

G U L F   O F   M E X I C O

CAL DIVE INTERNATIONAL

1998 Annual Report



# CORPORATE PROFILE

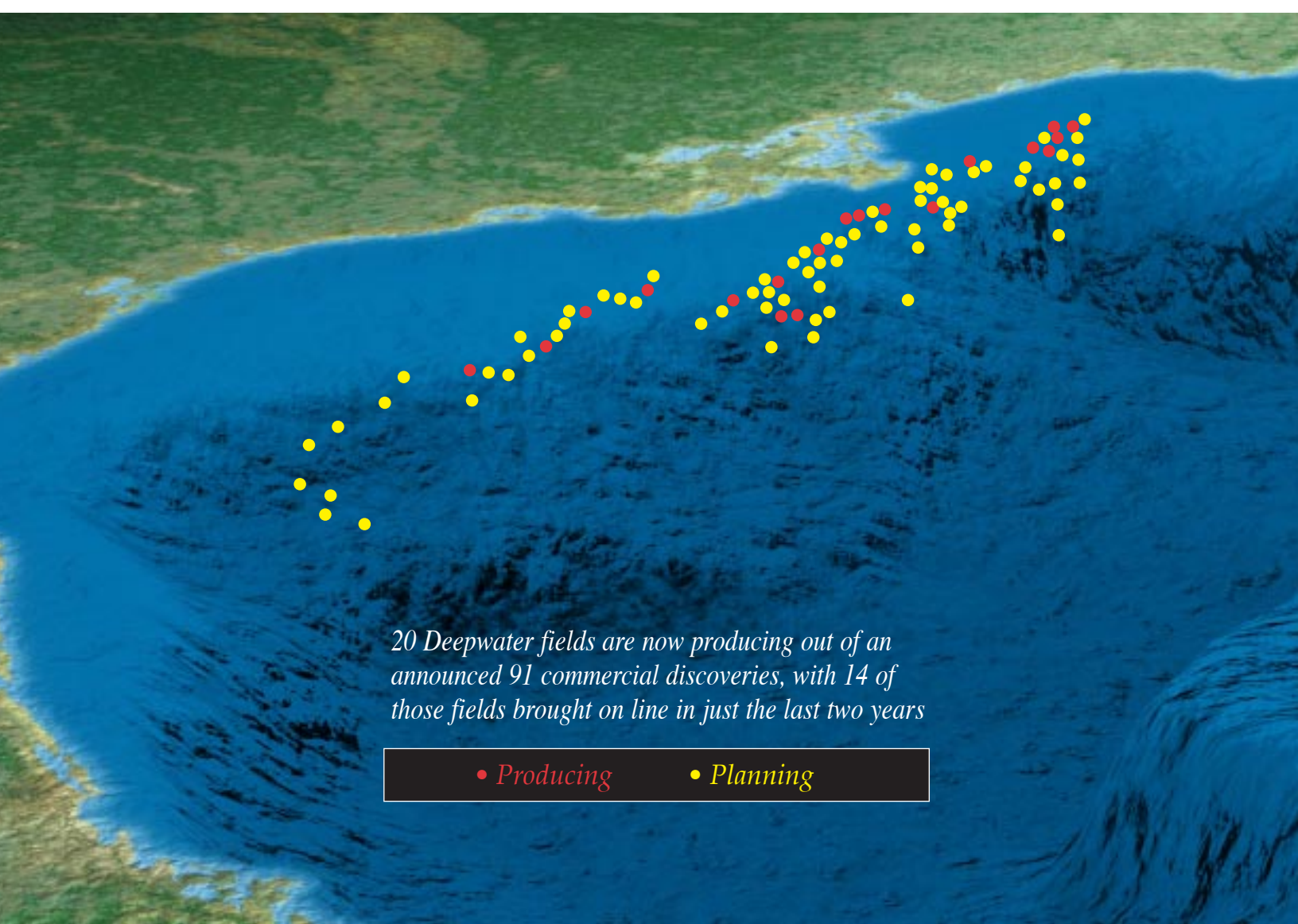
Cal Dive International (CDI), is a leading subsea contractor providing construction, maintenance and decommissioning services from the shallowest to the deepest waters of the Gulf of Mexico. Over three decades, Cal Dive has developed a reputation for innovation which has kept the company on the leading edge of underwater technological developments.

Cal Dive has positioned for the new Deepwater frontier by assembling a technically advanced fleet of dynamically positioned vessels. These vessels serve as work platforms for the services provided by CDI and alliances with a team of internationally recognized contractors and manufacturers. Key among these is the strategic alliance with Coflexip, a world leader serving the Deepwater market.

The entrepreneurial drive of CDI employees has enabled the company to excel in the Gulf spot market on the Outer Continental Shelf, one that is unique among world offshore provinces. The scheduling flexibility afforded by the CDI fleet enables the company to offer turnkey pricing while assuring customers of on-time project performance. Since 1984, when the company custom designed the first Gulf DSV with a moonpool deployed saturation diving system, CDI has been a major provider of saturation diving services to the "mid-water" Gulf (300 to 1,000 fsw). In 1998 the company expanded its capacity in the shallow water diving market from the shore to 300 fsw through an ownership position in Aquatica, Inc.

Cal Dive has also established a leading position in the salvage market by offering customers a number of options to address decommissioning obligations in the most cost efficient manner. An alliance with Horizon Offshore significantly expanded the derrick barge and heavy lift capacity of the assets employed in the company's salvage activities. In addition, Energy Resource Technology, Inc. (ERT), a wholly owned subsidiary, acquires mature offshore properties and assumes the obligation to decommission the field in full compliance with all regulatory requirements, relieving the customer of this obligation entirely.

Headquartered in Houston, Texas, CDI is publicly traded on Nasdaq under the symbol CDIS.



