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Conference Call Transcript

ESV - Q2 2008 ENSCO International Earnings Conference Call

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Operator

Good day, everyone. Welcome to the ENSCO International second quarter 2008 earnings conference call. As a reminder, this call is being recorded and your participation constitutes consent to its taping. I will now turn the conference over to Mr. Richard LeBlanc, Vice President of Investor Relations, who will moderate the call. Please go ahead, sir.

Richard LeBlanc - ENSCO International - VP IR

Thank you, Chad. We would like to welcome everyone to our conference call today. With me in Dallas are Dan Rabun, our Chief Executive Officer, and Jay Swent, our Chief Financial Officer, as well as other members of our executive management team. This morning we released our

earnings announcement and we filed our 8-K with the SEC. We also expect to file our 10-Q a little later today. The earnings release is available on our website at www.enscous.com, where you'll also find a reconciliation of any non-GAAP financial measures that may be used on the call. As usual, we'll keep the call to about an hour. Jay will provide a financial overview, Dan will then discuss our markets and operations.

I'd like to remind everyone that any comments we make today about our expectations of future events are forward-looking statements pursuant to the Private Securities Litigation Reform Act of 1995. All such statements are subject to risk and uncertainties and many factors could cause actual results to differ materially. We refer you to our earnings release and SEC filings available on our website, which define such forward-looking statements, state that the Company undertakes no duty to update any such statement and lists risk factors that could cause actual results to differ materially from our expectations. I'd also like to remind everyone that with regard to our rig status, a detailed listing is provided on our website and it's updated the middle of each month when we file our 8-K with the SEC. The last update was as of July 15.

At the end of our prepared remarks we'll have some time for questions. With that let me turn it over to Jay.

Jay Swent - ENSCO International - CFO

Thank you, Richard. Good morning and thank you all for joining us today. We're pleased to report another record quarter with net income up 17% from prior year levels to \$297 million and earnings per share up 20% to \$2.07. Our year-over-year improvement reflects higher day rates for our international jackup fleet, improved utilization of our Gulf of Mexico jackup fleet and significant day rate improvement on ENSCO 7500, our deepwater semi. We repurchased 1.5 million shares during the quarter at a total cost of \$108 million or an average price of \$72.43 per share. From inception of the share repurchase program in March 2006 through second quarter 2008, we have repurchased 14.3 million shares at a cost of \$790 million or an average of \$55.06 per share.

As of yesterday, we have completed an additional \$50 million of repurchases during July which brings us -- or leaves us \$160 million remaining under our \$1 billion share repurchase authorization. We continue to balance share repurchases with our growing deepwater investment. The six deepwater semis that we have under construction will represent an investment of over \$2.5 billion when completed in 2012. We believe that continued investment in our core business, combined with share repurchases, will generate excellent long term returns for our shareholders.

Now let's look more closely at second quarter specifics. Here we will compare second quarter 2008 sequentially to first quarter 2008. Second quarter revenue increased by approximately 10% from first quarter levels. I'll review the details of the quarter-over-quarter improvement in just a moment when we discuss regional results. Contract drilling expense increased to \$214 million in the second quarter, compared to \$191 million last quarter, generally in line with the guidance given last quarter. As expected, labor costs represented over one-third of this increase and the balance came from growth in repair and maintenance and mobilization expenses. As we explained last quarter, labor costs are up largely as a result of wage increases that were implemented late in the first quarter for many of our offshore personnel.

In addition, the weakening US dollar is negatively impacting certain payroll costs as well as the cost of local purchases in a number of the countries in which we operate. Most of the repair and maintenance cost increases were incurred in our Asia Pacific jackup fleet and this also resulted in reduced utilization in this region versus first quarter levels. G&A expense and depreciation were generally in line with expectations with both slightly below our guidance for the quarter. Our second quarter effective tax rate was approximately 19%, slightly higher than the 18% guidance given last quarter, primarily due to stronger profits in our US Gulf of Mexico operations that are taxed at a higher effective rate than our international operations.

Now let's look more specifically at second quarter results in each of our major geographic markets. The average day rate for our Asia Pacific jackups was \$152,900 a 7% increase compared to the first quarter as we realized day rate increases from contract rollovers or cost escalation reimbursements on nearly three quarters of the Asia Pacific jackup rig fleet. Asia Pacific jackup rig utilization was 91%, down from 97% last quarter, as we completed underwater inspections on two rigs and we brought three rigs into a shipyard for scheduled repairs.

The average day rate for our Europe Africa fleet was \$217,700, an increase from the \$213,100 average rate in the first quarter, as three rigs rolled to higher rates with existing customers. Utilization in our Europe/Africa fleet was 97% this quarter, down slightly from 99% in the first quarter and primarily due to a slight increase in repair activity.

Day rates for our North and South America jackup rigs increased by 9% to an average of \$97,800 in the second quarter compared to \$89,400 in the first quarter. North/South America jackup rig utilization improved significantly to 100% from 92% in the first quarter, reflecting a market that has tightened considerably over the last several months. ENSCO 7500 work during the second quarter 2008 at an average day rate of \$365,000

per day, a 31% increase from the first quarter average. This rig commenced the year at a day rate in the low 200s and reset to its current rate during February.

