USA – Offshore Drillers

March 16, 2009

POSITIVE VIEW

HIGH RISK

Could 2009 be like 1999? Let's party like its 1999…!

- Commodity prices and the Philadelphia Oilfield Service Index (OSX) have declined rapidly over the last few months, evoking memories of 1998 when oil, natural gas prices and the OSX declined by 31.7%, 14.1% and 54.9%, respectively. In 2008, oil, natural gas prices and the OSX declined by 53.5%, 24.9% and 59.8%, respectively. To-date, natural gas and the OSX are down, 30.1%, 1.1% and oil is up 3.7%, respectively.
- After the Asian currency crisis stabilized, in 1999, oil, natural gas prices and the OSX increased by 112.4%, 19.7% and 66.8%, respectively. **As we get closer towards the end of the first-half of 2009, we expect the sector to gear into partying like its 1999!**
- The market is currently calling for a 20%+ drop in cap-x spending this year, mirroring the drop in 1999. While cap-x will decline this year, **it is unfortunate that the sharp drop will take priority over the rebound in commodity prices this year, followed by an increase in share prices.**
- As of now, we see cap-x declining conservatively by 4.8% in 2009 to $116.0 billion, up from our previous estimate of $106.6 billon. **We note that our expected decline in cap-x spending in 2009 is considerably less than it would have been without OPEC strict compliance cooperation and oil prices trading above Street expectation.**
- As highlighted in this report, the trading environment of 1997-1999 is our best lead indicator on how the sector trades during a period of declining capital spending — a period we have shown to be highly correlated to today's trading environment. **This provides a robust and visible framework for us to conclude that the first quarter of this year will more likely be the bottom for the group.**
- We are currently bullish on the sector and are recommending accumulating shares of ENSCO (ESV – Buy), Diamond (DO – Buy), Pride (PDE – Buy), Rowan Cos., (RDC – Buy), Transocean (RIG – Buy), **and we are raising our rating on Noble (NE) to Buy from Hold.**
- The only possible downside risk in the sector, in our view, would be an escalation of contracts cancellation from Super Major, National Oil and Independent Oil & Gas companies and capital spending declining much below Street estimates of 20%+.

Please refer to the disclaimer of this research at the end of document.

OSX: 120.00

S&P 500: 756.55

NASDAQ: 1,431.50

DOW: 7,223.98

Equity Analyst
[redacted]

Could 2009 be like 1999…?

In 2009, could we be at a similar inflexion point and could history repeat itself?

Commodity prices have declined rapidly, evoking memories of 1998 when oil, natural gas prices and the Philadelphia Oilfield Service Index (OSX) declined by 31.7%, 14.1% and 54.9%, respectively. Fast-forward 10 years to 2008, oil, natural gas prices and the OSX declined by 53.5%, 24.9% and 59.8%, respectively. The drop is close to a similar level that was experienced during the Asian currency crisis. In 1999, after the Asian currency crisis stabilized, we witnessed oil, natural gas prices and the OSX rebound with striking returns of 112.4%, 19.7% and 66.8%, respectively. In 2009, could we be at a similar inflexion point and could history repeat itself? **Our quick response is YES! Yes, we expect the sector to gear into partying like its 1999!**

In 1999, cap-x spending fell by 21.7%. However, in the second-half of 1999, cap-x spending was up by 4% from the first half of 1999. The market is currently calling for a 20%+ drop in cap-x spending this year, mirroring the drop in 1999. While cap-x will decline this year, it is unfortunate that the sharp drop will take priority over the rebound in commodity prices this year, followed by an increase in share prices. This happened in 1998-1999, as the growth in cap-x spending unwound, even though commodity prices were rebounding in 1999. Today this appears to be the situation and historical stock and commodities performances tell us this is the case.

