28-Apr-2016

Ensco Plc (ESV)

Q1 2016 Earnings Call

Copyright © 2001-2016 FactSet CallStreet, LLC

CORPORATE PARTICIPANTS

Sean Patrick O'Neill
Vice President-Investor Relations & Communications

Carl Trowell
President, Chief Executive Officer & Director

P. Carey Lowe
Chief Operating Officer & Executive Vice President

Jonathan Baksht
Chief Financial Officer & Senior Vice President

OTHER PARTICIPANTS

Ian Macpherson
Simmons & Company International

David C. Smith
Heikkinen Energy Advisors

Praveen Narra
Raymond James & Associates, Inc.

Gregory Lewis
Credit Suisse Securities (USA) LLC (Broker)

Vaibhav Vaishnav
Cowen & Co. LLC

Jacob Ng
Morgan Stanley & Co. LLC

Mark Brown
Seaport Global Securities LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good day, everyone, and welcome to Ensco Plc's First Quarter 2016 Financial Results Conference Call. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note this event is being recorded. I will now turn the call over to Mr. Sean O'Neill, Vice President of Investor Relations, who will moderate the call. Please go ahead, sir.

Sean Patrick O'Neill
Vice President-Investor Relations & Communications

Welcome, everyone, to Ensco's first quarter 2016 conference call. With me today are Carl Trowell, CEO; Carey Lowe, our Chief Operating Officer; Jon Baksht, CFO; as well as other members of our executive management team. We issued our earnings release which is available on our website at enscoplc.com.

Any comments we make about expectations are forward-looking statements and are subject to risks and uncertainties. Many factors could cause actual results to differ materially. Please refer to our earnings release and SEC filings on our website that define forward-looking statements and list risk factors and other events that could impact future results. Also please note that the company undertakes no duty to update forward-looking statements. As a reminder, we issued our most recent fleet status report on April 11. A current investor presentation is also on our website that includes updates related to our recent capital management actions.

Now, let me turn the call over to Carl Trowell, CEO and President.

Copyright © 2001-2016 FactSet CallStreet, LLC

Carl Trowell
President, Chief Executive Officer & Director

Thanks, Sean, and good morning, everyone. As I mentioned on our last earnings call, we are facing extremely challenging market conditions with customers announcing further reductions in capital expenditures, which is extending the duration of the down cycle for the offshore drilling sector. Given this situation, we took further steps since our last earnings call to substantially reduce debt, enhance our liquidity, and bolster our equity position thereby significantly reducing leverage on our balance sheet.

We completed a very successful tender that reduced debt by more than $860 million at a meaningful 28% discount. And we raised more than $585 million of equity through a secondary offering. Raising equity at current stock price levels is not an easy decision, but the management team and the board believe it was a prudent step given the current lack of visibility regarding the timing of a market recovery and given opportunities, we believe we'll develop as the cycle unfolds. We believe that our decision to raise equity now gives us a competitive advantage and improves our position should the market recovery be extended.

As part of our disclosure surrounding the secondary offering, we've provided preliminary first quarter operating results that are in line with our final first quarter results released yesterday. Our first quarter financial results were better from the initial outlook we provided on our last earnings call with revenues exceeding our guidance and operating a general and administrative expenses, coming better than expected.

Exceptional operational performance with record fleet-wide operational utilization drove these results, coupled with disciplined expense management. As outlined in our press release, earnings from continuing operations was $0.74 per share. As previously disclosed, we also improved our full-year outlook for capital expenditures by lowering our estimate another $50 million. We now project only $240 million of CapEx for the remainder of the year. Our investor presentation on our website details our capital expenditure outlook, as well as our expense savings targets that we've previously communicated.

We are achieving the run rate savings that we've targeted. And as witnessed by first quarter expenses that were lower than our prior outlook, we continue to pursue further efficiencies and cost savings across our operations and support structure.

While we have some revenue backlog reductions as detailed in our most recent fleet status report, we also had several contract wins that Carey will discuss in a moment, driven by our crews' maintaining very high levels of operational performance. In our recent disclosures, we also provided an update regarding discussions with our customer for the 6000 Series rigs. And as we noted, the commercial terms as they stand now would result in a net reduction of approximately $140 million of revenue backlog. This could involve canceling one or more of these rig contracts with an effective date starting possibly as soon as the next few weeks concurrent with rate reductions on the others, partially offset of term extensions. To be clear, we have not yet executed a definitive agreement.

With respect to the ENSCO DS-5, as we previously disclosed, we are in arbitration with Petrobras regarding the drilling services contract. And as a reminder, we did not book any revenue for this rig in the fourth quarter of last year or in the first quarter of this year. Also, our revenue backlog does not reflect any amounts for this rig. We are also in arbitration with Samsung, the shipbuilder for ENSCO DS-5, to recover any monies due to us including potential overpayments related to alleged bribes Samsung paid to Petrobras.

Turning now to fleet management. Our two ENSCO 140 Series rigs remain on schedule for delivery later this year and our highgrading also included the sale of ENSCO 6000 for scrapping, bringing total rig sales to 22 since 2010 compared to 16 rig deliveries over the same period. Fleet management also included reducing costs through

Copyright © 2001-2016 FactSet CallStreet, LLC

expedited stacking of certain rigs as they rolled off contract without immediate follow-on work. As noted on our last call, we now have a total of 11 rigs that we plan to scrap or permanently retire factoring in the recent sale of ENSCO 6000 that I just mentioned.

As we stated previously, we believe rig scrapping industry-wide will continue as we go through 2016 and 2017 and we think this will be a major factor in rebalancing the rig market. So, in summary, given the lack of visibility regarding the duration of the market downturn, we continue to take steps that we believe are prudent and necessary to persevere until market conditions improve. Despite the challenges of the current market, we remain optimistic about the medium to long term prospects for our sector. Three forces are at play that will ultimately rebalance the offshore market.