Let's now look or turn to the outlook for the third quarter 2008. We expect third quarter revenue to increase by approximately 5% from second quarter levels primarily due to higher day rates for our Gulf of Mexico jackups and higher rates on two of our Asia Pacific jackups and one of our North Sea jackups. We anticipate third quarter contract drilling expense and G&A expense will be generally in line with second quarter actual results. I'll provide more detail on our outlook for contract drilling expense in a moment. Depreciation expense is expected to increase slightly to \$50 million in the third quarter and we expect our effective tax rate to remain at approximately 19% consistent with the second quarter rate.

Now, a few comments on full year 2008. We expect continued earnings growth over the last two quarters of the year given the strength of our international backlog and the favorable outlook for the Gulf of Mexico jackup market. We indicated on last quarter's call that we expected a downward trend in contract drilling expense in the second half of 2008 as much of our inspection and repair work was front end loaded. We still anticipate a reduction in quarterly contract drilling expense versus second quarter levels but it will not be as dramatic as originally anticipated. We now expect the full year increase in contract drilling expense versus 2007 to be in the range of 18% to 20%, an increase from the 15% guidance given last quarter. More than one-third of this guidance increase relates to higher mobilization and reimbursable costs that are directly recoverable from customers. Another third of the increase is due to higher than anticipated repair costs. The balance of the increase is split between labor increases and a variety of other cost categories.

We expect depreciation expense to be approximately \$196 million for the full year and G&A expense to be approximately \$53 million, both slightly lower than prior guidance. Our full year effective tax rate is expected to be approximately 18% to 19%, little change from our guidance last quarter. 2008 capital spending should be approximately \$725 million. \$590 million of this amount represents interim payments on our six new deepwater rigs now under construction. We also expect to spend about \$25 million for rig enhancement projects and \$110 million for sustaining projects. Our 2008 outlook is currently based on the assumption that there are no major rig relocations during the remainder of the year. Dan will brief you on some recent developments that could affect this assumption. And with that lead-in, I'll now turn the call over to Dan.

Dan Rabun - ENSCO International - CEO

Thanks, Jay, and good morning, everyone. We're very pleased with our second quarter results and we expect our performance will continue to improve for the remainder of the year. First, I will discuss recent developments regarding our deepwater initiatives and then provide some insight into our current markets and operations. I'll refer you to our monthly contract status report filed nine days ago for specific rig details.

ENSCO currently is undertaking one of the largest ultra deepwater rig fleet expansion programs in the industry. Since our last conference call in April, we placed orders for the construction of two deepwater semi-submersibles, ENSCO 8504 and ENSCO 8505. This is in addition to our four ENSCO 8500 series rigs currently under construction. Due to the unprecedented demand for deepwater drilling equipment, we continue to evaluate additional opportunities to expand our deepwater fleet. We are pleased to report that we're making good progress on our ENSCO 8500 series currently under construction. The naming ceremony for ENSCO 8500 was recently held at a shipyard in Singapore and we are on schedule for the anticipated delivery and departure from Singapore during the fourth quarter -- or during the fourth week of September. It will take an estimated 90 days to wet tow the rig to the Gulf of Mexico where we will commence operations in mid first quarter 2009. ENSCO 8501 also is on schedule and progressing well. The next key milestone in the project will be the main engine start up, which is scheduled for August 1. We look forward to the anticipated rig delivery in the early part of second quarter 2009. We continue on schedule with ENSCO 8502 and ENSCO 8503 as well.

With regard to our most recently announced rig construction projects, we plan to strike steel in February 2009 for ENSCO 8504 and in August 2009 for ENSCO 8505. We currently estimate that when all six rigs are delivered, approximately 30% of our total revenue will be derived from deepwater assets, and with a total of seven rigs, we will have one of the largest ultra deepwater dynamically positioned semi fleets in the world. I am pleased to advise that we are on schedule with the crewing of ENSCO 8500 series rigs. The staggered delivery of the rigs, staged approximately nine months apart, allows us to efficiently and prudently train personnel for each of the new rig additions. During the second quarter we filled all of our remaining key management and marketing positions for our newly formed deepwater business unit.

Now let's move to market reports starting with the Eastern Hemisphere. In Southeast Asia, Pacific Rim area, numerous contracts have been awarded and multiple requirements are outstanding. With the exception of ENSCO 56, the ENSCO jackup fleet is fully contracted through 2008. Following its current commitment in November, and demobilization from New Zealand to Singapore, ENSCO 56 is scheduled for approximately three weeks of shipyard work. We are discussing several opportunities for this rig and expect to have our contract upon completion of shipyard work. We believe there's sufficient incremental demand in the region to keep the industry jackup fleet utilized through 2008 and well into 2009.

In the Middle East, there continues to be a great deal of activity. Saudi Arabia hopes to further boost oil production capacity by March 2009 and has recently tendered for four incremental rigs -- three for oil and one for gas development. There are also several outstanding or likely requirements between the UAE and the Kuwait neutral zone. Iran remains the most under supplied market, having requirements for approximately nine additional rigs. With the recently executed LNG export agreement between Qatar and China, we expect that the additional rig requirements at Qatar will be announced for 2009 and beyond.