Exhibit 1. Macro Overview 1997-1999

	1997	**1998**	**1999**
Capital Spending[1]	$43.9	$42.6	$33.3
% Change	-	*-3.0%*	*-21.7%*
Crude Oil/bbl	$17.64	$12.05	$25.60
% Change	-	*-31.7%*	*112.4%*
Nat Gas Prices/MMbtu	$2.26	$1.95	$2.33
% Change	-	*-14.1%*	*19.7%*
OilService Index (OSX)	$114.37	$51.53	$85.96
% Change	-	*-54.9%*	*66.8%*

[1]$ in Million. Source: Zephirin Group, Inc. (ZGI) research

The oil and gas environment is very different now versus then, with cap-x spending higher than $100 billion. This growth was fueled by oil prices and we are confident that this will be the case in 2009 as soon as the current financial crisis starts showing sign of stability.

Exhibit 2. Macro Overview 2007-2009E

	2007	**2008**	**2009E**
Capital Spending[1]	$99.1	$121.9	$116.0
% Change	*7.9%*	*23.0%*	*-4.8%*
Crude Oil/bbl	$95.98	$44.60	$46.25**
% Change	*57.2%*	*-53.5%*	*3.7%***
Nat Gas Prices/MMbtu	$7.48	$5.62	$3.93**
% Change	*18.8%*	*-24.9%*	*-30.1%***
OilService Index (OSX)	$301.61	$121.39	$120.00**
% Change	*50.9%*	*-54.9%*	*-1.1%*

[1]$ in Million. **Price to date/Performance to date. Source: Zephirin Group, Inc. (ZGI) research

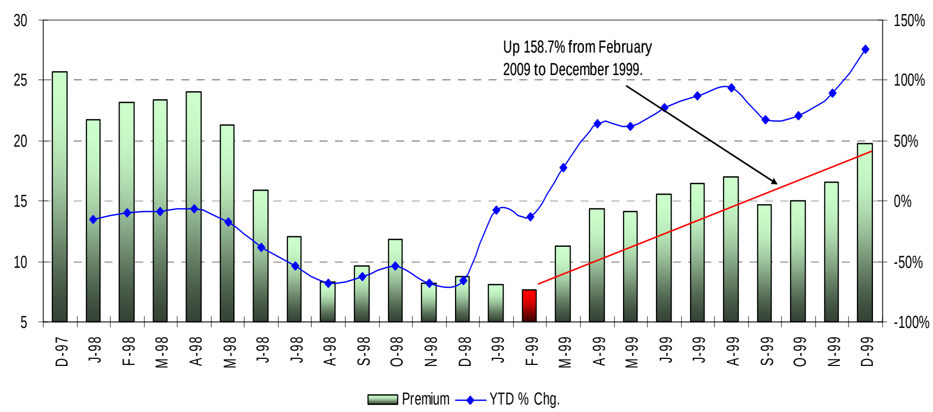
The poor performance in the first quarter of this year will more likely be the bottom for the group.

The bottom is near, or is it…?

In our opinion, the poor performance in the first quarter of this year will more likely be the bottom for the group. We have broken our universe into two groups, the Premium *(ENSCO, Noble and Rowan)* and Deepwater *(Diamond and Transocean)* in order to analyze past performances with current performances and to forecast our expectations for the foreseeable future. In 1999 *(see Exhibit 3 & 4)* both the Premium and Deepwater groups bottomed in February 1999 at an index price of $7.65 and $13.03, respectively. From February 1999 to the end of 1999, both the Premium and Deepwater groups were up by 158.7% and 56.4% to $19.79 and $20.38, respectively.

From February 1999 to December 1999, the premium sector was up by 158.7%.

