and this includes both on land and offshore. In 2006, nearly twice as many companies that spent both on and offshore worldwide spent more offshore. In 2007 though, the Lehman Bros. survey indicates that a "narrow majority" will spend more onshore. In 2006, 36% of the companies spent an increased percentage offshore, while 48% remained flat and 16% spent less offshore. Only 20% of the companies now report their offshore budget to increase, while 60% expect it to remain flat and 20% now expect offshore spending to decrease. More of the offshore budget is going deepwater with 83% of the companies looking to increase vs. 71% in '06. Talisman Energy is keeping their E&P spending flat in '07 at \$4.8 billion with about 80% going to projects in North America and the North Sea. ConocoPhillips approved '07 cash capital expenditures of approx. \$11.8 billion with 84% of the total authorized '07 capital program allocated to E&P. Chevron announced a \$19.6 billion capital and exploratory spending program for '07, 20% up from expected outlays of approx. \$16 billion in '06 – with about 75% of the '07 budget going for oil and gas exploration and production projects worldwide. Capital and exploratory spending of \$14.6 billion is budgeted for exploration, production and natural gas-related projects. The higher investment reflects several large, multi-year development projects being in their most capital-intensive phases plus, as with everyone, the higher costs for materials and services being experienced by the oil and gas industry worldwide. Hess is planning a \$3.6 billion capital and exploratory expenditure budget for '07 with approx. \$3.5 billion for E&P. The final overall E&P figures for '05 and '06 ended up higher than initial estimates as companies overspent their budgets and we expect the same to happen in '07. It is unlikely though that the growth in spending will approach the 20-30% enjoyed over the last two years.

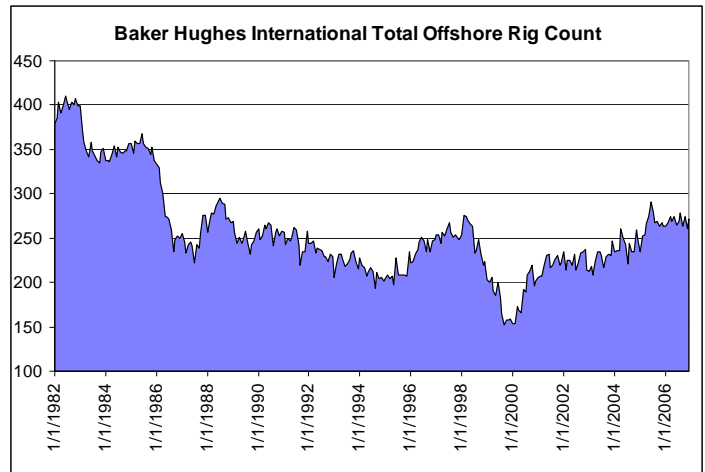


For OSV operators, it is important to take a look where exactly this money is going to be spent and what it is being spent for – expansion or inflation. Although the latest EIA report on “*Oil and Gas Lease Equipment and Operating Costs*” is not expected to be released until April 2007, we expect that costs will continue to rise and much of the projected 9% increase in global E&P spending will be eaten up by these increasing costs vs. any major expansion. In their May 2006 figures the EIA reported that both oil and gas well equipment and operating costs were higher in 2005. Gas equipment costs increased by about 8%, while gas operating costs increased 1%. The 8% increase in gas equipment costs was partly caused by an increase in the cost of steel items such as safety valves, chokes, separators and dehydrators. Oil equipment costs in 2005 were up over 4%, while