The unprecedented pull-back in customer spending that will ultimately cause production to decline and commodity prices to increase, rig scrapping and retirements that will significantly cut overall rig supply, and reengineering and cost deflation across the offshore supply chain that will lower the breakeven point at which it is economical to drill. While these forces play out, Ensco will continue to be proactive in terms of fleet and resource management, capital management, including streamlining capital expenditures, expense management, and investing selectively in opportunities that increase our leadership and competitive advantages.

Now, I'll turn the call over to Carey Lowe, our Chief Operating Officer and Head of Marketing.

P. Carey Lowe

Chief Operating Officer & Executive Vice President

Thanks, Carl. As the offshore sector navigates through the industry downturn, Ensco remains focused on things we can control, namely operational and safety performance. In terms of operations and safety metrics, our first quarter results were very strong as evidenced by 99.8% operational utilization for jackups and 99% for our floaters plus a total recordable incident rate or TRIR of 0.23. Both operational utilization and TRIR were new company records and a continuation of our record setting performance during 2015.

These operational and safety results benefit our customers and are a testament to the focus and commitment of our offshore crews and onshore personnel. These results are also a reflection of broader company initiatives aimed at three key areas, enhancing our management systems, further refining our training and development programs, and delivering higher levels of performance from our rigs and equipment.

The Ensco Asset Management System is a great example of this work. This proprietary system was developed with the support of several departments across the company and has been successfully implemented in the past year to improve the efficiency and cost-effectiveness of our repair and maintenance processes.

The combination of exceptional operational and safety results as well as the customer relationships we have built over many years led to Ensco being recognized as the top-rated offshore driller in customer satisfaction during 2015, the sixth consecutive year we've earned this distinction. In a challenging contract environment, this performance helps us to differentiate Ensco from the competition and to capitalize on pockets of demand that are available around the world, and has resulted in recent new contracts.

During the first quarter, we signed ENSCO 8504 to contracts with two different customers in Indonesia, contracting the majority of the rig's available days in 2016. We have previously highlighted ENSCO 8504's operational and safety track record over the years, which helped in earning these new contracts and benefit our marketing efforts for other opportunities in the region.

Copyright © 2001-2016 FactSet CallStreet, LLC

We also reached an agreement with a customer in the Mediterranean to extend ENSCO 5004's current contract by 18 months, which will keep the rig working in the region through mid-2018. Another positive sign is ENSCO DS-6's customer electing to place the rig back in operation in Egypt during third quarter 2016, following a period where the rig was on standby rate.

We also signed new contracts for drilling management service for Thunder Horse and Mad Dog, located in the U.S. Gulf of Mexico, for five years each. The exceptional safety record and efficient manner in which Ensco crews have operated these rigs for our customer were crucial towards securing these contracts.

Turning now to our premium jackup fleet. We were successful in securing several short-term contracts and extensions during the first quarter. In addition to the six-month contract for ENSCO 107 in Australia I mentioned on our last earnings call, we won short-term extensions for ENSCO 100, ENSCO 101 and ENSCO 102. All of which were located in the North Sea. Ensco has a strong operational track record in the region, as evidenced by our number one rating in the North Sea category of EnergyPoint's Annual Customer Satisfaction Survey. While we did see some short-term contracts among our jackup fleet, other operators for ENSCO 72, ENSCO 75 and ENSCO 110 opted to cancel specific drilling programs in light of the market environment. However, other customers elected to move forward with their drilling plans, including Saudi Aramco, with whom we completed negotiations to keep several of our jackups working in the Middle East.

Turning now to rig supply. Since third quarter 2014, offshore drillers have announced the retirement of 52 floaters and have cold stacked another 43 units. Approximately 45 floaters, including most of the cold stacked I just mentioned, are over 30 years of age and idle without follow-on work. Another roughly 35 floaters in the same age category will see their contracts expire by the end of 2017.

In total, these 80 floaters are likely candidates for retirement and three times the number of new builds currently scheduled for delivery by the end of 2017, excluding 15 Build-in-Brazil rigs that are scheduled on paper for delivery by year-end 2017. The attrition of these older rigs, plus other floaters less than 30 years of age, will help to reduce the supply side of the equation.

Similar to floaters, we expect stacking of jackups to continue. There are approximately 75 competitive jackups, defined as independent leg cantilever rigs that are over 30 years of age and stacked or idle without follow-on work. Another roughly 70 jackups in the same age category have contracts expiring by the end of 2017.

In total, these 145 jackups are candidates to be removed from the active fleet over the next year-and-a-half. And these jackups exceed the approximately 100 rigs currently scheduled for delivery over the same period.

Another factor impacting the supply/demand dynamic is the uncertainty of timing of – and delivery for jackups being built by speculators. Many of these orders were placed with small down payments, and their deliveries have been repeatedly delayed, a sign that many of these newbuilds may continue to be delayed indefinitely, and ultimately be cancelled.

For example, at the start of the downturn in mid-2014, there were 74 jackups on order from speculators. Based on original expected delivery dates, 55 of these rigs should have been delivered by now, but still show as under construction. Another eight of these rigs have been cancelled. So, questions remain on how many of these speculative rigs enter the competitive market, and over what time period. While the market headwinds impacting our sector are challenging, these conditions have led to a much-needed retirement of older rigs, and the delay and cancellation of newbuilds. We expect to see a further reduction in available rig supply through the retirement of aged rigs and the cancellation of newbuilds in the order book, which will be positive for well-positioned drillers in the mid to long term.