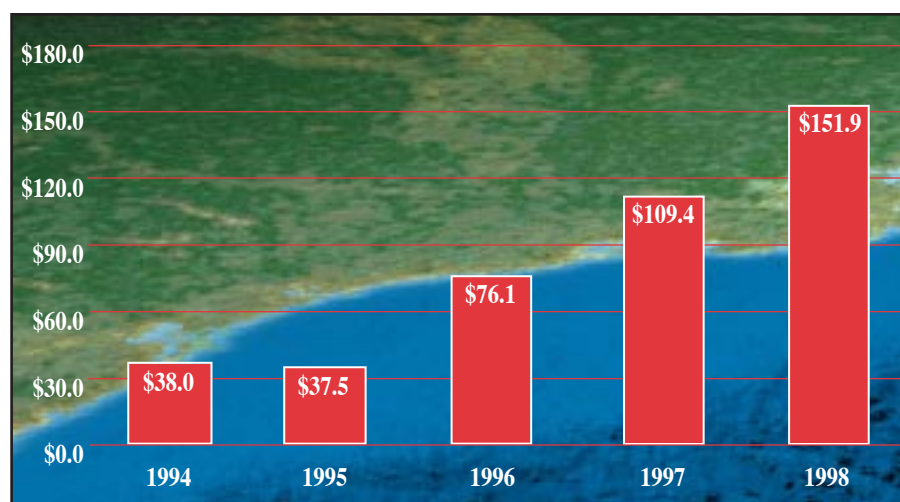
*20 Deepwater fields are now producing out of an announced 91 commercial discoveries, with 14 of those fields brought on line in just the last two years*

• *Producing*

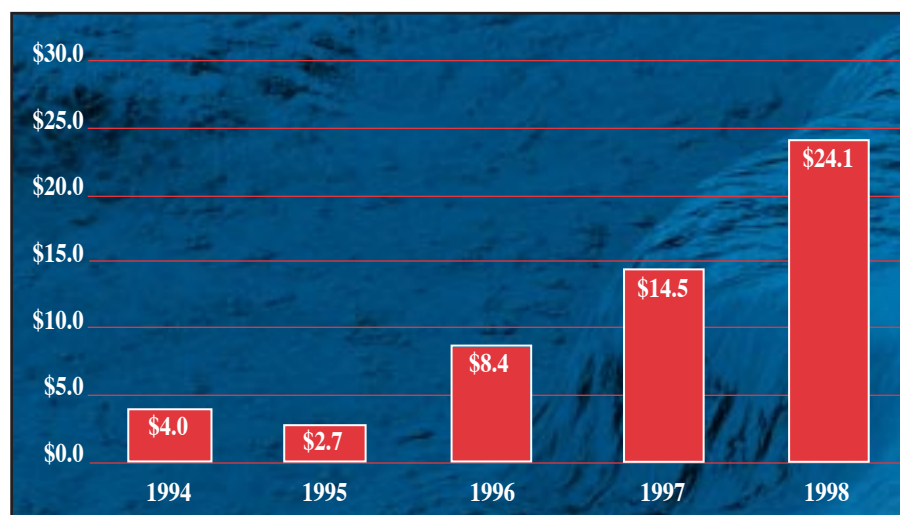
• *Planning*

# FINANCIAL HIGHLIGHTS

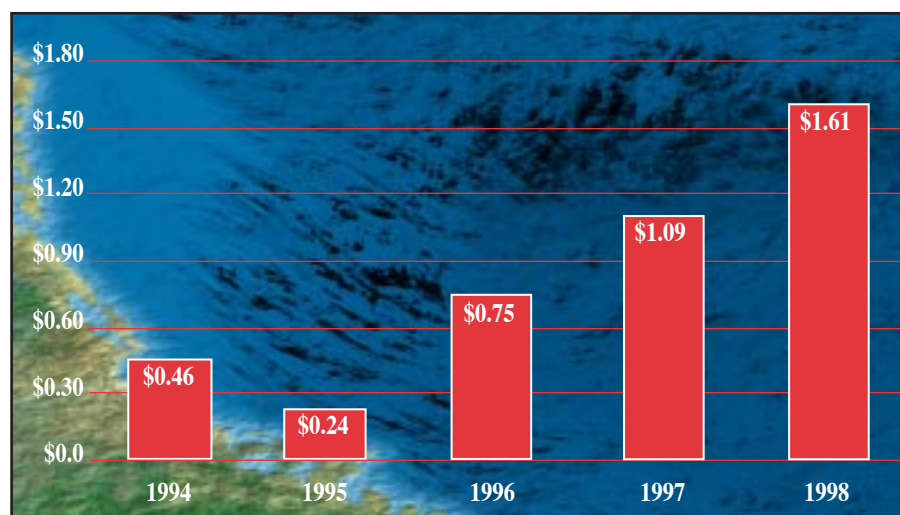
*Revenue In Millions*



*Net Income In Millions*



*Diluted Earnings Per Share*



## G L O S S A R Y

**BCFE (BCF):** Billions of cubic feet of natural gas equivalent.

**Deepwater:** Water depths beyond 1,000 feet.

**Dive Support Vessel (DSV):** Subsea services are typically performed with the use of specially constructed vessels which serve as an operational base for divers, ROVs and customized underwater construction equipment.

**Dynamic Positioning (DP):** Satellite based global positioning systems ensure the proper counteraction to wind, current and wave forces and enable the vessel to stay in position without the use of anchors.

**EBITDA:** Earnings before interest, taxes, depreciation and amortization is a supplemental financial measure of cash flow used in the evaluation of the marine construction industry.

**EPIC Contract:** Single contract to manage engineering, procurement, installation and commissioning of complex projects.

**E&P:** Companies involved in oil and gas exploration and production activities.

**FSW:** Water depth in feet of salt water.

**Gulf of Mexico:** Referred to in this report as Gulf, Deepwater Gulf, GOM, etc.

**Host Structures:** Compliant towers and SPARs which tie together the production of a number of subsea wells.

**Initial Public Offering (IPO):** Cal Dive shares sold to the public in a July, 1997 offering.

**MBOPD:** Millions of barrels of oil production per day.

**MCF:** Thousands of cubic feet of natural gas.

**Minerals Management Service (MMS):** The government regulatory body having responsibility for United States waters in the Gulf of Mexico.

**Outer Continental Shelf (OCS):** Areas in the Gulf of Mexico from the shore to 1,000 feet of water.

**Remotely Operated Vehicle (ROV):** Robotic vehicles used to complement, support and increase the efficiency of diving and subsea operations and for tasks beyond the capability of manned diving operations.

**Saturation Diving (SAT):** SAT diving, required for work in water depths greater than 300 feet, involves divers working from special chambers for extended periods at a pressure equivalent to that at the depth of the work site.