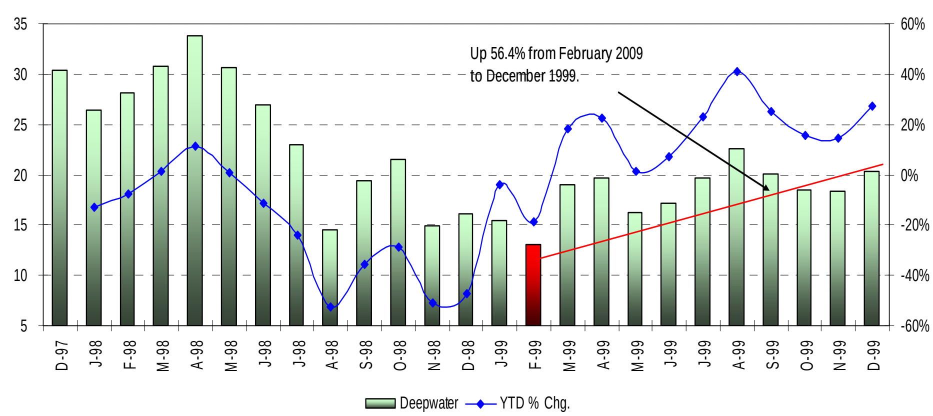
Exhibit 3. Premium Sector Index Share Price Analysis 1997-1999



Source: Members = ENSCO, Noble Corp., Rowan Cos. and Zephirin Group, Inc. (ZGI) research

From February 1999 to December 1999, the deepwater sector was up by 56.4%.

Exhibit 4. Deepwater Sector Index Share Price Analysis 1997-1999



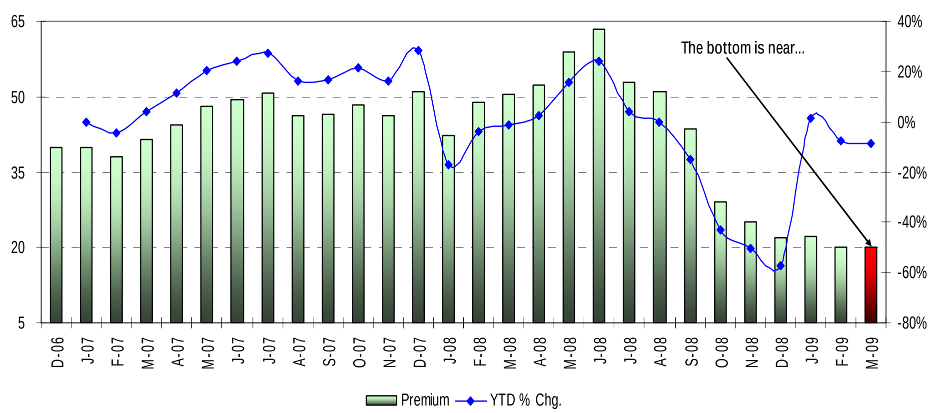
Source: Members = Diamond Offshore, Transocean and Zephirin Group, Inc. (ZGI) research

Approximately seven-to-eight months after the second half of 1997 through mid-1999, the developments related to the Asian Currency crisis shook the commodity and the Oilfield Service sector which lead to heavy drilling contract revenue losses; with dayrates at break even point and utilization rates surpassing historical lows. We are confident that dayrates will not reach break even point!

With this report, on the second-half view, we believe that oil prices will be the driver that will generate sustained positive momentum from current levels for the Oilfield Service sector. After the recent declines in both the Premium and Deepwater sectors in our view, the bottom is near and it is presenting itself with a strong opportunity for long-term investment in the Oilfield Service sector. According to Exhibit 5 & 6, March 2009 (Q1 2009), could possibly mark the bottom for the Premium and the Deepwater *(we note that the Deepwater sector is revisiting its recent December 2008 low)* sector. Year-to-date, the Premium sector is down approximately 6.1%, while the Deepwater sector is up 9.3%. We attribute the decline of the Premium sector to softness in near-term contractual day rates *(typically contracted for 40-90 days)* and natural gas prices versus the deepwater sector where day rates are contracted in average by 3-5 years.

