

Accelerating Land Rig Count Underscores a Strong Recovery

Land Rig Count Gains Exceeding Expectations

Since the last Rigzone Land Rig Review was published, the recovery has gained steam with E&P companies continuing to increase their land rig contract portfolios. The optimistic outlook we highlighted late-last year may have actually been on the conservative side given the pace of the recovery so far. In fact, over the last four months, the U.S. land rig count has increased more rapidly on an absolute basis than in any other four-month period over the past decade. Furthermore, the rig count has only posted weekly decreases four times in the 37 weeks since bottoming (*see fig.1a*). Frankly, the magnitude of the improvement in recent months has exceeded the expectations of many industry observers, ourselves included.

The rig count rise is impressive and the recovery is developing in a V-shaped pattern. Since the bottom, the industry has added an average of 13 rigs per week, and the best one-week gain came in late-December when 38 rigs went back to work. According to BHI, there are currently 1,313 land rigs working in the U.S., which is 60% above the June 2009 bottom but still 32% below the August 2008 peak (*see fig.1b*).

Land Rig Hiring Spree Could Moderate In the Months Ahead

Although we believe the rig count is headed higher this year, we expect to see the rapid pace of hiring over the last several months to begin to moderate over the next three to twelve months for several reasons, including those detailed below.

First, our recent E&P capital expenditure study projected a 10% increase from 2009 to 2010 in spending allocated to North American onshore exploration and development (see Rigzone's *2010 Land Rig Market Outlook Report* for more details). While higher spending levels bode well for the rig count, we believe that a 10% increase is not enough to fuel the current pace of rig count increases for too much longer, even accounting for lower spot market prices.

In addition, the rigs that have been rushed back into the field in recent months have largely been higher spec units capable of drilling horizontally in shale prospects. With a limited supply of these rigs available, hiring could begin to slow as high spec supply becomes more fully absorbed. With demand unlikely

to fully trickle down due to technical requirements, some of the more marginal rigs are likely to continue to stay sidelined even after higher spec units are fully absorbed. In essence, the pace of rig additions in this recovery is likely to turn out to be somewhat inversely related to high spec rig utilization. That said, there is a possibility that some horizontal wells could be drilled by a combination of legacy and newer equipment (i.e. lower spec rigs drill vertical well portions and higher spec rigs follow to drill horizontal well portions), and some legacy capacity is returning to mature fields to drill shallow wells.

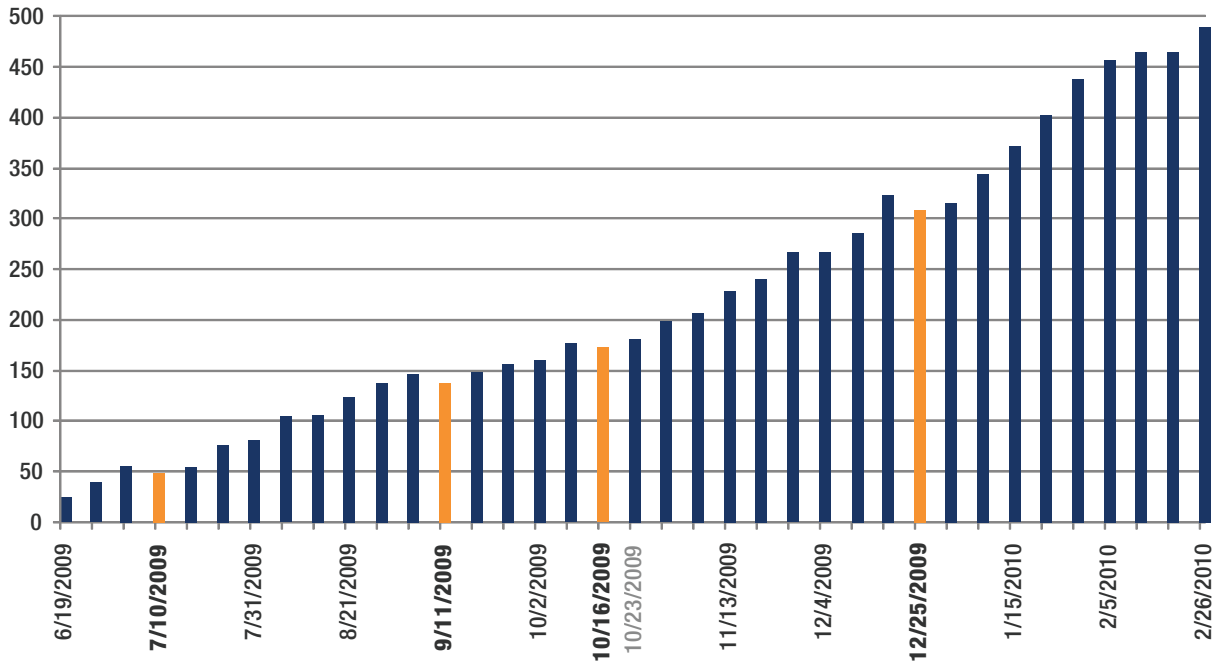
Finally, spot market land rig pricing seems to have bottomed and begun to make some increases across multiple areas of the Lower 48. While land rig demand can be relatively price inelastic during upcycles, the pace of hiring could slow a bit as contractors try to push pricing. We would also note that the pricing increases appear to be coming a bit earlier in the cycle than normal, as pricing power typically returns to contractors after utilization reaches the 80% level. With today's marketed utilization thought to be somewhere between 65-75%, the bifurcation in demand for high vs. low spec units is likely playing a role in dayrate increases – which have primarily been seen for the higher spec fleet.