# TO OUR SHAREHOLDERS

Your company delivered a record setting performance in a year which began with optimism yet ended in the midst of one of the most severe recessions ever to impact the oil and gas industry. A year ago we observed that unsettled commodity prices in 1998 would require that CDI adapt to changing circumstances on the fly and operate profitably “outside the box.” Although we had no idea how true this forecast would be, Cal Dive stood head and shoulders above the competition in such a demanding environment. This proved especially true in the second half of the year as earnings increased 61% relative to the same period of 1997 while most of our peer group reported a decline in year-over-year profitability. Highlights of 1998 included:

**Growth:** Revenues of almost \$152 million reflect a compound annual growth rate of 60% in the three years since implementation of the CDI Deepwater strategy.

**Fleet Utilization:** Hurricane *Georges* and a number of tropical storms lowered overall vessel usage to just under 70% in contrast to 77% last year. Still, weather-related reductions of utilization totaling 250 vessel days were more than offset by the 400 days generated by the two new vessels and the charter of Coflexip vessels.



**Gross Profit:** Increased 46% to just under \$50 million on only a 7% improvement in vessel days due to outstanding offshore performance, customer recognition of the unique features of our DP fleet and shortages of experienced divers which increased rates on the OCS.

**Net Income:** \$24.1 million represents a bottom line margin of 16% of revenues in contrast to 13% last year with the improvement a result of our investment in Aquatica and to Cal Dive remaining debt-free all year.

**Quarterly Results:** CDI set all-time earnings records in each quarter of 1998.

**Cash Flow:** EBITDA of \$45.5 million enabled the company to add \$20 million to cash balances after funding all 1998 capital projects.

This ability to deliver consistent earnings in both good and bad cyclical periods was one of the key factors underlying *Forbes* magazine's selection of Cal Dive as one of the best companies in America. The accompanying “Box Score” and the discussion that follows reflect our assessment of the degree to which CDI achieved 1998 corporate goals.

The Deepwater Gulf technical challenges described in last year's report caused the industry to retrench with most 1998 development activity concentrated in water depths from 1,000-2,000 fsw. Nine fields were brought into the completion and production stage during the year, in contrast to five in 1997. As a result, the MMS estimates that Deepwater oil production will more than double from 900 MBOPD in 1994 to 1,900 in 2001. CDI played a major role in commissioning the *Baldpate* compliant tower, the tallest freestanding structure in the world, and supported

the construction of the SPAR at *Genesis*. Other CDI Deepwater achievements involved geotechnical sampling at the Na Kika prospect at 6,700 fsw, the deepest coring project ever by a non-drilling rig, the use of a monohull DP vessel for well intervention and the deepest ever catenary riser installation and tie-in.

Performance on the Outer Continental Shelf was exceptional as CDI assets combined with those of Aquatica to generate a 56% increase in revenues in this market. The *Cal Diver I* saturation vessel celebrated its 15th year in the GOM by turning in her best performance ever, as did our General Diving profit center (where Cal Dive provides diver-tender teams to work off of platforms and third party vessels). Aquatica, Inc., the new shallow water diving company formed by Sonny Freeman, generated superior returns on more than \$20 million of revenues as our two companies gained significant market share. CDI shareholders received a return of \$2.6 million on this \$5.0 million Aquatica investment in just 11 months. These record performances on the OCS reflect our ability to attract and retain experienced diving and offshore construction personnel even as the severe decline in commodity prices causes good people to flee the industry.

1998 was not without disappointments. While it was a slow year for the salvage market (the number of two-pile or greater platform removals declined by almost 50%), our dominant market position resulted in strong demand for CDI salvage assets. However, performance suffered as weather combined with high third party vessel costs to reduce margins below our expectations. ERT also struggled a bit (although many would not classify 28% gross profit margins a struggle) as a number of key wells went offline in the second half and natural gas prices declined by 18%. Throughout most of 1998 acquisitions of mature oil and gas properties failed to materialize as small, inexperienced E&P companies were offering to buy offshore properties at prices which did not appear to include the abandonment obligation. However, the decline of commodity prices resulted in credit constraints being placed upon those companies as 1998 ended, creating an open field of opportunities for ERT property acquisitions.

The outstanding results achieved in 1998 and uptempo review of CDI accomplishments detailed in this report are tempered by the across the board decline in valuation of all oilfield service stocks, including CDIS. Your management team is acutely aware of this loss of value as we own 20% of the company. Through the euphoria of 1997 and depression of the past year we have been patiently implementing a strategy designed to make Cal Dive a preeminent Deepwater player in the new millennium.

The prolonged period of depressed oil and gas prices is now driving customer spending reductions of 20 to 50%, massive layoffs and delays of Deepwater and OCS construction projects. While negativism is prevalent throughout the industry, CDI management has targeted an aggressive list of goals for 1999:

**Shareholder Return:** Deliver a return on invested capital which exceeds 12%, the industry average over the past 5 years.

**Mature Properties:** Double ERT oil and gas revenues through property acquisitions and exploitation of existing natural gas reserves.

**Salvage Operations:** Utilize the alliance with Horizon Offshore to expand our market position so that combined salvage revenues (barge operations and ERT) reach 30% of consolidated revenues, thereby achieving a long-term corporate goal.

**Continental Shelf:** Support Aquatica growth in shallow water and expand the CDI general contractor role in full field development and laying reeled pipe.

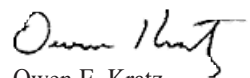
**Deepwater:** Develop DeepStar directed technologies and utilize the DP fleet to deliver innovative solutions to Deepwater challenges.

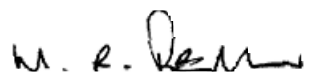
**Q4000:** Complete design, model testing, shipyard selection and commence construction of this revolutionary, semi-submersible vessel.