Exhibit 5. Premium Sector Index Share Price Analysis 2006-2009 To-date

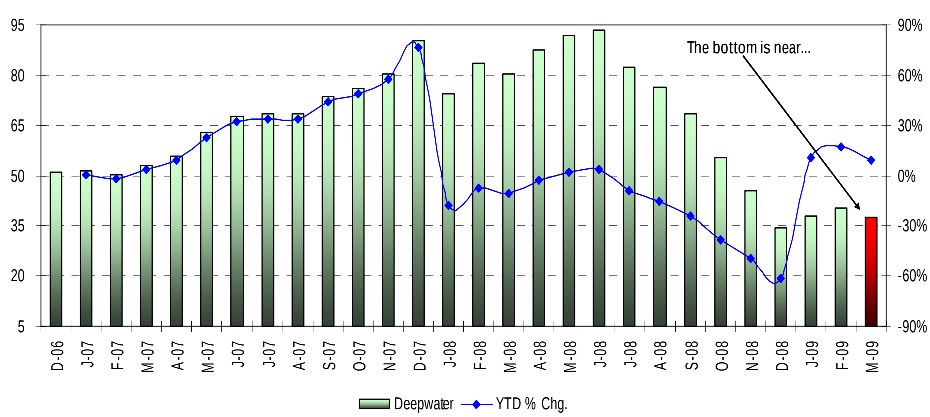
We are estimating a slight 6.3% decline in cap-x spending in 2009 to $106.6 billion. We expect cap-x spending to remain above 2006 level of $91.9 billion.



Source: ENSCO, Noble Corp., Rowan Cos. and Zephirin Group, Inc. (ZGI) research

Exhibit 6. Deepwater Sector Index Share Price Analysis 2006-2009 To-date

Despite the early out-performance, the deepwater sector is still trading at a discount.



Source: Diamond Offshore, Transocean and Zephirin Group, Inc. (ZGI) research

We believe that evidence in comparison to how the sector traded in 1999 has begun to emerge which, perversely, builds our confidence in the likelihood of the next oil price increase(s), while at the same time begins to undermine share prices that could reasonably be expected to be discounted in the near-term.

Cap-x spending to strengthen the market, again!

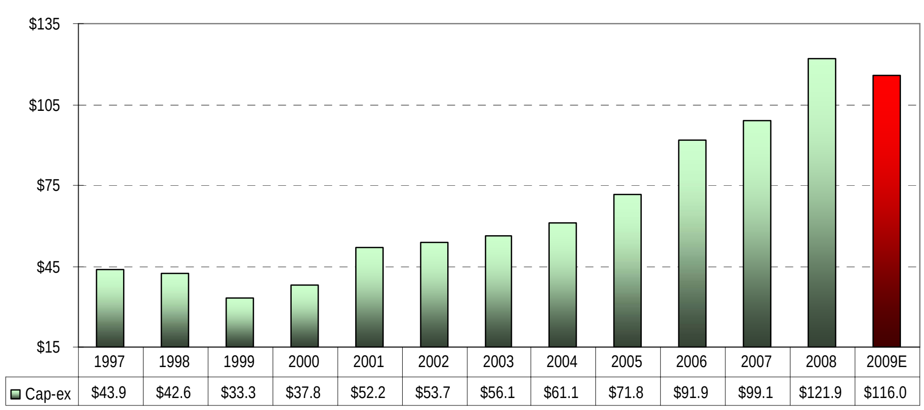
The expected decline in cap-x spending in 2009 is considerably less than it would have been.