We anticipate that our Middle East jackup market -- or jackup fleet will be fully committed to at least the third quarter of 2009 as options were recently exercised on two of the four ENSCO rigs working for Saudi Aramco, and we expect that the other two rigs will be extended soon as well. In India, several outstanding tenders are yet to be awarded and we expect demand to continue increasing. India currently imports the majority of its hydrocarbon requirements and will likely continue to increase drilling activity as a matter of national priority. ENSCO 50 and 53 have been working for BG India for several years and we are optimistic that this will continue.

The North Sea standard jackup market remains tight with several inquiries and a tender still outstanding. Recent fixtures for standard work in late 2008 and 2009 are at higher rates and suggest an extremely tight market. All ENSCO rigs in this region are fully committed through 2008. We are encouraged by the level of additional inquiries for work in the Mediterranean. The market is under supplied by at least one rig. We currently have two jackups committed to this market with good prospects for continued work, and there are opportunities for further expansion.

Now turning to the Western Hemisphere. The US Gulf of Mexico jackup market has seen a substantial improvement since our second quarter earnings call. The improvement in the market is being driven by several factors -- balance between demand and supply of drilling rigs due to the substantial decrease in the size of the jackup fleet in recent years, the property divestitures that have impacted activity in 2007 are now being drilled following completion of evaluations from the new owners, and favorable commodity pricing. ENSCO owns the entire 250 foot independent leg premium jackup fleet currently in this market. The 250 to 300 foot jackup market continues to gain momentum and demand in day rates for these rigs have increased. We are adding backlog, which is significant when considering the historic short-term nature of this market. We have also received inquiries from customers for possible term work in the Gulf of Mexico which is a further indication of possible changes in the market. With a limited supply of larger jackups in the area, currently only 11, and with the likelihood of additional rig departures, we expect the high end rig market will tighten further. One industry rig is scheduled to mobilize to Canada in 2009, and it's highly likely that more rigs in this class, potentially ENSCO rigs, will mobilize in the near term to Mexico and Venezuela.

We get questions from the financial community about customers limiting drilling activity during the hurricane season which impacted our results in 2007. During the third quarter of 2007, our utilization for jackups in the Gulf of Mexico was 78%. We are currently outlooking utilization for our Gulf of Mexico jackups at 97% during the third quarter 2008. This increase in expected utilization is a further indication of the strengthening in this market.

Recently there's been much discussion about opening up more of the US outer continental shelf to offshore drilling. It is difficult to predict whether this will occur but, given the limited supply of premium equipment remaining on the Gulf and with the expected additional departures, rig availability to address any new offshore areas would likely be an issue.

We are seeing a considerable increase in activity in Mexico. PEMEX has outstanding tenders for one 250 foot rig and one 350 foot independent cantilever jackup. The results of those tenders were opened yesterday in Mexico and we were the low bidder on both of these jobs. These jobs were approximately two year contracts and we bid \$185,000 per day and \$155,000 per day for the 350 foot and 250 foot independently, respectively, plus a lump sum mobilization and demobilization. PEMEX has until August 12 to accept our tender so it will be a few weeks before we know definitively whether these two rigs will be going to Mexico. In addition, PEMEX indicates that it now will be seeking six incremental rigs for work beginning in late 2008 and early 2009. There's also a requirement for jackup work in Venezuela for which we are in the midst of negotiating with operators. These requirements will likely pull rigs out of the US Gulf of Mexico, adding additional pressure to the demand supply balance.

Now let's turn to the deepwater market where recent contract fixtures clearly demonstrate continued market strength. The Gulf of Mexico, Brazil and West Africa continue to be the most active deepwater areas. We believe Asia will become an important deepwater market with exploration activity increasing in Australia, Malaysia, and India. We are very encouraged by the level of dialogue with customers on our two available new build rigs. We believe ENSCO is uniquely positioned to take advantage of this market with our recently announced new build rigs as existing shipyard and supplier capacities are constrained, and there are few rigs under construction without long term contracts. Our growing backlog and earnings potential we believe demonstrates that we're on the right path, and we have every reason to be optimistic about our future.

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Before opening the conference call to questions, I want to acknowledge a change in our senior management. Mark Burns joined us in June and became President of our international business following Paul Mars's retirement. Mark has over 25 years of experience in the industry and most recently Vice President and Division Manager for Noble Drilling. We welcome Mark and are delighted with his enthusiasm about joining the ENSCO team. We look forward to his contribution over the coming years. Mark would have been a participant in today's call but he and Bill Chadwick, our Chief Operating Officer, are traveling on business this week. Jay and I are available to answer your questions. Additionally, several other members of our management team are here and can address questions regarding their respective areas. Richard, I'll now hand the call back to you.

Richard LeBlanc - ENSCO International - VP IR

Okay. Chad, at this time we'll be happy to take some questions.

QUESTION AND ANSWER

Operator

Thank you. (OPERATOR INSTRUCTIONS). We'll go first to Collin Gerry with Raymond James.

Collin Gerry - Raymond James - Analyst

Good morning, guys.

Dan Rabun - ENSCO International - CEO

Good morning.

Collin Gerry - Raymond James - Analyst

Appreciate the commentary on the jackup market. I guess my first question seems a little bit more relevant these days. We're watching natural gas pull back rather substantially, the merits or longevity of which can be debated all day long, but what's your sense of the Gulf of Mexico's response to natural gas prices? Is there a floor price where you see demand tail off, and what price are you assuming in your commentary about the strength of the market?