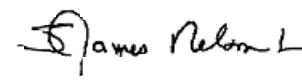
| 1998 BOX SCORE   |       |  |  |
|--|-------|--|--|
| Goals  | Grade | Comments   |  |
| <b>Growth:</b> Continue to rapidly increase revenues and net income.   | A+    | 1998 revenues and net income increased 39% and 67%, respectively.  |  |
| <b>Deepwater:</b> Utilize DP fleet to expand market penetration and develop cost efficient solutions to technical challenges.                      | B+    | 15 Deepwater projects included bringing new fields into production and well intervention tasks.  |  |
| <b>Quantum:</b> Develop Coflexip joint venture into a leading EPIC contractor in the Gulf by securing a significant, industry recognized contract. | D     | Failed to close the targeted industry-recognized contract. The decline in oil prices resulted in few EPIC contracts in the market.   |  |
| <b>Continental Shelf:</b> Expand and strengthen market position while improving client satisfaction.   | A     | Traditional CDI marine support vessels combined with Aquatica to capture a significant increase in OCS market share.   |  |
| <b>CDI Assets:</b> Purchase mature properties and add vessels which provide a market niche advantage.  | C-    | ERT went almost a full year prior to closing the second Sonat transaction in early January, 1999. Of the two new vessels, the <i>Merlin</i> had a satisfactory inaugural year while the <i>Sea Sorceress</i> involvement at Terra Nova was a disappointment. |  |
| <b>New Build Vessel:</b> Secure long-term contract and equity participation in a new build deepwater completion vessel, the <i>Q4000</i> .         | I     | An "incomplete" reflects the additional time devoted to engineering and vessel design, a process greatly enhanced by our equity partner.   |  |

Few appreciate the damage presently being done to the infrastructure of the Domestic energy industry. While many in the "oil patch" are looking to Washington for regulatory relief, there are far more voters thrilled at the prospect of filling up at 73 cents a gallon than there are those worried about the current dismantling of U.S. energy capacity. Your management team successfully guided CDI through the cyclical downturns of 1985-86 and 1992; history has proven that Cal Dive personnel showcase their talent in such periods. \$40 million of cash in the bank and no debt suggest that Cal Dive will weather the storms of volatile commodity prices better than most. While it is difficult to forecast the full impact of such a severe cyclical downturn, we hope to use the coming year to position your company for the V-shaped recovery that such circumstances have produced in the past.

Respectfully submitted,

  
Owen E. Kratz  
Chairman  
Chief Executive Officer

  
Martin R. Ferron  
President  
Chief Operating Officer

  
S. James Nelson, Jr.  
Executive Vice President  
Chief Financial Officer





## DEEPWATER TECHNOLOGIES

During the 1970s, the excitement of technological breakthroughs was focused upon the North Sea, a region characterized by rough seas yet water depths which seldom exceeded 1,000 fsw. Subsea technology moved to offshore Brazil in the 1980s as exploration approached the then unheard of depth of 2,000 fsw. The new Deepwater frontier in the Gulf of Mexico has returned the technology center to the United States, where the offshore industry began 50 years ago. Over the past five years two-thirds of the wells in water depths beyond 1,640 fsw were drilled in the Gulf. The underwater industry is now poised to attempt completion and construction operations in water depths from 4,000 to 10,000 fsw as the Gulf remains the most active Deepwater play in the world.

Last year our report described a number of technical issues that the industry faced. Early in 1998 a number of wells were lost to shallow sand flow, a geological phenomenon apparently unique to the Deepwater Gulf. CDI, with alliance partner Fugro-McClelland, performed geotechnical sampling throughout the year to determine the possible presence of these underground aquifers at several prospects including Na Kika (6,700 fsw), Brutus (3,000 fsw), and Llano (2,600 fsw). Currently we are involved with DeepStar, the consortium of 22 oil companies having significant lease positions in the Deepwater Gulf, in the design of a hammer which can drive a 36-inch caisson 2,000 feet into the ocean floor to provide a drilling conduit through these aquifers.



*Falling oil prices in 1998 provided the industry a period of retrenchment that is enabling technology to catch up with the breathtaking pace of Deepwater exploration and development activity.*





A second major issue is that of hydrates, the waxy substance which impedes pipeline flow as the high paraffin content of the oil interacts with the extreme cold of the Deepwater. This situation presently limits offsets and step out wells as flow-line insulation costs escalate to non-economic levels. CDI and alliance partner Ambar are developing an extended reach method of cleaning hydrates from the pipeline. A more cost-effective approach, now in the final stages of design, is a unique, retrievable pig. In each case CDI works in tandem with DeepStar with a goal of developing new Deepwater products which can be deployed from our fleet of DP vessels.

Of the fifteen 1998 Deepwater projects completed by CDI the accompanying chart highlights those which involve first ever or unique subsea applications. Installation of the catenary risers and commissioning of *Baldpate* required five CDI vessels over the course of several months. The *Uncle John* worked four months in support of the construction of the *Genesis* SPAR without a single hour of mechanical or weather downtime (even during Hurricane *Georges*). That vessel also conducted the abandonment of a subsea gas well which had 3,500-psi shut-in tubing pressure, a project that historically has required the use of a conventional drilling rig. The *Witch Queen* served as the work platform for the world's deepest removal and replacement of an electronic control module from a subsea tree. Well intervention projects included a complex wireline project for Sonat at East Cameron Block 378 and abandonment of the *Seattle Slew* subsea well where we also removed 12 miles of associated pipelines.

Recently the MMS released a projection of daily Deepwater oil and gas production rates from 1999 through 2003. While low oil prices have resulted in the delay or cancellation of five projects scheduled for 1999, at least ten fields are expected to come on line this year. The report also notes that average daily gas production is expected to increase from 13 BCF in 1995 to 17 BCF in 2001. Given that Deepwater gas reservoirs are less expensive to develop and that it is currently economical to

subsea - complete isolated gas wells with tiebacks, the MMS gas projection may prove conservative. Although the Deepwater Gulf is viewed principally as an oil province, this additional natural gas supply may prove essential if shortages of the product develop in the United States.