While 2009 is shaping up to be a tough year for Oilfield Service companies, we remain confident that total cap-x spending will not decline below $100 billion from our lucky 14 Super, Other oil & gas, and Exploration & Production surveyed companies. For Q1 2009, we are estimating that cap-x spending will increase by 9.2% YoY to $31.2 billion, and down by 7.6% sequentially. According to our cap-x index analysis, since the start of each quarter starting with Q1 2000, cap-x spending has sequentially declined seven times in each of the first quarter of a new year, and is up only twice. For 2008, total cap-x spending from our surveyed companies has increased by 23.0% in 2008 to $121.9 billion, $8.1 billion above our estimates of $113.8 billion. Since 1998, cap-x spending has increased by 186.3%. The CAGR for the past 10-years is 11.1%. For 2009, we are estimating a slight decline from our surveyed companies of 4.8% to $116.0 billion, up from our previous estimate of $106.6 billion. We note that the expected decline in cap-x spending in 2009 is considerably less than it would have been without OPEC strict compliance cooperation and oil prices trading above Street expectation.

We strongly advise investors to disregard the Street estimates calling for cap-x spending to fall to 2005 levels in the 2009-2010 years. It is too early now to make such a bearish call as demand is still sound and oil & gas companies need to continue to replace lost reserves. Also, it is unclear that crude oil prices will fall to $30.00/bbl in 2009 (to date, oil prices are up by 3.7%). Though we realize that will probably not take place, hence why we are only forecasting a 4.3% decline in cap-x spending in 2009. If we are wrong, it will be due to the oil & gas companies shifting capital away from production to fund strategic acquisitions given that two or five oil & gas companies might find it difficult to fund exploration and production projects. ***However, given the steep drop in commodity prices and the tightening credit market, asset acquisitions in the oil & gas space cannot be ruled out in 2009.***

Exhibit 7. Total Upstream Capital Expenditure 1997 – 2009E ($ in Mil.)

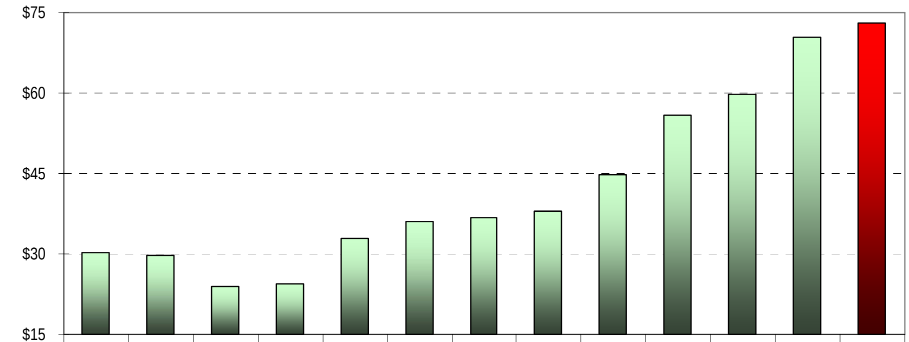
We are estimating a slight 4.8% decline in cap-x spending in 2009 to $116.0 billion. We expect total surveyed cap-x spending to remain above $100.0 billion.



Source: BP Petroleum, Chevron, Exxon-Mobil, Royal Dutch/Shell, ConocoPhillips, Hess, Marathon Oil Corp., Murphy Oil, Apache, Anadarko, Devon Energy, Occidental, EOG Resources, Noble Energy, company data and Zephirin Group, Inc. (ZGI) estimates

We expect Super Majors cap-x spending to increase by 3.7% in 2008 to $73.1 billion. Our slight increase is based on BP's and ExxonMobil reiterating their strong commitment to the sector in 2009. However, we believe that capital spending budget will be set aside for asset and property acquisitions in 2009.

Exhibit 8. Super Majors Upstream Capital Expenditure 1997–09E ($ in Mil.)