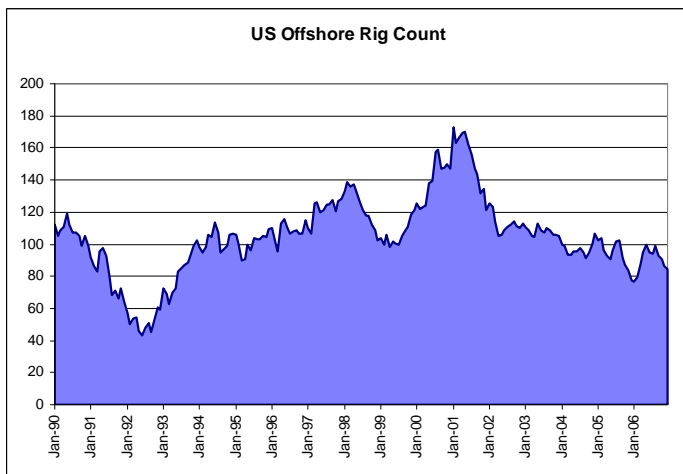
operating costs increased about 7%. The 7% increase in oil operating costs was partly attributable to the 27% increase in the average cost of natural gas from 2005 to 2005 because natural gas is used in many oil production processes. Oil equipment costs were affected by an increase in the cost for steel. This increased the cost for tubulars and most surface equipment. Offshore operating costs increased by over 20%. The increase in the operating cost index for 2005 was primarily caused by an increase in costs for transportation and offshore rigs. The Lehman Bros. survey projects that after a strong upward move in drilling costs in both 2005 and 2006, there will be a more moderate change in 2007. One-third of companies surveyed believed that drilling costs would be flat (-5% to +5%), while another third see costs up moderately (+5% to +15%). These higher costs, even if more moderate than in 2005 and 2006, can easily “eat” into a 9% worldwide overall growth in spending – and after watching the increase in dayrates, shipyard costs, labor and other items I would not be surprised to see the final costs at the close of 2007 coming in at the upper end of the estimates.

Although economists continue to report low inflation of 2 – 3% in the U.S., as measured by the theoretical “*basket of goods*” including food, clothing, housing, transportation and other goods and services purchased on a regular basis – these percentages cannot be applied to the marine industry, in the U.S. or abroad. The September 2006 “**Steel Markets Monthly**” by **American Metal Market Research**, who provides industry intelligence and analysis through a number of newsletters and reports, indicates that steel plate supply in the U.S. and Canada remains tight. Energy industry demand, post-hurricane reconstruction and high order levels among industrial equipment makers are keeping plate mills fully booked and prices high. In September 2006 prices rose to abt. US\$ 926-948/tonne from \$882/tonne in September 2005 and there was a possibility of a further increase in October. Plate supplies are also tight in Europe and with Buyers realizing that they have to pay the asking price with no haggling numbers have risen upwards of 9.6% over the last year in Germany. Demand is also healthy in Asia and domestic prices are expected to increase into the first quarter of 2007. As of September 2006 domestic steel plate in Japan was at \$683/ton, up 12.8% since 2005. While there has been a downward pressure on prices in China due to oversupply, prices are stabilizing and expect Chinese export prices for flat product into Southeast Asia and the Mid-East to climb. Shipyards also report higher costs for machinery as suppliers absorb higher manufacturing costs plus recognize a tightening market due to the old equation of supply and demand. In January 2006, the propulsion package for a series of azimuthing tugs built overseas was 17.5% higher than the previous year. Last year while one major U.S. engine manufacturer reported costs for their engines increased only abt. 9% over 2005, the auxiliary equipment required increased at a higher rate so that the final figure for the total engine package ended up abt. 13% higher. Main engine packages for several tugs built in 2006 at a U.S. shipyard reportedly increased 40% in just over a year and a half. From a driller’s point of view, just look at the charter rates he is paying for boats. Tidewater’s worldwide fleet was earning an average day rate of \$8,935 for the quarter ending 30 September 2006 compared to \$7,191 for the same quarter in 2005 and \$8,540 the previous 2006 quarter. I doubt that we will see the same growth in dayrates over 2007 – and probably will see a softening, but believe that dayrates will remain “*healthy*” as long as the supply and demand equation for boats remains in balance. New and more expensive boats are coming on line and they have to earn their keep. Costs for newbuilding have increased about 25 – 30%, and in some cases higher, over the last twelve to eighteen months. Prices keep climbing for materials required both for new construction and repair & maintenance. Cost of labor and materials are definitely higher and one shipyard in Singapore we discussed this with commented that its “*Just a simple principle of economics, supply and demand, and with demand grossly outpacing supply, price increase is the inevitable result, coupled with scarcity of raw materials and high energy cost, 30% is a conservative estimate indeed.*”

How many active offshore rigs are we going to have out drilling and requiring OSV services over the next couple of years? The Baker Hughes International Offshore Rig Count was at 271 in December 2006, up 11 from 260 in November, up 4 from December 2005, but down from 274 in October 2006 and definitely down from the high of 410 in June 1982 during the boom period. Over the last year the number of active rigs in Europe, North Sea and Middle East have declined by 10, 8 and 8 rigs respectively. The big gain in rigs has been in Asia Pacific with 114 in December 2006 vs. 104 in December 2005, while Africa gained 7 and Latin America gained 5 rigs. As with OSVs, the rig market is tight. As of mid-January 2007, ODS-Petrodata is showing rig utilization ranging from 93.3 – 97.7% for Australia/Asia, Europe and Africa and rigs are in demand with, like the OSV market, dayrates doubling or tripling over the last two years.