The *Q4000*, a totally new concept that will revolutionize the economics of



Deepwater completion and construction support, is the CDI "Bridge to the Twenty-First Century." Much of the year was spent refining the design of this new build, sixth-generation vessel to incorporate current state-of-the-art features and those just over the horizon. The name of the vessel was changed from the *MSV 3500* to the *Quantum 4000* to highlight an essential capability: 4,000 metric tons of deck load. Our technology sharing alliance with R&B Falcon allowed us to incorporate the experiences of operating the *Uncle John* and the *Iolair*, two third-generation semi-submersible vessels into the *Q4000* specifications. We are presently evaluating final cost estimates from a select group of shipyards and expect construction to commence by midyear. Adhering to that schedule would put the new vessel into the market in July 2001, timing which coincides with our forecast of the explosion in demand for Deepwater construction services.

| FIELD      | CUSTOMER          | DESCRIPTION  | DEPTH (fsw) |
|------------|-------------------|--|-------------|
| Ursa       | Shell             | Record depth for installation of risers                              | 3,916       |
| Genesis    | Chevron           | Logistical support for construction of SPAR                          | 2,599       |
| GB 287     | EEX               | Removal and replacement of control pod utilizing monohull DP vessel  | 2,200       |
| Neptune    | Oryx              | Installation of reeled pipeline, flexible risers and umbilical       | 1,930       |
| EW 1006    | Walter Oil & Gas  | Jumper spools installed from pipeline sleds                          | 1,884       |
| Baldpate   | Amerada Hess      | Deepest catenary riser installation and tie-in                       | 1,641       |
| Penn State | Amerada Hess      | Installed two control umbilicals with first of its kind flying leads | 1,548       |
| Amberjack  | British Petroleum | Repaired leaking flange from DP vessel                               | 1,033       |

## SUBSEA SERVICES

Words really cannot capture the 180-degree change in psychology impacting construction projects on the Outer Continental Shelf between 1998 and 1999. A year ago, customers were so concerned with equipment availability that the timing of a number of construction projects was accelerated into the first quarter. It would be an understatement to say that equipment availability is no longer a concern in today's markets.

CDI fared well in 1998 even as the market cratered. Demand and rates held fairly firm throughout most of the year, especially in the shallow water regions from the beach to 300 fsw. CDI dominates the next sector, the saturation diving market on the OCS from 300 to 1,000 fsw. Since divers receive premium pay for SAT diving, personnel shortages did not curtail operations. In fact, a record 46 offshore personnel cracked \$100,000 in wages and company paid benefits in 1998.

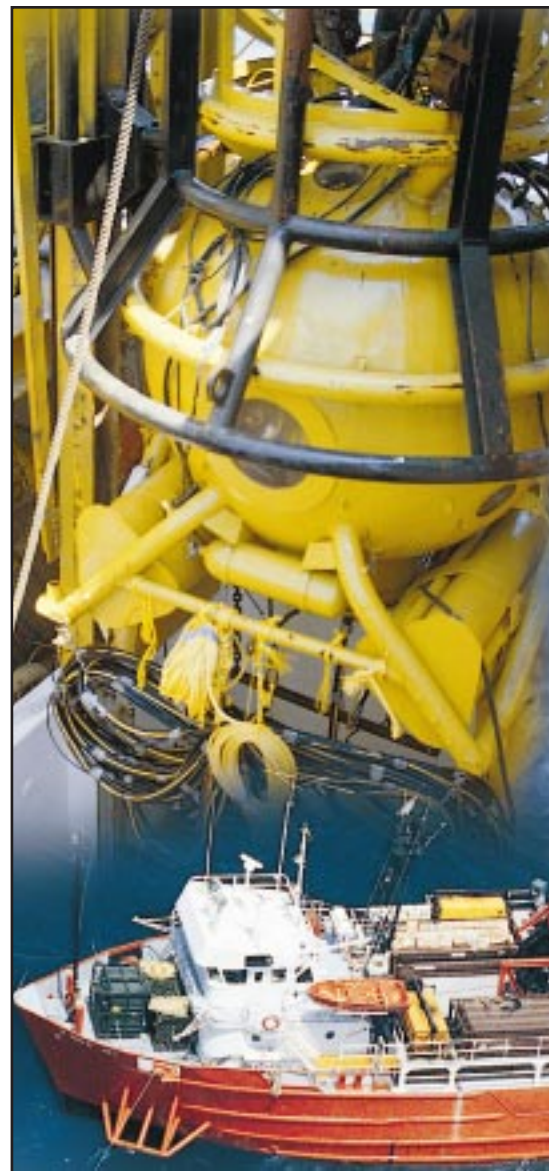


We shared the vision of Sonny Freeman, formerly the Chief Operating Officer of American Oilfield Divers, that a void was opening in the shallow water market. The reputation of Sonny and his Aquatica management team attracted experienced divers and customers with whom they had developed relationships over many years. Acceptance of the new company was beyond our most optimistic expectations as Aquatica exceeded its 1998 Business Plan with just two of the four DSVs planned. This investment allows CDI to participate in a market segment experiencing strong demand while keeping our people focused upon the company's Deepwater strategy.

1998 was an outstanding year for CDI vessels that operate on the OCS. Utilization of the two saturation vessels, the *Cal Diver I and II*, improved to 80% from 73% in the prior year due principally to work in support of alliance partner Horizon Offshore. Shortages of diving personnel were particularly evident in the rates paid for our two utility boats as the *Cal Diver III and IV* generated revenues of \$11,200 per day, an 18% improvement over 1997.

The versatility of our fleet was also demonstrated as CDI DP vessels conducted a number of technically challenging construction projects on the OCS. The *Witch Queen* performed extremely well on a complicated turnkey project which involved setting risers, installing hot taps and tying in six High Island pipelines. At *Orsis*, Cal Dive subcontracted Horizon to lay 20,000 feet of eight-inch pipe and a control umbilical, while the *Balmoral Sea* and *Merlin* handled the tie-in and pipeline crossings. Customers responded enthusiastically to a new product offering: laying coiled line pipe and umbilicals as a very cost effective means of hooking up OCS reservoirs which decline rapidly.

Overshadowed by the Deepwater Gulf excitement is the "Subsalt" play which extends from mid-water OCS to depths that overlap Deepwater discoveries. The large size of the fields, relatively shallow water depth and reservoirs in close proximity to existing infrastructure all make the Subsalt trend attractive. At present only three of 46 announced Subsalt discoveries are on production. During 1998 CDI assisted in construction activities related to three Subsalt discoveries: *Gemini*, *Agate* and *Penn State*. Advances in technology, particularly 3D and 4D seismic that can "see through" the salt layers, are expected to reignite exploration on the OCS at some point in the next few years.



*During 1998, CDI expanded its dominant market position on the OCS, an operating base that provides fleet utilization and profitability as the Deepwater frontier develops.*





We are building a new 120-foot utility DSV to replace the original *Cal Diver IV* as part of an ongoing process to upgrade the quality of the CDI fleet. The *Cal Diver IV* is an excellent case study of the economics of our business. This utility boat, converted to facilitate diving operations, was purchased at a cost of \$300,000 in November 1990. Exactly eight years later the vessel was retired after generating a cash return (EBITDA) of \$4.4 million. We are happy to report that she remains a part of the Cal Dive family as the *Mr. Joe* of the Aquatica fleet.