Dan Rabun - ENSCO International - CEO

Yeah, the commodity prices clearly have backed off here recently. We're basing our outlook based upon what we currently have booked for 2008.

Jeff Saile - ENSCO International - SVP Business Development

And Jeff Saile here. I don't think the Operators are really focused on the spot market so much as they are are some anticipated supply demand forecasts that they have in place and that's the basis for their activity level. Okay. Which certainly helps with the majors kind of coming back to the jackup market a little bit more I would imagine.

Collin Gerry - Raymond James - Analyst

Yeah. You know, the three factors we list which is the demand- supply equation and then people drilling on these areas they've recently acquired and then commodity pricing, I think that those are the orders of priority. I think the biggest driver for demand right now is supply equation in the Gulf of Mexico.

Jeff Saile - ENSCO International - SVP Business Development

Okay, and then I guess to follow-up, offsetting that, Mexico certainly seems like an incremental bullish kind of data point here. The incremental tenders are certainly positive news and I guess the rates that you all are bidding are a little bit higher than what I would have guessed. One of your competitors recently spoke about on top of that, PEMEX seeking to replace its current MAC fleet with independent leg cantilevers. Is that something you've heard as well?

Dan Rabun - ENSCO International - CEO

We've seen a trend as those rigs are rolling off contracts that they are not renewing those contracts, but PEMEX has not stated that that is their position but it seems to be what's happening.

Collin Gerry - Raymond James - Analyst

Okay. Well that wraps it up for me. I'll turn it back over. Thanks, guys.

Operator

Next we'll go to Arun Jayaram with Credit Suisse.

Arun Jayaram - Credit Suisse - Analyst

Good morning, gentlemen. I was thinking or trying to get a good gauge of where you think the daily operating costs are for the deepwater fleet today on the 7500, what your expectations are for the 8500 class rigs. Are those come in to fold?

Dan Rabun - ENSCO International - CEO

Are you talking about the operating cost?

Arun Jayaram - Credit Suisse - Analyst

Yes, sir. Yes, sir.

Dan Rabun - ENSCO International - CEO

Yeah, just bear in mind one thing on the 7500 and all of our 8500 series contracts, we have full cost reimbursement from the day we signed the contract, so costs are definitely going up but they're dollar for dollar recoverable.

Arun Jayaram - Credit Suisse - Analyst

Just wondered if you could help me with the daily costs are.

Jay Swent - ENSCO International - CFO

Probably about 75, maybe a little above that, Arun, 75,000 a day.

Arun Jayaram - Credit Suisse - Analyst

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Okay, that's very helpful. And then on the two rigs in Mexico, ENSCO 87 and 93, would you have to do any contract specific upgrades for those two rigs, if you're awarded the commitments on those two rigs?

Jay Swent - ENSCO International - CFO

The answer is yes. I mean, any time you take rigs into Mexico or most international Markets are contract specific modifications that you need to make to your equipment, so the answer is yes.

Dan Rabun - ENSCO International - CEO

And that's why I made the point in our outlook right now. Right now we haven't outlooked any impact of that move since it's not a done deal at this point. Obviously, to the extent we have to go in the shipyard, there would be some revenue impact in the fourth quarter of this year but we don't think it would be dramatic.

Arun Jayaram - Credit Suisse - Analyst

And follow-up on that, what would be the timing of these two awards, understanding that you haven't been awarded those but if you were awarded, when would these contracts start?

Dan Rabun - ENSCO International - CEO

Do you remember?

Jay Swent - ENSCO International - CFO

Yeah, one of them will start in mid November for the first one which is the 116 and the 250 would begin in the first part of February.

Arun Jayaram - Credit Suisse - Analyst

Okay. That's all I got, guys. Thanks.

Jay Swent - ENSCO International - CFO

Arun?

Arun Jayaram - Credit Suisse - Analyst

Yes.

Jay Swent - ENSCO International - CFO

Back on your OpEx question, just remember that the classification of the 7500 and the 8500 are dynamically positioned non-self-propelled, so those are the only rigs that are classified in that manner so we do not have to have marine crews on Board the rig. So on a comparative basis, we're going to have lower OpEx than most competitors.

Arun Jayaram - Credit Suisse - Analyst

Right, because you don't have the marine coast, it makes sense. Thanks.

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Jay Swent - ENSCO International - CFO

You're welcome.

Operator

Next we'll go to Pierre Conner from Capital One South Coast.

Pierre Conner - Capital One Southcoast - Analyst

Good morning, gentlemen.

Dan Rabun - ENSCO International - CEO

Hi, Pierre.

Pierre Conner - Capital One Southcoast - Analyst

Congratulations on Mexico, assuming that it progresses. My question to you on those contracts, the last one I think that was awarded to a competitor had an index in it. Are these fixed rates or will they be indexed?

Dan Rabun - ENSCO International - CEO

They're indexed to global rates.

Pierre Conner - Capital One Southcoast - Analyst

Okay, so global as opposed to just Gulf of Mexico?

Dan Rabun - ENSCO International - CEO

Absolutely.

Pierre Conner - Capital One Southcoast - Analyst

And the other potential one you mentioned that's Saudi Arabia, that seems to be that they were out and maybe it was delayed. Could you give us an update on what you think the timing of those potential tenders might be?