Transocean is charging Reliance \$320,000/day for their drillship *“Deepwater Frontier”* working off India through August 2008 compared to the \$145,000/day she was earning on a previous contract and their semisubmersible *“Transocean Richardson”* working for Total off Angola until July 2007 is earning \$355,000 vs. \$85,000 on an earlier contract. Their jack-up *“Trident XII”* was last contracted out at \$62,250 and is now working for ONGC in India until February 2010 at \$147,500/day. It is no wonder that drillers looking to expand their fleets are finding little on the second-hand market. We have prospective buyer inspecting units that we would have been ashamed to even offer five years ago. With the global shortage, drillers are forced either to upgrade older rigs or flock to shipyards from China to Singapore to Russia to order new floating rigs. More floating rigs are being built worldwide now than have been on order for decades – and drillers are patiently waiting until for delivery with lead-times out until 2009 due to the back-log at shipyards. I would not be surprised to see several mergers in the next two years as the easiest way for a driller in today’s market to expand their fleet, grab market share and at the same time pick up earlier newbuilding slots for floating rigs.



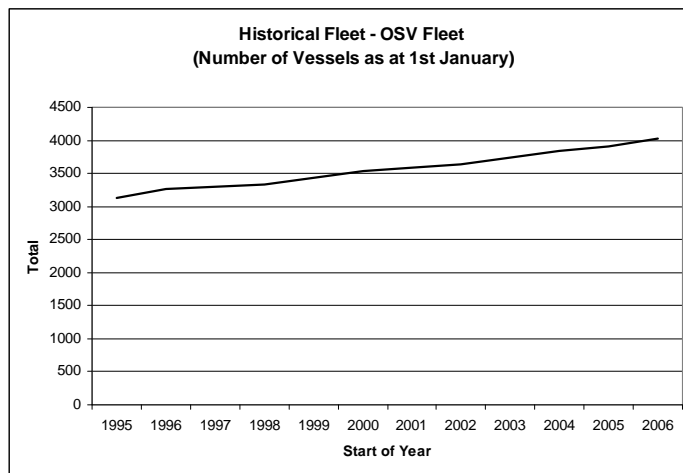
In the U.S., as of mid-January 2007, the Baker Hughes Offshore Rotary Rig Count (see graph) was at 83, down two from the earlier week, but up from 78 the previous year – and less than half the number of the 171 offshore rigs that were working in May 2001. Of those 83 U.S. Offshore rigs, 81 are actively drilling in the Gulf of Mexico down from 100+ in August 2005 just before Hurricane Katrina. Many people ashore wonder why there is not more drilling in the Gulf of Mexico with the high price of oil we have been seeing. 80 of the 81 active rigs presently in the Gulf of Mexico are drilling for gas with only one drilling for oil. In Canada there were 4 offshore rigs working in mid-January 2007, down from a peak of 13 during February 1985. Dayrates have increased for select high-spec units in the Gulf of Mexico. On her last contract Transocean’s 5th Generation drillship *“Discoverer Deep Seas”* earned \$226,700/day. She is now finishing a

contract with Chevron at \$240,500/day and renewing through January 2008 at \$276,500/day. Next year this increases to \$317,900/day and from March 2009 through January 2011 she is expected to earn \$485,000/day.

Day rates for jack-ups though remain well below an early 2006 high. GlobalSanteFe’s Score for the Gulf of Mexico fell in mid-January to 100.9 - 7.7% lower than last year at this time, and ODS-Petrodata utilization for jack-ups is now at 78.3%. The number of rigs working the Gulf of Mexico is decreasing and with the exception of high-spec deepwater units this attrition will continue until U.S. natural gas prices improve. Rig owners are looking to yet *“greener pastures”* elsewhere. Rowan’s cantilever jack-up rigs *“Hank Boswell”* and *“Scooter Yeargain”* both departed the Gulf of Mexico on 6th January this year for four year drilling contracts with Saudi Aramco in the Middle East. After undergoing repairs following 2005 hurricane damage the conventional jack-up *“Rowan-Louisiana”* did return to Gulf of Mexico service in December and Rowan’s cantilever jack-up has been assigned to Petrobras for one well, but the rig count will continue to fall. This reduction could signal an increase in rig rates later this year, but that does not necessarily mean that we will have more rigs working requiring additional U.S. flag OSVs in the immediate future.