Copyright © 2001-2016 FactSet CallStreet, LLC

Before I turn the call over to Jon, I would like to comment on newly released regulations by BSEE for drilling in the U.S. Gulf of Mexico. Based on our understanding of the final regulations, we believe the U.S. Gulf will continue to be a very viable basin for offshore drilling. Furthermore, based on our initial assessment of these regulations, we currently expect the costs for Ensco to comply with the new regulations, which will be phased-in over time, will not be significant. Now, I'll turn it over to Jon.

Jonathan Baksht

Chief Financial Officer & Senior Vice President

Thanks, Carey. Today, I'll start with our first quarter financial results, our outlook for second quarter 2016, and then I'll wrap up with a discussion of our financial position and capital management actions. As noted in our earnings release, first quarter 2016 earnings per share from continuing operations were $0.74 compared to an adjusted $1.49 a year ago.

Total first quarter revenue was $814 million versus $1.16 billion last year. Lower fleet-wide utilization was partially offset by the addition of ENSCO DS-8, which commenced its initial contract offshore Angola during fourth quarter 2015, ENSCO DS-9, which was delivered in the second quarter 2015, the addition of ENSCO 110 to the active fleet, and the reactivation of ENSCO 5006 following a shipyard upgrade.

In the floater segment, revenue declined to $513 million, compared to $695 million a year ago, primarily due to lower utilization of 64% versus 86% last year, and the decline in average day rate to $365,000 from $425,000 last year.

Earnings contributions from ENSCO DS-8 and ENSCO DS-9, plus the reactivated ENSCO 5006, helped to partially offset the impact of lower rig demand. Operational utilization for the floater segment, which adjusts for uncontracted days and planned downtime, was a record 99%, up from 93% a year ago.

In the jackup segment, revenue was $278 million, compared to $428 million last year. As reported, utilization declined to 66% from 87% in 2015. The average day rate declined to $118,000 from $144,000 a year ago. These factors were partially offset by the addition ENSCO 110 to the active fleet.

Operational utilization for the total jackup fleet was 99.8%, up from 99.6% in 2015. Total contract drilling expense declined to $364 million better than our guidance of $385 million to $390 million that we provided on our last conference call due primarily to lower personnel and repair and maintenance costs.

Year-over-year, we reduced contract drilling expense by 30% from $518 million in the first quarter 2015. Proactive expense management and fewer operating rig days offset the incremental cost of two newbuild drillships, a newbuild jackup and the reactivation of ENSCO 5006. Depreciation expense declined $24 million to $113 million, in line with our expectations due to noncash asset impairments recorded in fourth quarter 2015.

General and administrative expense was $23 million, beating our outlook due in part to reduced compensation costs. We anticipate that G&A expense will increase to approximately $27 million in the second quarter. This quarter-to-quarter variance is mostly due to the timing of compensation-related items. For the second half of 2016, we expect total G&A expense will be in line with our total G&A outlook for the first half of the year.

As detailed in our earnings release, other expense is $8 million lower year-to-year due to a $27 million loss from the debt refinancing we completed a year ago, partially offset by higher interest expense for the new senior notes

Copyright © 2001-2016 FactSet CallStreet, LLC

issued as part of this debt refinancing. The effective tax rate was 29% for the first quarter, in line with our previous outlook.

Now let's shift to our outlook for the second quarter 2016. Total revenues are expected to decline on a sequential quarter basis due to an estimated 3.5% to 4.5% decline in average day rates from first quarter levels of $208,000. We expect reported utilization for the fleet to be in high 50% range. Our average day rate and reported utilization outlook ranges incorporate assumptions for two open items, the Letter of Award for ENSCO 5004, the details of which were disclosed in our most recent fleet status report and assumptions regarding the effective date for revised commercial terms for the 6000 Series rigs based on the current status of discussions with our customer.

It is important to note that we have not yet executed definitive agreements for ENSCO 5004 or the 6000 Series rigs, and revenues will be subject to final definitive agreement. Second quarter contract drilling expense is expected to decline to $350 million to $355 million as we further reduce costs on rigs that do not have near-term contracting opportunities. This contract drilling expense outlook included $9 million of incremental costs for ENSCO DS-4 and DS-5 including costs to move the rigs from a higher-cost environment in the U.S. Gulf of Mexico to a less expensive location in Tenerife.

As noted in our most recent fleet status report, we have more rigs rolling off contract and to the extent we do not recontract these rigs, we will be proactively managing costs down on an expedited basis. Depreciation expense is expected to decline by $3 million to approximately $110 million in the second quarter, primarily due to the adjustment to ENSCO 5004's expected useful life.

As I mentioned earlier, we expect second quarter G&A expense to be approximately $27 million. Net interest expense is estimated to be $57 million in the second quarter. We also anticipate other income of $245 million due to a pre-tax gain on debt repurchased during our recently completed tender offer.

For the second quarter, we expect our effective tax rate into be in the low-teens due to a discrete tax item related to our debt repurchase in April. Excluding this discrete tax item, we anticipate our effective tax rate for the second quarter to be in line with the first quarter. For the second half of the year, we expect our effective tax rate to decline from first quarter levels due to planned restructuring that we expect will create further tax efficiencies. As Carl mentioned, we are achieving our run rate saving targets and we will continue to proactively manage our cost in line with market conditions through the cycle.

Before we review our financial position, I'd like to briefly comment on the tender and equity offers we've recently completed to reduce leverage on our balance sheet. In March, we announced tender offers for near-term debt maturities that were trading at a significant discount to par value. Through this tender process, we repurchased $861 million of senior notes for $622 million, which represent an average discount of 28%.