Dan Rabun - ENSCO International - CEO

Saudi Arabia tenders?

Pierre Conner - Capital One Southcoast - Analyst

Yeah.

Dan Rabun - ENSCO International - CEO

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They're outstanding currently.

Pierre Conner - Capital One Southcoast - Analyst

And in terms of when they could be awarded?

Dan Rabun - ENSCO International - CEO

Bids are due in mid August.

Jay Swent - ENSCO International - CFO

That's right.

Dan Rabun - ENSCO International - CEO

Yeah, I think mid August, so some time shortly thereafter.

Pierre Conner - Capital One Southcoast - Analyst

Dan, you're pretty comfortable with those. You mentioned coming out of the Gulf of Mexico, obviously for you all but that that would be where this, where they would pull from?

Dan Rabun - ENSCO International - CEO

For Saudi?

Pierre Conner - Capital One Southcoast - Analyst

Yeah.

Dan Rabun - ENSCO International - CEO

No, I think you'll get a lot of rigs over in that market competing for those jobs as well.

Pierre Conner - Capital One Southcoast - Analyst

Okay. When you sum up these incrementals as well, you know, you mentioned that obviously you're fully contracted for 08 and you see the Markets balance, how far do you see out now, the balance with the new supply coming on and what you know about for incremental demand in the jackup market worldwide?

Jay Swent - ENSCO International - CFO

Well, I think the last time we looked at this, Pierre, it's been a little while but we could see based on the ODS petro data information that everything through 09 was pretty well accounted for in demand. As you know, as you get out past that time frame, the demand forecasts are a little less precise, but certainly all of 08 and 09 looks like every rig that comes out will have a job.

Pierre Conner - Capital One Southcoast - Analyst

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Okay. So I think the big issue has been and of course the international jackup Markets and we've seen some good numbers and you mentioned even the North Sea. I just wanted to see if your sense of talking to customers has been just in the last 90 days or the last two quarters has there been an increase in demand or these rates, has it kind of always been there and we're just now seeing it visible with new contracting?

Jay Swent - ENSCO International - CFO

I think you are, we've been pretty bullish about the jackup market for a long time and a lot of people haven't been, so our customer engagement, what we're seeing today is what we're seeing six months ago from customer engagement. It's a fairly robust market out there.

Pierre Conner - Capital One Southcoast - Analyst

Okay. That's it on the jackup side and that's the perspective but quickly on the other, on your 8504 and 5, I know it's kind of early and just early discussions, contract levels are potentially high, but do you see a trend towards increasing term, you've been typically in the two year type frame, would you look for longer term here or is it the shorter term potentially getting you better rates?

Jay Swent - ENSCO International - CFO

Pierre, that's a hard question to answer.

Pierre Conner - Capital One Southcoast - Analyst

Yes.

Dan Rabun - ENSCO International - CEO

The customer I will say just based on the customers that have inquired today, it's been much longer term work than shorter term work, but clearly, the Marketing activity is in the initial status.

Pierre Conner - Capital One Southcoast - Analyst

Okay. We'll watch it with interest. All right, thanks, gentlemen.

Jeff Saile - ENSCO International - SVP Business Development

Pierre, this is Jeff. From what we've seen here lately, I think that the likelihood for the term on the 8504 and 5 will be of a longer duration than a two year period. Even there seems to be some interest developing here not even four years but even longer than the four year term, so --

Jay Swent - ENSCO International - CFO

I think one of the dynamics and one of the reasons we placed orders for two rigs, the shipyards are really going to be fully tied up with all of these rigs being built for Brazil, for an extended period of time. I think our customers are starting to realize that there's not going to be a lot of new deepwater equipment that's going to be available for the marketplace, so we see customers at least trend right now is that they're looking for longer terms that have gone through this period.

Pierre Conner - Capital One Southcoast - Analyst

So we have seen them move towards longer. That's what I was trying to say Friday. Thanks, gentlemen.

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Operator

Moving on we'll go to Tom Curran from Wachovia.

Tom Curran - Wachovia - Analyst

Good morning, guys.

Dan Rabun - ENSCO International - CEO

Hi, Tom.

Tom Curran - Wachovia - Analyst

Jeff, with regards to those first two PEMEX bids you have pending, when you say they're indexed to global rates, when would the indexing kick in and then how long are the terms for each? Sorry if I missed that.

Jeff Saile - ENSCO International - SVP Business Development

I don't think that was mentioned. It resets every six months and it would initially, you know, it would Quinn, we actually, it's not indexed against a bid but it resets every six months.

Tom Curran - Wachovia - Analyst

Okay, so the first six months would be fixed at the day rates you shared and then from that point forward for however long each of the respective terms are, it would reset to this index every six months?

Jeff Saile - ENSCO International - SVP Business Development

That's correct.

Dan Rabun - ENSCO International - CEO

It's so the high fixtures during that period for 250 or 350 foot rigs on a global basis, in the various Global Markets.

Tom Curran - Wachovia - Analyst

Okay. Great. Thank you. And then for the six incremental tenders you mentioned, are any of those for or open to mat-supported jackups and then are your Marketing guys aware of any potential forthcoming tenders that would be eligible for mats supporting jackups?