Boats, Boats & More Boats

Every source uses different parameters for their data and we end up comparing “apples and oranges”, but they all point to a surge in new OSVs. Clarkson’s “Offshore Vessel Register” statistical tables reported the worldwide offshore fleet in January 1995 at 3,122 vessels – including not only PSVs and AHTSs, but related types such as dive support, heavy lift crane ships, pipelayers, survey vessels, standby/rescue vessels, etc. By January 2006 the total count rose 28.9% or 903 vessels to 4,025 vessels. Looking at the traditional vessel types most operators think of when talking about OSV’s - PSV’s increased from 59 to 381 boats, supply boats from 632 to 728 and AHTS from 1,064 to 1,344 vessels and these numbers continue to rise. During this same 11 year period, the Baker Hughes International Rig Count increased by only 58 active offshore rigs and the U.S. count actually decreased by 29.5 active offshore rigs. Luckily some of these OSVs are not directly dependent on E&P spending and drilling and may be employed in alternate, but related trades, such as development, repair, construction and decommissioning. In the Gulf of Mexico, although Hurricanes Katrina and Rita were bad news to the drillers, they proved to be a proverbial silver lining in the cloud for many boat operators.



The number of newbuildings on order is noteworthy. As of mid-December 2006 Fairplay’s “Newbuildings Online” reported 508 OSV’s of various types on order with 78 to be delivered in 2006, 219 in 2007, 145 in 2008, 54 in 2009 and 11 in 2010. Looking over this list of newbuildings it seems that almost every major owner is represented with anywhere from a couple of boats for smaller operators to sixty plus vessels for Bourbon in the next three-four years. 105 vessels are scheduled to be built in China, 61 in the U.S., 60 in India, 47 in Norway, 44 in Romania, 35 in Indonesia, 27 in Singapore, 21 in Malaysia, 18 each in Brazil and Spain, 17 in Poland, 11 in Italy and lower numbers in various countries from Australia to the U.A.E.

Tidewater, Inc., for one example, has 30 vessels on the order books costing about \$390 million. These include 18 AHTSs varying from 5,000 to 10,000BHP for a total cost of approx. \$283 million at five different shipyards with delivery beginning in January 2007. The last AHTS of this group is scheduled to come on line in December 2008. Tidewater also committed to bareboat charter agreements on three AHTSs under construction. The bareboat charter agreements have a purchase option that will allow Tidewater to purchase the vessels at certain times during the lease period. Scheduled delivery for these three vessels is expected to begin in February 2007 through October 2007.

In the U.S., two 220’ and three 250’ supply vessels are being built for approx. \$80.6 million. Quality Shipyard is building the two 220’ vessels which are to be delivered in August 2007 and February 2008. A different U.S. yard is constructing the three 250’ vessels to be delivered in May, July and September 2007.

Vessel class and type	Tidewater New Construction Scheduled Deliveries					
	Quarter Period Ended					
	3/07	6/07	9/07	12/07	3/08	Thereafter
Deepwater vessels:						
Platform supply vessels	—	1	2	—	—	—
Replacement Fleet:						
Anchor handling towing supply	2	1	3	4	4	7
Platform supply vessels	—	—	1	—	1	—
Crewboats and offshore tugs:						
Crewboats – 175-foot	—	—	—	2	—	—
Offshore tugs	1	1	—	—	—	—
Totals	3	3	6	6	5	7

Are we looking at a possible over-supply of OSV’s similar to what we endured in the mid-1980’s if day rates cannot be sustained at the current level? Will we have a surplus of boats chasing jobs before scheduled new rigs are delivered and working? These two questions have been kicked around “in-house” by analysts, brokers and owners, but the OSV Owners still have to build. If they do not upgrade their fleets to offer newer and better equipment, their competitors will.