This opportunistic debt repurchase generated a 15% pre-tax internal rate of return and over $460 million of cash savings inclusive of principal and interest. More recently, we completed a successful secondary offering of 65.6 million shares, raising $586 million of net proceeds. That will further bolster our liquidity position and capital management flexibility as we navigate the downturn. This additional liquidity provides us with a clearer runway to manage through this cycle, which we believe gives us a competitive advantage to pursue opportunities that may arise, such as the recent debt repurchase that generated a 15% pre-tax risk-free return.

Note that this equity offering will impact our earnings per share calculation going forward. Weighted-average shares outstanding for the second quarter, which includes a partial quarter impact of the equity offering, are expected to be approximately 284 million for the purposes of calculating earnings per share.

Copyright © 2001-2016 FactSet CallStreet, LLC

Now, let's wrap up with a review of our financial position. Pro forma for our tender and equity offers, we had $1.3 billion of cash and short-term investments as of March 31, 2016 and our net debt to capital ratio is 33%, a significant improvement over net debt to capital ratio of 41% at year-end 2015.

We have a fully available $2.25 billion revolving credit facility that matures in 2019. We have $5.2 billion in revenue backlog, and we have no debt maturities until 2019.

Moving to our capital expenditure outlook, total remaining newbuild CapEx is approximately $750 million. As Carl mentioned, our 2016 capital expenditure budget has been reduced by $50 million to $400 million in total.

Forecasted CapEx for the rest of 2016 is $240 million and includes the final milestone payments for ENSCO 140 and ENSCO 141. Our 2017 CapEx budget is $450 million, and our CapEx budget declines from there to $325 million in 2018. These updated figures are included in the most recent investor presentation on our website.

In closing, since the downturn in the offshore drilling markets began in mid-2014, our actions have been aimed at proactively managing our financial position in light of this market downturn. As we saw conditions deteriorating, we accessed the debt capital markets to improve our liquidity position and term out our 2016 debt maturities. We reduced our dividend and operating costs, including offshore compensation, ongoing rig maintenance expense and onshore support costs to further improve our liquidity position. We managed capital expenditures by deferring milestone payments for uncontracted newbuilds and reducing our CapEx projections for major and minor upgrades through 2018 by $200 million.

We opportunistically repurchased near-term maturities at a discount which will generate significant cash savings in the coming years and raised equity to bolster our liquidity. These decisive actions, coupled with our improved operational and safety performance will continue to help us optimize our financial results in both the short and long-term.

So, with that, I'll turn the call back over to Sean.

Sean Patrick O'Neill

Vice President-Investor Relations & Communications

Okay. Operator, you may now open up the line for questions, please.

Copyright © 2001-2016 FactSet CallStreet, LLC

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question-and-answer session. [Operator Instructions] At this time, we'll pause momentarily to assemble our roster. Our first question comes from Ian Macpherson of Simmons. Please go ahead.

Ian Macpherson
Simmons & Company International

Q

Hi there. Well done on the nimble capital markets maneuvering. I have a question the DS-4 and DS-5, if you could share with us more about the stacking process, where those cost go to, and what sort of analysis you provide in terms of the back-end? If they were to be reactivated, what that might entail since this is, I guess, terra nova for Ensco in terms of cold stacking high-end drillships?

Carl Trowell
President, Chief Executive Officer & Director

A

Hi there, Ian. So, it's Carl here. Well, the first thing to say is that we're not fully cold stacking these rigs. We're relocating them from the Gulf of Mexico where they have basically been at anchor and using the thrusters and burning fuel to a new cluster stack approach, which we're going to do in Tenerife. And we're going to do that because it's a lower-cost environment to do it. We can put the rigs dockside there, and they are better-positioned for any future work that might come because of that location, be it East Africa, be it Latin America, be it the GOM. So, that's the reason we've done that, and the upfront charges we'll take in doing that, we think will pay off in a relatively short while from the reduction in cost that we might – we'll be able to get from it.

We are still in the process of doing the final plan for that, so we'll give closer guidance on what the average running cost for those rigs are once we've got them in place. So, that's likely to be next quarter.

Ian Macpherson
Simmons & Company International

Q

Okay. And I guess no insight to share at this point in terms of what it might cost to get them back into service on the back-end?

Carl Trowell
President, Chief Executive Officer & Director

A

No, not at this point because it will depend on how long they have been in the cluster stack mode and what jobs they're going to next.

Ian Macpherson
Simmons & Company International

Q

Sure, understandable. Well, against this back drop of rising oil prices, I was wondering maybe, Carey, you might share what you think the demand situation is and how it might be evolving if we continue to get this melt up in crude and if we're theoretically between $45 and $50 oil for the rest of this year, if you think that will be sufficient to drive some green shoots in demand and if so, where do you think you might see it first?

Copyright © 2001-2016 FactSet CallStreet, LLC

P. Carey Lowe
Chief Operating Officer & Executive Vice President
A

Ian, I think it's probably to start right now predicting when the green shoots in demand will come into place, it's a little bit early for that, but I think, I'll refer you back to what Carl said, this pull-back in customer spending is going to cause production decline. I think we're starting to see that now, and commodity prices have started to rise some. And from the supply and demand standpoint between the rig scrapping and retirements and the cut in – the delayed delivery or possibly cancelation of newbuilds, everything will come together at some point in the future and we will see utilization pick up and at some point after that, pricing increase, but to predict right now when that will be is, I think, a little bit premature.

Carl Trowell
President, Chief Executive Officer & Director
A

Ian, I'll add a little bit to that. I think everything does begin to look like it's pointing towards some form of rebalancing in the market for the second half of the year. And I think the run-up that we've seen in commodity prices is an early indication that that's filtering through to sentiment in the market.