Jeff Saile - ENSCO International - SVP Business Development

Tom at this time, we haven't seen any interest in the additional mats or what mats they have, they seem to be releasing those and replacing them when they can.

Dan Rabun - ENSCO International - CEO

Of course we haven't made that inquiry. What they're looking for is five 250 foot rig and one 300 foot rig.

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Tom Curran - Wachovia - Analyst

Okay.

Dan Rabun - ENSCO International - CEO

All independently.

Jeff Saile - ENSCO International - SVP Business Development

But those are independent legs. And so anyway, I don't think, my own personal opinion, I don't think they're going to be asking for additional mats. I can't guarantee that.

Tom Curran - Wachovia - Analyst

Okay. That's helpful. Thank you for that color. And then as you look out internationally which foreign markets look most promising in terms of emerging growth? We know what the major drivers of growth of incremental demand in Markets have been up cycle to date but looking ahead which market do you think might have the potential to surprise?

Jeff Saile - ENSCO International - SVP Business Development

Are you talking about jackup market ?

Tom Curran - Wachovia - Analyst

Jackups, sorry, guys, yes, still speaking to jackups here.

Dan Rabun - ENSCO International - CEO

Southeast Asia.

Richard LeBlanc - ENSCO International - VP IR

Yeah, Southeast Asia. And no specific country, just all across Southeast Asia.

Tom Curran - Wachovia - Analyst

Okay. All right, thanks, guys, I'll turn it back.

Operator

We'll move on and go to Mike Drickamer with Morgan Keegan. Mr. Drickamer, please go ahead with your question. Hearing no response we'll move on and go to Jeff Spiddle with Natixis.

Jeff Spiddle - Natixis Bleichroeder - Analyst

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Good morning, guys, first question you talked about escalation in mobilization expenses. Can you talk a little bit about the timing of recapturing some of that?

Jay Swent - ENSCO International - CFO

It will get matched up quarter for quarter. Most of the mobilization is in the fourth Quarter as we move ENSCO 56 from New Zealand and Singapore.

Jeff Spiddle - Natixis Bleichroeder - Analyst

And then on the labor cost front, could you characterize I guess your ability to recapture some of the escalation and labor costs on a regional basis? Is it a little bit easier right now to recapture that in terms of day rate in Asia Pacific versus say the Gulf of Mexico?

Jay Swent - ENSCO International - CFO

Yeah, I mean, most of our Gulf of Mexico contracts are short-term in nature and don't have any cost escalation provision in them with the exception of our deepwater contracts there. So in the case of the 7500 or any of the newer rigs that will come into the Gulf, we'll have dollar for dollar cost recovery pretty much on those. As you look out into the international jackup market, we have varying forms across recovery and each contracts unique probably in its own right. Labor is generally the one that we have the best cost recovery provisions against, so it's pretty good and in some cases, it's dollar for dollar, it's most cases it's dollar for dollar and there's sometimes a lag there and I would say that if you looked across the entire universe of our international jackups we're probably going to be recovering 30% of those labor increases in the current period.

Jeff Spiddle - Natixis Bleichroeder - Analyst

Okay, thanks very much.

Jay Swent - ENSCO International - CFO

That's a very rough estimate.

Jeff Spiddle - Natixis Bleichroeder - Analyst

Sure. Thanks.

Operator

(OPERATOR INSTRUCTIONS). Next we'll go to Byron Pope with Tudor, Pickering.

Byron Pope - Tudor Pickering - Analyst

Good morning, guys. Just in terms of the R& M side of the equation in an environment where rigs are pretty full utilized across-the-board, there's areas that tend to surprise to the upside. Could you give us a little more color on kind of what some of those drivers might be in terms of repair and maintenance costs for you, in instances where they come in a little bit higher than what you would expect?

Dan Rabun - ENSCO International - CEO

Well I think it's a couple things. One as you rightfully point out, Byron, these rigs are working flat out, full time and under more pressure than they've been under for a long long time. So to the extent that you work them hard, you're going to have more repair maintenance costs. There's a tendency when business is as brisk as it is to try to delay that as much as you can, ultimately it catches up with you but in terms of what's driving

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the cost, there's an awful lot of third party costs involved. At the end of the day, everything is driven off of oil prices and steel prices in our industry and all of that is translating in through third party costs for work on the rigs. So it's really, I'd say it's not a simple answer. It's a combination of more activity and higher inflation for the people that are providing at the helm.

Byron Pope - Tudor Pickering - Analyst

Okay, thank you.

Operator

Next we'll go to Ian Macpherson with Simmons & Company.

Ian Macpherson - Simmons & Co - Analyst

I wanted to see if I could dig into the two jackups that might be moving in Mexico in Q4 and Q1. Do you, can you give us a ballpark of what the shipyard time looks like in terms of days and dollars? Or like a broad range around it?

Dan Rabun - ENSCO International - CEO

Yeah, I don't know that we have a dollar amount yet to share with you. I'd say in terms of timetable, it's probably something on the order of 60 days for each one of those rigs.

Ian Macpherson - Simmons & Co - Analyst

60 days door to door?

Dan Rabun - ENSCO International - CEO

There's probably a little bit of time for mob on top of that but it's in that range.

Ian Macpherson - Simmons & Co - Analyst

Okay, would the cost be capitalized or would that hit OpEx?