Other considerations include the commodity price outlook and storage situation for natural gas (injection season is just around the corner), broader US economic concerns and the potential future supply response from today's increased horizontal drilling activity levels. Moderation in the pace of hiring may be avoided if commodity prices move materially higher, lower spec rigs become more attractive to operators or operators opt to increase their 2010 budgets.

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Cumulative Weekly Change in U.S. Land Rig Count From Bottom

fig. 1a

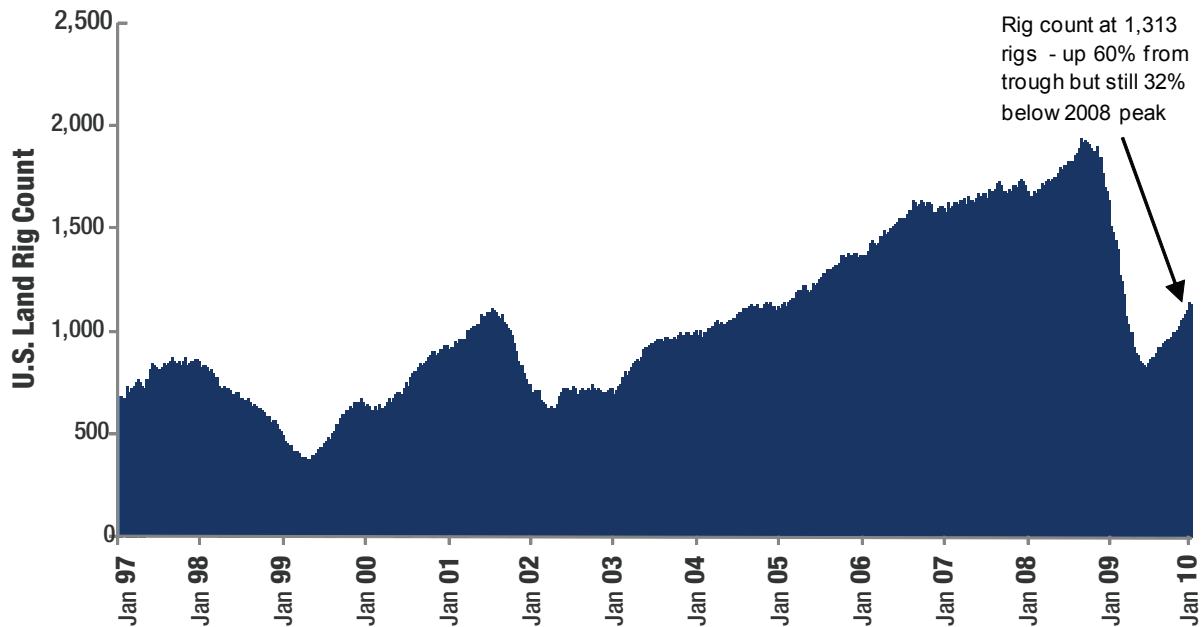


*Orange indicates a weekly decline, while blue signifies an increase or no change

SOURCE: Baker Hughes, Rigzone

Historical U.S. Land Rig Count

fig. 1b



SOURCE: Baker Hughes