Regardless of that, I think 2016 is pretty much baked in. If there is a higher oil price, if we go above $50 Brent in the second half of the year, we may see the increase in activity pick up, but it's going to be on the margin and won't drastically change 2016. We're going to exit 2016 across the whole sector, not Ensco specific, we're going to exit with lower utilization and lower average day rates than we went in.

But what will begin to happen, I believe is, if we do see this run-up, and we do see question marks building over the supply side and we exit the year, as we go towards the end of 2016, we see a higher oil price environment, I think it will start to have an influence on 2017, in the sense of an increased activity. That is likely, and we certainly believe it's going to come in the shallow water first, where we're well-exposed in the jackup market, and we'll see an activity pickup in 2017.

Now admittedly, it's coming off a very low base and it will be, I think, in Asia and the Middle East that we will probably see it first. Asia is usually the first to go down and the first to come back up in this particular arena. And the Middle East will still remain relatively strong – Middle East, and I also include West Africa a little bit in that area. But I don't believe that will necessarily kick through into pricing in 2017, and then we'll have to look at where we sit on the commodity side in 2017.

But just to reiterate the points we made before – the seeds have been sown to-date for the recovery, I mean, the pullback in expenditure is really unprecedented, and I don't say that lightly. We are seeing customers take relative – unprecedented decisions based around near-term cash and CapEx decisions that will ultimately, and quite quickly, start to have an effect on reserves and production. And so, the recovery here I believe is going to happen, the question is just when. And that is very difficult to predict.

Ian Macpherson
Simmons & Company International
Q

That all makes a lot of sense, and I tend to agree on all points. So thanks for that thoughtful answer, both of you.

Operator: Our next question comes from David Smith, Heikkinen Energy Advisors. Please go ahead.

David C. Smith
Heikkinen Energy Advisors
Q

Copyright © 2001-2016 FactSet CallStreet, LLC

Hi. Thank you. And congratulations on the quarter and the proactive equity raise. I wanted to ask, just going back to those relocated drillships in Tenerife, can you give us a broad range of the cost to put those rigs back in service, if they sit for a couple of years? More than $10 million, less than $50 million?

Carl Trowell
President, Chief Executive Officer & Director
A

David, we're not going to do that at the moment, and it's not that we just try to dance and avoid the subject, it's just that the range varies drastically depending on how long they have been in stack, and what maintenance gets deferred and how many of, say, the [ph] SBS (33:05) or big surveys get deferred. So there's quite a range there.

But, needless to say that we think the economics work well for moving them over because of the cost reduction we can get in the near term, and that we can bring them back economically to market them. And, as with some of the other rigs that we've done, we won't necessarily wait for a firm contract to bring some of them back. We will – as we begin to see the market improve, we will phase back in some of the stacked rig that we've got back into service, and proactively do some of the, if you like, the remobilization costs. But just to be clear, we'll continue to market those rigs.

David C. Smith
Heikkinen Energy Advisors
Q

Appreciate it. I ask this because the cost to return rigs to service, the six and seven generation rigs to service, seems like the most important driver of the eventual deepwater day rate recovery. So, maybe not asking the question about your ships, but more generally, do you think the smart stacked concept, and not just for PACD, but for others, do you think those idle drill ships can remain the relatively low cost of marginal supply for an extended period of time, where they can be stored for a couple of years and brought back for less than $10 million, $20 million?

Carl Trowell
President, Chief Executive Officer & Director
A

I mean, it very much depends on what state the rig is in, as to how it can be brought back. But I think that the stacking of some of these floaters in general will improve the market dynamics, because people – once you have done this, you're not going to bring that rig back for a short-duration, low-priced contract.

David C. Smith
Heikkinen Energy Advisors
Q

Right.

Carl Trowell
President, Chief Executive Officer & Director
A

So, in that case, it will remove rigs from the supply in the near term for that type of contract. You're much more likely, and I'm talking generically now, to only bring those rigs back when you feel that you're going to have a sufficiently long contract that's worth that cost, and the day rate supports it.

David C. Smith
Heikkinen Energy Advisors
Q

Appreciate it. And just the follow-up was, I think of Ensco as the driller which has been the most proactive to protect the shareholders against potential prolonged downturn between the dividend cut, the debt tender, the equity raise, but you also have a pretty good history of opportunistic growth. So, I'm really curious to get your view on what signals you need to see before M&A becomes compelling or attractive to you?

Copyright © 2001-2016 FactSet CallStreet, LLC

Carl Trowell
President, Chief Executive Officer & Director

A

That's a good segue for me to make a couple of points, because I think it's important to just point out that the equity raise that we did is very much as you described it. It was not driven by one specific catalyst, but it was driven by the strategy, that we have had to basically do a series of actions to strengthen liquidity and make sure that we are in control of our own destiny. And as you say, protect our shareholders against any further deterioration or an extended downturn.

At the same time, it gives us flexibility and the ability to be more forward-leaning at a time when a lot of our competitors are very internally focused. They're either still trying to drive through additional liquidity measures within the company to meet short-term liability or they're in the middle of renegotiations or even restructuring.

And so whilst they're very much internally focused, we have the ability to look outward and now – and one of the reasons we did it at this time, and as we said in the pre-prepared statements, going to the market at this time under these price levels and mindful of the dilution for shareholders, it wasn't an easy decision and it wasn't one that was lightly taken.

But we – one of the reasons we did it now is – well, first of all, we wanted to do it early and proactively and we didn't want to be at the back of the queue given that we were doing it from a position of strength and – or relative strength and opportunity to be behind oil field services companies that were doing it from a distressed position. But the other element was that we think that the market dynamic has changed and we're entering a new phase, and I don't mean with respect to customers contracting activity. I mean, with respect to the window of opportunities that are going to come. We have been through a phase where people have been kicking the can down the road trying to keep finances going, trying to keep companies and assets going that were not really viable and deferring a lot of difficult decisions.