Jay Swent - ENSCO International - CFO

Most of that would be capitalized. Some would be recovered probably through the mob cost.

Ian Macpherson - Simmons & Co - Analyst

Okay. If I can get a follow-up on the deepwater side. Is there, what is the strategy for the 8504 and 05 with respect to timing? Are you disposed to contract those sooner than later or do you prefer to see how day rates develop over the next year and I guess as a follow-up to that, I assume you want to keep building these, building more of these as long as the demand is there and would we need to see backlog materialize on one or both of those before an 8506 comes into the fold?

Dan Rabun - ENSCO International - CEO

The way we've always explained the strategy is every day that we go uncommitted there's more risk that we take and then we want to be paid for it so we look at all of the opportunities as they come in the door and we've already received some inquiries, and as you might expect, the

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Operators would like a better price if they sign up today because they know they're taking a risk so it's a balance, and the longer we go uncontracted, the higher those rate expectations we have, so there's a balance there. On 8506, we continue to evaluate the opportunities. We still think we have a real cost advantage over our competitors and it's a competitive advantage, and we plan to be very aggressive and have been in terms of expanding our fleet.

Ian Macpherson - Simmons & Co - Analyst

If you ordered today, would that be a second half of 2012 delivery?

Dan Rabun - ENSCO International - CEO

Yeah, what we're trying to do is stage these things out six to nine months apart so approximately that time period after 8505.

Ian Macpherson - Simmons & Co - Analyst

Okay. Could you, if you were so disposed, could you pay the shipyard more and get an earlier delivery slot or not?

Dan Rabun - ENSCO International - CEO

No.

Ian Macpherson - Simmons & Co - Analyst

No? Okay. All right, that's all I have, thank you.

Dan Rabun - ENSCO International - CEO

Just depends on how much more.

Operator

Then we'll go back to Mike Drickamer from Morgan Keegan.

Mike Drickamer - Morgan Keegan - Analyst

Sorry, guys, can you hear me this time?

Dan Rabun - ENSCO International - CEO

Yes, we can.

Mike Drickamer - Morgan Keegan - Analyst

All right, you talked earlier about inquiries about returned contracts for jackups in Gulf of Mexico. But on your side strategically what are your thoughts on accepting guide term contracts at this time?

Dan Rabun - ENSCO International - CEO

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You talking about on the jackups?

Mike Drickamer - Morgan Keegan - Analyst

Right. No, sorry, the jackups. Are you will willing to accept term at this point in the cycle for jackups in the Gulf of Mexico?

Dan Rabun - ENSCO International - CEO

Well that would be a new twist to have term, but we would , we certainly would, maybe not for the entire fleet. We want to maintain some leverage but with the rates where they are and where the levels they're approaching, we would certainly accept term in the Gulf of Mexico and I mean by term, I think term in the Gulf of Mexico may be referencing approximately one year as opposed to three or four, so we would expect some term in that neighborhood.

Mike Drickamer - Morgan Keegan - Analyst

Right.

Dan Rabun - ENSCO International - CEO

At these prices.

Mike Drickamer - Morgan Keegan - Analyst

Okay, that was my question. Thanks, guys.

Operator

Next we'll go to Dan Boyd with Goldman Sachs.

Dan Boyd - Goldman Sachs - Analyst

Hi, just a quick clarification on the PEMEX tenders. How many of those do you expect to be incremental as opposed to just bidding against the existing rigs in the region?

Dan Rabun - ENSCO International - CEO

Far as we know they're all incremental.

Dan Boyd - Goldman Sachs - Analyst

And then more of a strategy question. Even with your new builds your generating quite a bit of free cash flow in the next couple years. Lead times are getting pretty far out there for new builds and you seem to be getting more comfortable with the longer term outlook for deepwater so with that in mind, are you interested at all in adding leverage to the balance sheet to acquire deepwater assets to speed up this expansion or would you say that an 8506 is more likely?

Dan Rabun - ENSCO International - CEO

I think we're certainly open to both. I mean unfortunately, there's a unlimited number of opportunities on both fronts, as we said earlier, you can throw all of the money in the world you want it and you can't speed up shipyard deliveries, at this point, so there's a finite amount of capacity that

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can be added there, and quite frankly can be managed there. I think we've always said we're open to M & A opportunities if they present themselves. At the moment we don't see a lot that on the horizon that makes sense but we continue to look at situations and we will continue to look at situations going forward.

Dan Boyd - Goldman Sachs - Analyst

So if nothing arises should we expect to see maybe increased share buybacks then?

Dan Rabun - ENSCO International - CEO

Yeah, I think what we've always said is that to the extent we have cash, that can't be productively put to work in the near term, that we would return that to shareholders and that we would always be willing to lever up to do a deal that made sense. So we don't view ourselves as needing to stockpile a strategic pile of cash for an M & A activity that we can't describe to you. We feel like to the extent there is cash available that can't be put to work immediately, we should return as much of that as we can efficiently to shareholders, but as I said, we are more than willing to tap the balance sheet for the right transaction.

Dan Boyd - Goldman Sachs - Analyst

All right, thanks.

Dan Rabun - ENSCO International - CEO

Just one additional follow-up, because there's been a couple of questions about shipyard deliveries. One thing everyone needs to remember even if you can find a shipyard that can deliver or you couldn't find the equipment to get there, so the whole Supply Chain, shipyards, suppliers, everything is fairly constrained at the moment.