The average fleet age for many companies is still too old. Up until the 1980's, many Owners put their vessels on the market as they reached 15 – 20 years of age and replaced them with newer or new built vessels. This investment created a gradual and steady renewal of the fleet. Several operators who back then almost automatically listed 15 year old equipment for sale now have average fleet ages substantially older than that. According to Clarkson's "Offshore Vessel Register", Tidewater's global offshore fleet averaged 23.2 years at the beginning of 2006. Due to disposing of older equipment and newbuilding this fleet is now about 18 – 19 years of age and like most operators still getting younger.

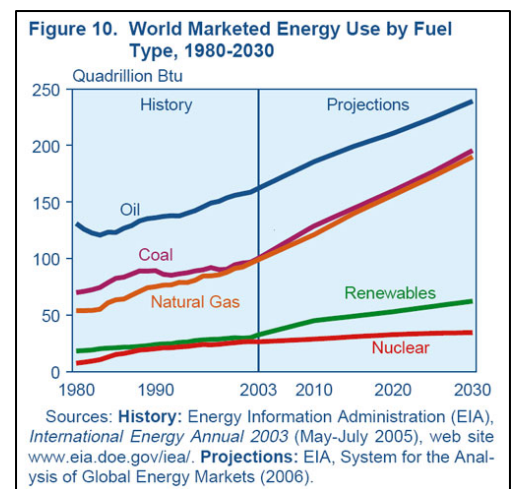
Clarkson's Analysis of Fleet by Owner / Operator as of 1st January 2006 *

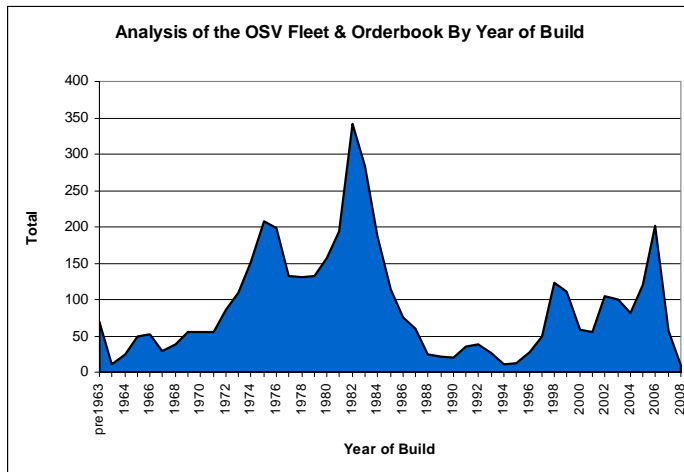
Owner	Number of Vessels	Average Fleet Age
Tidewater Marine	508	23.2
Seacor Holdings	211	21.9
Edison Chouest	86	11.2
A.P. Moeller	76	16.0
Trico Marine	73	23.6
CNOOC	70	19.3
Swire Group	55	13.9
GulfMark Offshore	50	14.2
Groupe Bourbon	49	8.8
Viking Supply Ships	46	28.5
Farstad Shipping A/S	42	12.4

* Some of the above averages will change dramatically in 2007 after divesting older vessels and taking delivery of newbuildings

The 508 new vessels coming into the various segments of the offshore industry over the next four years will definitely have some effect on the market, but we do not expect any major worldwide OSV over-supply similar to the late 1970's and early 80's. There will be times of "correction" and softening of day rates, but as long as oil and natural gas demand, commodity pricing and E&P spending remain healthy the global market should be able to absorb the influx. Boats follow the work. As the number of active rigs working offshore in the Gulf of Mexico has declined, operators have shifted vessels overseas. Last quarter, Tidewater mobilized eight boats out of the Gulf into international markets for longer and more lucrative term work – and if the Gulf happens to pick back up again in the future over 50 of their U.S. flagged vessels, in addition to those belonging to other operators, could migrate back. This flexibility adds resilience and strength to both the overall OSV market and those companies that can take advantage of it.