We're now at a point in the market that we believe that we're really starting to see those opportunities materialize. We have seen dislocations on the bond pricing which we decided we would act upon. We've seen dislocation on asset pricing. We're seeing for the first time now the shipyards seriously reach out and start to approach people like ourselves to discuss some of the assets that they've got that people have walked away from.

We are seeing some of our competitors start to consider strategic options or alliances or various things they were not even considering three to six months ago. And to that end, that's why we think that we're entering a bit of a different phase on the market and having liquidity available both from a defensive and offensive point of view is what drove part of our strategy around liquidity.

Now, there's three types of M&A open or starting to develop. The first is distressed assets, single distressed assets from forced sellers or from shipyards. Second is M&A activity around the smaller companies, the sort of 6 to 10 rig-based companies. And then the third is more peer group M&A with the international drillers. And it behooves us to have a look at all of those as we go through the cycle and as I said, I think we're getting to the point where those are becoming more realistic and the opportunities may come along.

Now, that said, whatever we do, we're going to approach with – opportunistically and with real discipline about how we deploy the liquidity that we've got. And the other element is that whatever we do, we want to make sure that it strengthens the position of the company both for the near term and in the long term, and not to do something that actually increases our liability. So, we're going to be very disciplined about looking at it, but our liquidity position does allow us, at this point, to look at some of these things when some of our competition can't.

Copyright © 2001-2016 FactSet CallStreet, LLC

David C. Smith
Heikkinen Energy Advisors

Q

That's great color. Thank you very much.

Operator: Our next question comes from Praveen Narra of Raymond James. Please go ahead.

Praveen Narra
Raymond James & Associates, Inc.

Q

Hi. Good morning, guys, and congrats on the balance sheet measures as well. If we could stay on that kind of line of thinking, in terms of what you're saying, presumably the rigs that are still being held at the shipyard and newbuilds are in pretty good shape, but can you give us a sense for what you think of in terms of the shape of the more distressed assets? Obviously, we saw the sales, the $65 million sale, the Ocean Rig. But in those types of situations, from what you've looked at, can you give us a sense of how those stand on an operations go -forward basis?

Carl Trowell
President, Chief Executive Officer & Director

A

Yeah. Maybe I'll answer the question, I think you asked it, and if I didn't, come back. So, we've been looking at – and we've been to see nearly all of the assets that are available and have been marketed for sale at the moment. But consistent with things that we've said before, we didn't look, we didn't proactively bid on that, on the Cerrado rig that's just been sold. And the reason for that is, as we've indicated before, we're going to sit on the sidelines a little bit for the first sales, want to see what the pricing clears at. The other is that – a one-off deal like that doesn't move the needle for us, and potentially becomes a liability in the near-term, not an asset.

And the third is that the actual competitiveness of that particular rig was not something that we felt comfortable with. So, as I've said a few times, with the liquidity cushion that we have, we are going to be extremely disciplined about how we deploy that. And so, the deal that has just sold was one that didn't scream for us, by the time we looked at how long we thought the asset might be stacked, the work that would be taken, and the investment required to bring it up to competitive levels. And actually, the ultimate competitiveness of that rig under its current specifications meant that we couldn't see a sensible risk return on it even at a very low discount.

Now, that doesn't necessarily mean that there aren't other rigs out there that we will be more interested in. And there are rigs there which, I think, we will be more interested in because they strategically fit our view of the market better and that they fit our fleet structure better. And so, we will keep looking. The fact that we've not played thus far doesn't mean that we won't. But we are not going to rush, partially because we think there's going to be more opportunities and those that we think are better-suited to us as a company and that actually strengthen us.

Praveen Narra
Raymond James & Associates, Inc.

Q

I guess to stick on the line of – the places that strengthen you and where you guys see the opportunities, in terms of doing something, is there any preference at this point or is it just opportunistic in terms of gaining increased leverage due to the jackup or the floater market?

Carl Trowell
President, Chief Executive Officer & Director

A

Copyright © 2001-2016 FactSet CallStreet, LLC

If you don't mind, Praveen, I'm not going to show my hand.

Praveen Narra
Raymond James & Associates, Inc.

Q

Okay.

Carl Trowell
President, Chief Executive Officer & Director

A

And the other thing as well is that I think the way to view this a little bit more is that we – any action we take will be very carefully considered and it will be aimed at materially strengthening the company as we go through the cycle. So, it would need to fit with our view of the market and our overall strategy going forward rather than just picking up the old rig here or there because it was on the discount. And by the way, I think there will be opportunities to do that.

Praveen Narra
Raymond James & Associates, Inc.

Q

Perfect. Thank you very much for the color.

Operator: [Operator Instructions] Our next question comes from the Gregory Lewis of Credit Suisse. Please go ahead.

Gregory Lewis
Credit Suisse Securities (USA) LLC (Broker)

Q

Yes. Thank you and good morning. So, as we look at some of the recent contracts that have been happening I guess for the last few quarters now, it generally seems like whether it's a floater or a jackup, and this is across industry, that there's been the ability for the customers to have contracts of – termination convenience. Is that sort of the market that we're in right now, where generally if you're looking to put a rig to work that there's going to be that clause in it that allows customers to exit those contracts?

P. Carey Lowe
Chief Operating Officer & Executive Vice President

A

Hey, Greg. This is Carey. Are you finished, Greg.

Gregory Lewis
Credit Suisse Securities (USA) LLC (Broker)

Q

I was just going to say, at least is that what you're seeing in the tenders that you – the few tenders that are coming across your desk that you've been bidding on? Is that sort of the market we're in right now?