1999 will see CDI launch a new product line, full field development, to assist cash constrained customers on the OCS. CDI originally designed this concept to respond to the impact of Deepwater lease expirations. Stated simply, the goal is to

bring new fields online in periods as short as seventeen weeks. Working with industry standard designs, Cal Dive has stocked subsea trees, prefabricated modules, well panels and controls and umbilical tubes ready for immediate assembly. Decks, caissons and platforms are accessible in the "inventory" of ERT-owned facilities. 1999 should also see the impact of cost efficiencies resulting from a supply chain study performed by Arthur Andersen LLP. The recommendations from that study drove a complete reorganization of our newly expanded operations base in Morgan City, LA.







## SALVAGE SERVICES



*The combined gross profit of CDI salvage assets and ERT declined by almost 50% due to weather induced scheduling delays and falling natural gas prices.*

A decade ago Cal Dive began to implement the strategy that has made it a dominant player in the salvage market, a regulatory driven business that serves as a hedge against downturns in commodity prices. The MMS estimates that it will cost over \$5 billion to remove the 4,200 platforms and over 20,000 wells that have been installed in the Gulf of Mexico over the last 50 years. Government regulations require that the well be plugged and abandoned, pipelines serving the field be capped and buried, the platform removed and the site cleared of all debris within 12 months after lease expiration.

*Offshore* magazine recently affirmed Cal Dive as the number one player in the decommissioning market as CDI was responsible for 24% of the structures removed from the Gulf during the years

1996 through 1998. As the market leader we were busy throughout 1998 even though the number of two-pile or greater platform removals declined by almost 50%. Profitability suffered as Hurricane *Georges* and several named tropical storms idled *Cal Dive Barge-I* and our well servicing assets while we were still incurring high third party costs for tugs and material barges. Our well recognized position in the salvage industry also brought one of the more emotionally challenging projects as the *Sea Sorceress* was engaged to recover the wreckage of Swiss Air Flight 111.

There is a significant backlog of structures where the decommissioning "clock is ticking," evidenced in part by the fact that permits have already been filed for 152 platform removals in 1999. For this





contrast to \$2.57 in the prior year. In addition, production declined 14% as a number of key wells went offline in the second half and efforts to reestablish production were expensive. We elected to sell two offshore blocks in 1998 as we did in the prior year. While this runs counter to the goal of growing our reserve base, in each case we were able to lock in acquisition economics in situations where ERT was not operator of the field. Our ending balance of proven developed reserves remained constant at 30 bcf even though the significant decline in natural gas prices caused a 2 bcf downward reserve revision.

ERT's success is a function of three variables: lower salvage costs using CDI assets, operating the field more cost effectively and extending reservoir life through well exploitation operations. Taking over as operator is important not only to lower lease operating expenses but also to control the decision as to which contractor will abandon the field.

Oil company downsizing and layoffs induced by this protracted period of low commodity prices are providing an opportunity to add properties and technical talent. We have recently hired the following technical disciplines to assist in exploiting potential property acquisitions and the value of existing ERT reserves:



**Geophysicists:** 2-D and 3-D seismic evaluation of existing properties so that ERT receives a promoted position in drilling operations conducted by independent oil and gas companies.

**Drilling Engineers:** Provide procedures, quality control and offshore supervision for both rig and through tubing well work on recompletion and remedial workovers.

**Reservoir Engineers:** Ensure that budgeted production goals are achieved while also developing economics for potential property acquisitions.

The rapidly declining number of rigs drilling for natural gas in the United States in the face of increasing consumption has put in place a set of dynamics which we believe will self correct in the future. The Gulf remains the most significant source of this product as it provides almost 30% of the natural gas consumed in this country. 1999 should represent a unique opportunity to expand the reserve base of ERT while at the same time assisting customers who are grappling with reduced operating budgets and manpower levels yet facing large abandonment obligations.

reason and because we were turning away work in 1998, CDI entered into an alliance agreement with Horizon Offshore that significantly expands our salvage and pipelay services. Horizon operates three derrick barges, the *Pacific Horizon*, *Atlantic Horizon* and *Phoenix Horizon*, that have lift capacities ranging up to 800 tons. As a result we will no longer have to subcontract those projects where the lift exceeds the 200-ton capacity of the *Cal Dive Barge-I*.

Energy Resource Technology was formed to offer customers the option of selling mature properties rather than having to manage the eight separate phases of the decommissioning process. 1998 was a lackluster year for ERT in terms of financial results and property acquisitions. Our natural gas price averaged \$2.12/mcf in

#### ENERGY RESOURCE TECHNOLOGY: PROVEN DEVELOPED RESERVES

| (Net BCFE)                       | 1994  | 1995  | 1996  | 1997  | 1998  |
|----------------------------------|-------|-------|-------|-------|-------|
| Beginning Balance                | 0.2   | 3.8   | 21.1  | 25.3  | 30.3  |
| Production                       | (1.4) | (2.6) | (4.5) | (5.7) | (4.9) |
| Purchase of Reserves             | 5.0   | 19.9  | 8.9   | 9.9*  | 7.4*  |
| Sale of Properties               | 0.0   | 0.0   | 0.0   | (0.9) | (0.6) |
| Property Exploitation (Revision) | 0.0   | 0.0   | (0.2) | 1.7   | (2.0) |
| Ending Balance                   | 3.8   | 21.1  | 25.3  | 30.3* | 30.2* |

\*Includes Sonat acquisitions which were effective in January 1998 and 1999.