Operator

[OPERATOR INSTRUCTIONS]. We'll take our next question from Sonny Randhawa from Banc of America Securities.

Sonny Randhawa - Banc of America - Analyst

Good morning, guys. Quick question on you're seeing PEMEX or indications are that they're going to be high grading their jackup fleet. In other markets, you really don't have the mat supported rigs out there but there are older jackups within those markets or less capable jackups. Are you seeing move in any other markets for the same sort of high grading of the fleet?

Dan Rabun - ENSCO International - CEO

I think you see around the world some of the customers prefer some of the newer equipment, and so I think as these new builds come into the marketplace, they get some opportunities presented to them that may displace some older equipment.

Sonny Randhawa - Banc of America - Analyst

So there's not I guess a strategic shift by any other market into just newer rigs?

Jay Swent - ENSCO International - CFO

Not that we're seeing. I think one of the things that trend we'll see in the future is the balance between the older equipment and the brand new equipment, and that's kind of in the middle of the market where we have upgraded equipment that are already stacked crude and up and running

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that can produce the efficient results that these Operators are looking for. When you get on each end of the spectrum, you know, there's other challenges around the equipment and the people.

Sonny Randhawa - Banc of America - Analyst

Okay, I guess on the upgrading side then, you guys have actually done a pretty good job of sustaining your fleet or upgrading your jackup fleet. Right now, I have a pretty good handle on what the new build costs are, we get or at least we can see how they're escalating every time another new build is announced, on the shorter term lead time items like shipyards R& M, I'm assuming those costs are going to be even higher in terms of just escalation; right? Yes.

Jay Swent - ENSCO International - CFO

Yes, absolutely.

Sonny Randhawa - Banc of America - Analyst

Okay. So I guess from a, could you see looking out a year or two since we've actually been drilling pretty much non-stop for an extended period now and contractors that didn't do the types of sustaining on their jackup fleets, could you actually see an increase in attrition, just due to the return requirements for doing upgrades?

Dan Rabun - ENSCO International - CEO

Well, I think you're going to see a number of things. One is that as people have really older pieces of equipment that they didn't invest in several years ago and that they've worked really hard for a few years, as they're trying to pass inspections and things like that, they're going to find it very expensive to upgrade those rigs, and I think you'll possibly see some rigs leave the fleet as people make decisions about does it make sense to invest that kind of money in the rig. You actually set us up for a pretty good commercial about ENSCO which as you know, we've invested heavily in our fleet, we got all that worked on right before the big up swing here but we've also invested in lots of new jackups overtime through the Childs acquisition and new builds that we did with KFELS, so we feel like we have a great balance between new rigs that are the most capable rigs in the market and very cost effectively upgraded rigs and well maintained rigs that may be older but as Jeff said, can still efficiently do the work that the Operators want done and generate good returns for us. So we feel like the direction that the Market's moving and I think the point everybody has been kind of getting at is that the market is going to move to newer more capable assets and I think that plays very well to the rig fleet that we have.

Sonny Randhawa - Banc of America - Analyst

If you could just for the last follow-up, if you could get to a number on the shipyard escalation cost for short lead time items, what will we put that on an annual run rate at?

Dan Rabun - ENSCO International - CEO

Huge. I don't think I could give you a number but it's large.

Sonny Randhawa - Banc of America - Analyst

Great. Thanks a lot.

Operator

Moving on, we'll go to Jud Bailey from Jefferies & Company.

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Jud Bailey - Jefferies & Co - Analyst

Thank you, good morning.

Dan Rabun - ENSCO International - CEO

Hi, Jud.

Jud Bailey - Jefferies & Co - Analyst

Dan, a follow-up to your comment regarding Venezuela. You already have the 69 down there and it is up for renewal later this year. Are you looking at another opportunity to move another one of your Gulf rigs into that region? Did I understand that correctly?

Dan Rabun - ENSCO International - CEO

That's correct. Okay.

Jud Bailey - Jefferies & Co - Analyst

When we look at the rate on the 69 and a rollover second half of the year, is it reasonable to expect that to be at a similar rate that it's working today?

Dan Rabun - ENSCO International - CEO

Yes.

Jud Bailey - Jefferies & Co - Analyst

Okay. And the incremental requirement, is that for long legged jackup or a 250 foot unit?

Dan Rabun - ENSCO International - CEO

Long legged.

Jud Bailey - Jefferies & Co - Analyst

Okay, so a rate probably in line with the 69 is something that we could potentially see?

Dan Rabun - ENSCO International - CEO

Potentially.

Jud Bailey - Jefferies & Co - Analyst

Okay. That's all I've got.

Dan Rabun - ENSCO International - CEO

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Thank you, Jud.

Operator

It appears there are no more questions at this time. Mr. Le Blanc, I'll turn the call back over to you for additional or closing remarks.

Richard LeBlanc - ENSCO International - VP IR

We would like to thank everyone for joining us today. Look forward to talking to you again on Thursday, October 23rd for our third quarter 2008 earnings conference call. With that, Chad I'll turn it back to you to close it out.

Operator

And ladies and gentlemen, that will conclude today's presentation. Thank you again for joining us and have a great rest of your day.

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