P. Carey Lowe
Chief Operating Officer & Executive Vice President

A

Yeah, I think that is the market we're in right now and it's not much different than any other point in the cycle in the past. The newer contracts have more favorable early termination provisions for the operator. So, I agree with you, that's where we are. As you know, the older contracts had much stronger early termination provisions and we have some of those still.

Copyright © 2001-2016 FactSet CallStreet, LLC

Gregory Lewis
Credit Suisse Securities (USA) LLC (Broker)

Q

Okay. And then just as, clearly, you guys have been successful on winning some P&A on a small scale. As we look at the next couple of quarters, typically it seems like this activity picks up a little bit in the summer. Is there going to be any potential short term jobs that are in the market right now or we can see or is it kind of across the industry, there's just really not much desire by customers to move forward with those types of little projects?

P. Carey Lowe
Chief Operating Officer & Executive Vice President

A

Yeah, Greg. Carey again. We've been very aggressive in going after P&A and short-term work and particularly with the 8500 Series in the Gulf of Mexico that is really well suited for this kind of work and particularly for the customer who wants to go back and forth between P&A or intervention work and drill at the same time. And in addition to that, with the mooring upgrades we've put on two of the 8500s are ready, we have given a lot of optionality to work in the shallow water and the deeper water at the same time. So, we see opportunity in the P&A area and we've started to build a reputation, and in the job that we're doing so far, we've been very efficient and the customer is very pleased.

Carl Trowell
President, Chief Executive Officer & Director

A

Yeah. Greg, I'll add a little bit more to that. I think that, it is an area where there's still pockets of work and we do expect there to be other short-term work picked up in that arena. The other one is that we think that if you broaden it out a little bit to not just P&A, but if you describe it as infield work, so that is the kind of workhorse constant work that has to be done on a deepwater or an offshore field, of doing P&A, an intervention, a sidetrack, maybe a step-out well, that is where we are seeing some pockets of work. But it's also one of the areas where we think in floater segment, that the work will come back earliest and fastest, because what's happened largely, is around the world, that that work has somewhat shut off with a few places where it's still continuing a little bit.

But if you go back 10 years ago, as an industry, we're talking about declined rates and it was a really big issue. That effectively went away when oil prices went up above $80 a barrel, and then certainly as it went over $100 a barrel, because what – although a lot of headline attention went to the big new field developments and the FID, what was happening at that oil price is that people were doing a huge amount of infield work. They were drilling infield wells, recompleting old wells, drilling step-out wells. That has effectively stopped and, as a consequence of that, we're going to start to see, very rapidly, decline rates on existing fields. And so, you start to see oil prices come back up above $50 and things like this, and I think we will see that switch back on, because the incremental barrel is very cheap, because it doesn't carry the full weight of development. It has existing infrastructure. And also, it will be really important to actually prevent decline rates on existing fields for customers.

That's where – so that work, combined with P&A, is one that we think will come back, and that's why we've been very much targeting it with the 8500s and the mooring conversions that we've been doing, because we think that rig class is incredibly well-suited to that, and will be one of the first floater segments to pick up a bit.

Gregory Lewis
Credit Suisse Securities (USA) LLC (Broker)

Q

Okay, guys. Thank you very much for the time.

Operator: Our next question comes from Vaibhav Vaishnav of Cowen. Please go ahead.

Copyright © 2001-2016 FactSet CallStreet, LLC

Vaibhav Vaishnav
Cowen & Co. LLC Q

Hi. Thanks for taking my question. So, one of your peers fleet status report reflected operators are asking for lower crewing levels. I just wanted to see if you are seeing the same, what kind of clues, any color you can provide around that?

Carl Trowell
President, Chief Executive Officer & Director A

I wouldn't say that that was a general approach. A lot of – certain minimum crewing levels are also governed by jurisdictions of the countries you work in. Particularly with floaters, you need to maintain certain marine crewing levels for safety standards. So, there – anything that is happening around this at the moment is a little bit on the periphery.

What we are seeing is that, as we're in discussions for new contracts or any kind of concessions on existing contracts, where clients have, in some cases, specified additional crew that is not really adding value, we have seen the willingness of the operators to strip that back. But you're talking about a few crew. And what we have done is also seeing some examples where we have looked at multi-crewing and multi-skilling across some of the jobs, but it's a little bit on the periphery. Where we have been able to look at some of the crewing is, when we've had rigs work on, say, intervention and P&A that require a different level of crewing, because you're not running the BOP or the stacks or anything like that.

Vaibhav Vaishnav
Cowen & Co. LLC Q

Okay. Okay. And, on a different subject, one of the oilfield services companies said they're expecting Saudi to cut 10% rigs. Unclear if they were talking onshore or offshore, but just want to get your sense as to how – what you are seeing in that region?

Carl Trowell
President, Chief Executive Officer & Director A

Well actually, Saudi is one the places where it's still maintaining a relatively high level of activity and as you – I'll refer you to our fleet status report, our latest one that we issued, where we've actually just reached a renegotiation with Saudi for our rigs that are working there. So, Saudi Aramco are constantly trimming and adjusting the balance of their rigs between the drilling and the work-over rig. But we're not seeing, at this point, anything that I would say is a further – indication of a further pullback.

Vaibhav Vaishnav
Cowen & Co. LLC Q

Okay. And one last, if I may, a couple of jackups contracts were shortened recently, just how should we think about similar additional risk in your backlog?