# CDI FLEET PROFILE

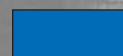
|  | Outer Continental Shelf (<1,000 ft.) |          |                |                   |                     | Deepwater                       |                            |                        |        |   |
|--|--------------------------------------|----------|----------------|-------------------|---------------------|---------------------------------|----------------------------|------------------------|--------|---|
| Vessels                                | Salvage                              | Resupply | Surface Diving | Saturation Diving | Reeled Products Lay | ROV Support, Light Construction | Subsea Well Service, P & A | Infield Flowline J-Lay | Coring | Deep Heavy Construction Templates, Moorings |
| <i>Barge Operations:</i>               |                                      |          |                |                   |                     |                                 |                            |                        |        |   |
| Barge-I / Well Service                 |                                      |          |                |                   |                     |                                 |                            |                        |        |   |
| Atlantic Horizon*                      |                                      |          |                |                   |                     |                                 |                            |                        |        |   |
| Pacific Horizon*                       |                                      |          |                |                   |                     |                                 |                            |                        |        |   |
| Phoenix Horizon*                       |                                      |          |                |                   |                     |                                 |                            |                        |        |   |
| <i>Dive Support Vessels:</i>           |                                      |          |                |                   |                     |                                 |                            |                        |        |   |
| Cal Diver III                          |                                      |          |                |                   |                     |                                 |                            |                        |        |   |
| Cal Diver IV                           |                                      |          |                |                   |                     |                                 |                            |                        |        |   |
| Cal Diver V                            |                                      |          |                |                   |                     |                                 |                            |                        |        |   |
| Cal Diver I                            |                                      |          |                |                   |                     |                                 |                            |                        |        |   |
| Cal Diver II                           |                                      |          |                |                   |                     |                                 |                            |                        |        |   |
| <i>Dynamically Positioned Vessels:</i> |                                      |          |                |                   |                     |                                 |                            |                        |        |   |
| Merlin                                 |                                      |          |                |                   |                     |                                 |                            |                        |        |   |
| Witch Queen                            |                                      |          |                |                   |                     |                                 |                            |                        |        |   |
| Balmoral Sea                           |                                      |          |                |                   |                     |                                 |                            |                        |        |   |
| Uncle John                             |                                      |          |                |                   |                     |                                 |                            |                        |        |   |
| Sea Sorceress (proposed)               |                                      |          |                |                   |                     |                                 |                            |                        |        |   |
| Q4000 (Yr. 2001)                       |                                      |          |                |                   |                     |                                 |                            |                        |        |   |



Primary



Secondary or  
Capable of Function



Limited Function or  
Modifications Needed

\*Alliance Vessels



A detailed black and white photograph of an offshore oil platform. The structure is complex, with multiple levels of decks, a large lattice crane on the left, and various pipes and structural elements. It is situated in the middle of the ocean. A dark red banner is positioned at the top right, containing the text 'FINANCIAL STATEMENTS' in a serif font.

# FINANCIAL STATEMENTS

# FINANCIAL REVIEW

The company's management information system treats each vessel as a profit center. For ease of understanding 1998 financial results, the accompanying chart groups CDI revenues into services provided by the DP fleet, traditional subsea services on the OCS and salvage services (with the latter combining derrick barge and ERT operations).

Revenues of just under \$152 million represent a \$42.5 million increase over 1997. The entire variance came from the DP fleet as our three core vessels (the *Uncle John*, *Witch Queen* and *Balmoral Sea*) increased their revenue contribution by \$26 million. In addition, the two new vessels (*Sea Sorceress* and *Merlin*) contributed \$10 million of the increase. The balance of \$8 million was added as a result of chartering two Coflexip vessels, the *Marianos* during the first quarter and the *Constructor* in the second. The more technically advanced features of the DP fleet resulted in our func-

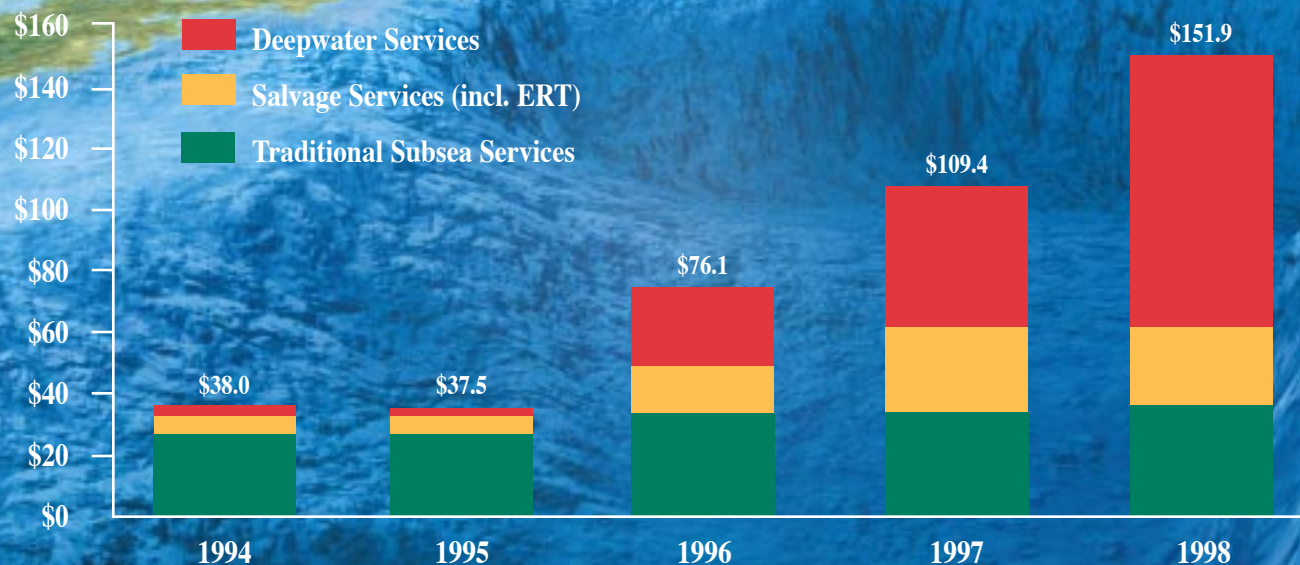
tioning as the prime contractor on an increasing proportion of work for oil company customers; i.e., Chevron, Shell, Amerada Hess and Sonat represented four of our top five customers in 1998. A year ago 26% of consolidated revenues came in support of just two pipelay companies, J. Ray McDermott and Allseas. Revenues of the DSVs that operate on the OCS increased 12% to a record \$40 million as we worked on a number of pipelines tying new Deepwater production into the Shelf infrastructure. ERT revenues decreased by almost \$4 million as the average gas price declined by 18% on just under 5 bcf of equivalent production.

Gross profit margins climbed almost two points to an all-time high of 32.4%. The company reports gross profit on a fully absorbed basis; i.e., after depreciation of the vessels, amortization of oil and gas properties, offshore insurance premiums, and the cost of the operations support base.