Overbuilding of OSV's in the late 70's and early 80's was created by over-optimistic forecasts in the 1970's and a throng of inexperienced investors. Regrettably this was followed by a world oil glut that caused average world oil prices to fall to just under \$9.00/bbl by July 1986. E&P spending plummeted. Too many vessels ended up chasing too few jobs and day rates crashed. Although we will see periods of lower oil and gas prices in the future, another major world oil glut like the last is unlikely. The EIA in their "International Energy Outlook 2006" forecasts worldwide oil consumption to rise from 80 million bpd in 2003 to 98 million bpd in 2015 and then to 118 million bpd in 2030 with worldwide, transportation and industry the major growth sectors for oil demand. On a global basis, the transportation sector — where there are currently no alternative fuels that compete widely with oil — accounts for about one-half of the total projected increase in oil use between 2003 and 2030, with the industrial sector accounting for another 39% of the incremental demand. The higher world oil price path in the "Outlook" also affects natural gas markets with natural gas demand expected to rise by an average of 2.4% per year over the 2003 to 2030 period. Total world natural gas consumption is projected to rise from 95 trillion cubic feet in 2003 to 134 trillion cubic feet in 2015 and 182 trillion cubic feet in 2030.





The overbuilding and consequent slump in the 70's and 80's created a problem that we are still seeing the lingering effects of today – an old average fleet age. In 1999, I reviewed Statistical Tables from Clarkson's Research Studies for an article on *"The Age Profile and Future of the OSV Fleet"*. Statistics then showed 138 OSVs operating worldwide built in 1978. The number of boats in the global fleet, by year built, increased to 338 for 1982 built boats, falling to 228 for 1983, 185 for 1984 and on down to 75 for 1986 built. These ages reflected the number of vessels that were delivered worldwide during those years. Supply and demand. In the early and mid-80's as vessels were laid up, no one was building and shipyards closed their doors. When improved, first in the late 80's and future upswings, there was no ready source of "newer" boats to replace either old tonnage, those vessels lost or sold into other

trades. Not until 1996-7 were owners confident enough that day rates had reached the levels required to justify building new OSVs. Note that of those 138 1978 built boats in the fleet in 1999, 131 were still sailing as of January 2006, twenty-eight years after they were launched.

73% of the worldwide OSV fleet is 15 years or older. 46% is now 25 years of age or older. Although many boats have been rebuilt one or more times to prolong their useful life, those boats built in the 70's and 80's were originally designed for only a 15 to 20 year economic life. We are there now. These 20 – 30 year old boats require more and more maintenance at higher and higher cost. Equally important, the time spent alongside the dock or in the shipyard for repairs and maintenance reduces their utilization. Although many customers will accept a mature vessel from a good operator if the boats are well maintained – and especially if a back-up vessel is available, others place restrictions in their tender documents. Charterers do have a say in the age of the vessels they employ. Various tenders over the years have placed 10, 15 or 20 year and sometimes as short as 5 year age limits on vessels. Both higher maintenance & repair costs and charterers' desires will provide pressure on owners to dispose of older boats especially during "market corrections" when they may have to bid against newer vessels.

At the beginning of this article I was looking for words to complete the title – especially those words starting with the letter "P" in honor of the Year of the Pig. The best words I can think of for the international market are both "precaution" and "progress", although I wish I could come up with something better. The international market is definitely strong with most operators continuing to report generally higher average day rates and utilization. However no matter how strong it is, the market is still based on the normal commercial building blocks of global growth, demand / cost for crude oil & natural gas, E&P spending, the number of rigs working and another "P" word called "politics" which it seems we have little control over. If any of those building blocks get knocked over it will have an effect right down the line to the OSV operator. This is why "precaution" always has to be taken into account. "Progress" comes to mind since the international market is strong and this is a good time to improve global fleets. There will always be rocky periods when the delicate balance of supply and demand for OSVs gets out-of-kilter, but you can't stand still. An OSV owner has to move forward or "progress" – either by ordering new vessels, purchasing or bareboat chartering ones built by speculators and/or buying out companies with younger fleets. If he doesn't "progress", he will be left behind.

While both words also apply to the Gulf of Mexico, I believe that "precaution" may outweigh "progress". We will continue to see an exodus of rigs through 2007, and are still faced by stagnant E&P spending. While most OSV Owners and Marcon hope for an improvement this Spring, one operator last week said that his new boat is now earning \$3-5,000/day less than it did in July 2006 and if rates fall much lower then he could be working at break-even or maybe even at a loss.

If anyone else has a good suggestion for a title or a prediction for the future, please let me know. I will add them at the end of this article.

We here at Marcon are keeping our fingers crossed that 2007 will be as profitable for us as was 2006. We all wish you a most profitable and successful New Year.