Carl Trowell
President, Chief Executive Officer & Director A

Well, just to restate the situation that we typically have, which is that, for our longer duration, higher value contracts, they usually come with quite high protections against termination at convenience; the shorter-term, lower value jackup ones often come with more limited protection. The three cases you referred to, which is three jackups that had – were terminated for convenience by the client, were all contracts that had been issued in the

Copyright © 2001-2016 FactSet CallStreet, LLC

relatively recent past. And because of where we are in the cycle, they have slightly reduced and more limited protection against termination and so, I think that it's indicative a little bit of where we are in the market, but a situation, I think, that will begin to reverse if we move into the second half of the year and we're in a slightly higher oil price environment.

Vaibhav Vaishnav
Cowen & Co. LLC Q

That makes sense. Thank you for the time.

Carl Trowell
President, Chief Executive Officer & Director A

Thank you.

Operator: our next question comes from Jacob Ng of Morgan Stanley. Please go ahead.

Jacob Ng
Morgan Stanley & Co. LLC Q

Thank you. Carl, could you kindly elaborate on your earlier comment of competitors considering strategic alliances? Are you referring to fleet pooling arrangements, similar to that of the tanker market?

Carl Trowell
President, Chief Executive Officer & Director A

No. I think more, rather than just looking at that, I think read in to my comments the fact that people are considering strategic options that they just didn't six months ago. But I wasn't, in any way, specifically referring to a sort of pool sharing type of approach sometimes seen in the bulk or the tanker market. That hasn't raised its head yet.

Jacob Ng
Morgan Stanley & Co. LLC Q

Got it. Thank you.

Operator: Our next question is from Mark Brown of Seaport Global Securities. Please go ahead.

Mark Brown
Seaport Global Securities LLC Q

Hi. I was wondering on the last fleet status, you referenced that the ENSCO 6001 would – allegedly reached the downtime limit and led you to renegotiate with Petrobras across the rigs on contract. I guess just two questions, one is did you agree that you in fact reached that downtime limit or is that just what Petrobras is asserting? And two, of the four rigs, which ones do you expect would have the duration of the contract reduced as a result of the negotiations?

Carl Trowell
President, Chief Executive Officer & Director A

So, I can't really add more than we've already disclosed because we don't have a definitive agreement in place other than just reiterating very clearly what we've already disclosed. So, as a consequence of that situation where we had allegedly reached the downtime limit, we ended up in a negotiation with Petrobras where we believe – and

Copyright © 2001-2016 FactSet CallStreet, LLC

we're in pretty advanced stage of negotiations. Where we believe this is going to close is that we will – one or two of the rigs will be terminated, early terminated.

There will be a reduction in day rates, offset by an extension of term and the resetting of the downtime on ENSCO 6001. And the consequence of that is $140 million reduction on our backlog from what we have currently reported. And there's nothing more I can add at this point without kind of potentially misleading or without prejudging what we're going to finally land on.

But the one important aspect which we've made clear is that if this goes ahead as we believe then we could reach conclusion within the next week or so, and the impact of these changes will be almost immediate. They would happen within the next few weeks.

Mark Brown
Seaport Global Securities LLC

Okay. Well, that helps. I appreciate the explanation. Thank you.

Operator: And this concludes our question-and-answer session. I would now like to turn the conference back over to management for any closing remarks.

Sean Patrick O'Neill
Vice President-Investor Relations & Communications

I just want to thank everyone for participating on our call today. We greatly appreciate your interest in Ensco. Have a great day.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect your lines. Have a great day.

Disclaimer
The information herein is based on sources we believe to be reliable but is not guaranteed by us and does not purport to be a complete or error-free statement or summary of the available data. As such, we do not warrant, endorse or guarantee the completeness, accuracy, integrity, or timeliness of the information. You must evaluate, and bear all risks associated with, the use of any information provided hereunder, including any reliance on the accuracy, completeness, safety or usefulness of such information. This information is not intended to be used as the primary basis of investment decisions. It should not be construed as advice designed to meet the particular investment needs of any investor. This report is published solely for information purposes, and is not to be construed as financial or other advice or as an offer to sell or the solicitation of an offer to buy any security in any state where such an offer or solicitation would be illegal. Any information expressed herein on this date is subject to change without notice. Any opinions or assertions contained in this information do not represent the opinions or beliefs of FactSet CallStreet, LLC. FactSet CallStreet, LLC, or one or more of its employees, including the writer of this report, may have a position in any of the securities discussed herein.

THE INFORMATION PROVIDED TO YOU HEREUNDER IS PROVIDED "AS IS," AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, FactSet CallStreet, LLC AND ITS LICENSORS, BUSINESS ASSOCIATES AND SUPPLIERS DISCLAIM ALL WARRANTIES WITH RESPECT TO THE SAME, EXPRESS, IMPLIED AND STATUTORY, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURACY, COMPLETENESS, AND NON-INFRINGEMENT. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, NEITHER FACTSET CALLSTREET, LLC NOR ITS OFFICERS, MEMBERS, DIRECTORS, PARTNERS, AFFILIATES, BUSINESS ASSOCIATES, LICENSORS OR SUPPLIERS WILL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION DAMAGES FOR LOST PROFITS OR REVENUES, GOODWILL, WORK STOPPAGE, SECURITY BREACHES, VIRUSES, COMPUTER FAILURE OR MALFUNCTION, USE, DATA OR OTHER INTANGIBLE LOSSES OR COMMERCIAL DAMAGES, EVEN IF ANY OF SUCH PARTIES IS ADVISED OF THE POSSIBILITY OF SUCH LOSSES, ARISING UNDER OR IN CONNECTION WITH THE INFORMATION PROVIDED HEREIN OR ANY OTHER SUBJECT MATTER HEREOF.

The contents and appearance of this report are Copyrighted FactSet CallStreet, LLC 2016 CallStreet and FactSet CallStreet, LLC are trademarks and service marks of FactSet CallStreet, LLC. All other trademarks mentioned are trademarks of their respective companies. All rights reserved.