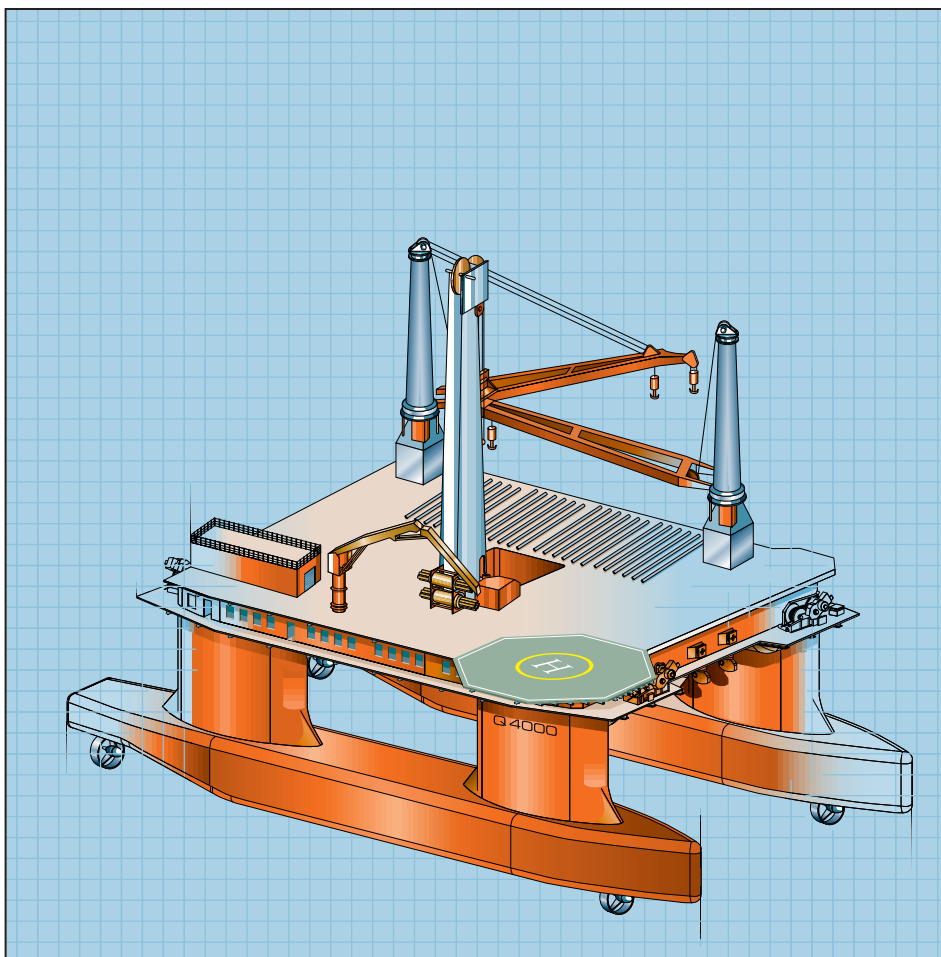
CDI is a performance driven company and we are particularly proud of the focus and execution of project management and off-shore personnel reflected in the 1998 financial results. The record level of gross profit was achieved even though ERT margins declined by over 20 points given lower natural gas prices. The 1998 performance of our three core DP vessels was so outstanding that we recovered their total capital investment in just over two years. Gross profit generated by assets which work on the OCS increased 28% as offshore performance was exceptional and shortages of experienced divers led to strong demand and rates. The cost of the Morgan City operations base remained constant at 5% of revenues even though we moved to a much larger facility and began implementing a new supply chain management system that should produce operating efficiencies in 1999 and beyond.

## REVENUE CONTRIBUTION

(In Millions)







Selling, general and administrative (SG&A) expenses increased by \$4.6 million, or 41% with roughly half the increase due to higher levels of incentive compensation. Employees earned cash bonuses of approximately \$4 million as 1998 gross profit and earnings per share targets were exceeded by 29% and 22%, respectively. In both years SG&A remained constant at 10% of revenues.

Aquatica, Inc. had an outstanding year with roughly 55 dive teams and two DSVs as customers responded favorably to a “hands on” style unique in today’s offshore industry. Margins were strong and in fact better than expected as the previously dominant competitor basically exited the market.

Invested excess cash balances produced net interest income of \$1.1 million in contrast to \$200,000 of interest expense in the prior year.

While taxes are provided at the 35% statutory rate, \$4.5 million of the \$13 million provision for federal taxes was not paid out in cash during 1998 due to timing differences and the company’s research and development efforts.

Net income of \$24.1 million increased 67% over prior year and was almost three times the \$8.4 million earned just two years ago in 1996. We take pride being part of a technology-driven, asset intensive business delivering net income which is 16% of revenues. Diluted earnings per share were \$1.61 in contrast to \$1.09 in 1997 with the variation between years effected by the new shares issued in the July 1997 IPO. Shareholder equity stood at \$114 million at December 31, 1998, in contrast to \$22 million at the end of 1995, the year our Deepwater strategy was put in place.

Net cash provided by operating activities of \$35.7 million fully funded \$15 million of capital expenditures and the \$5 million investment in Aquatica, taking working capital to a record \$46 million at year-end. A key component of the improved cash generation was a \$1 million decline in accounts receivable at year-end 1998 even though revenues grew 39% over the prior year as we did a better job of invoicing and collection. Cash provided by operating activities has been such that the company has not had to borrow money since the July 1997 IPO.

Cash balances on hand and funds generated from operating activities should enable the company to meet planned 1999 capital expenditures without drawing on the revolving credit facility. Half of the cost of the new Q4000 is expected to be shared by an equity partner with most of the funding required coming in the years 2000 and 2001. We have purchased the thrusters and completed engineering for the conversion of the *Sea Sorceress* to full DP; however, this \$30 to \$35 million capital expenditure will not be undertaken until commodity prices and market conditions improve.

The severe decline in commodity prices resulted in the utilization of offshore mobile rigs dropping to approximately 70% in the second half of 1998 and into the low



60% range early in 1999. This compares to almost full utilization in the two years through June 1998. Should this period of low oil and gas prices and rig utilization persist, marine construction activities in 1999 could be significantly lower than recent years and the company’s operating results could suffer accordingly.





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