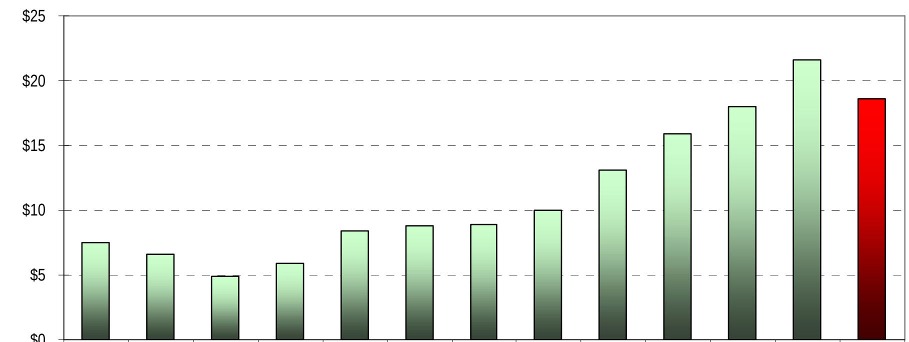


	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009E
Cap-ex	$30.2	$29.9	$23.9	$24.5	$32.8	$36.0	$36.8	$37.9	$44.8	$55.9	$59.7	$70.5	$73.1

Source: BP Petroleum, Chevron, Exxon-Mobil, Royal Dutch/Shell, company data and Zephirin Group, Inc. (ZGI) estimates

We are estimating a 13.9% decline in cap-x spending for other oil majors in 2009.

Exhibit 9. Other Majors Upstream Capital Expenditure 1997–09E ($ in Mil.)

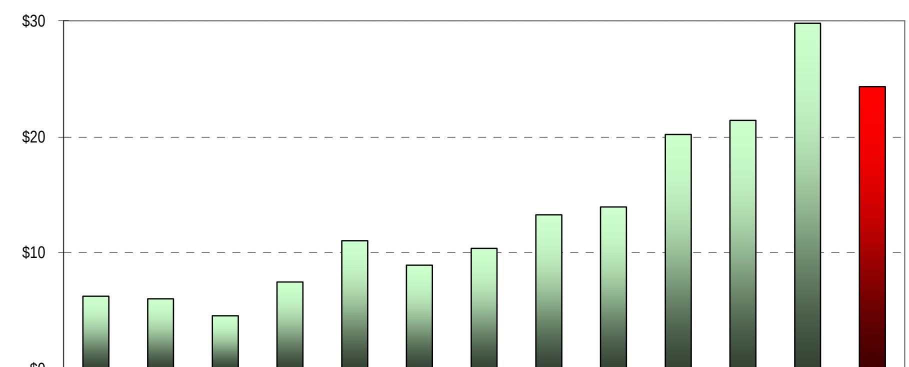


	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009E
Cap-ex	$7.5	$6.6	$4.9	$5.9	$8.4	$8.8	$8.9	$10.0	$13.1	$15.9	$18.0	$21.6	$18.6

Source: ConocoPhillips, Hess, Marathon Oil Corp., Murphy Oil, company data and Zephirin Group, Inc. (ZGI) estimates

We are estimating a 18.4% decline in cap-x spending for exploration & production companies in 2009.

Exhibit 10. E&P Cos. Upstream Capital Expenditure 1997–09E ($ in Mil.)



	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009E
Cap-ex	$6.2	$6.1	$4.6	$7.4	$11.0	$8.9	$10.4	$13.3	$13.9	$20.1	$21.4	$29.8	$24.3

Source: (Exploration & Production Companies) Apache, Anadarko, Devon Energy, Occidental, EOG Resources, Noble Energy, company data and Zephirin Group, Inc. (ZGI) estimates

Companies are poised to hold well…!

1997-1999 is our best lead indicator on how the sector trades during a period of declining capital spending.

As highlighted in this report, the trading environment of 1997-1999 is our best lead indicator on how the sector trades during a period of declining capital spending — a period we have shown to be highly correlated to today's trading environment. This provides a robust and visible framework for us to conclude that March 2009 (Q1 2009) could possibly be the bottom.

This is despite the disappointing capital spending guidance by the Street with the uncertainty around the timing of day rates pricing recovery and contracts that are being abruptly canceled, which understandably lead to the under-performance of share prices. However, we believe that investors have certainly overreacted, given that oil prices are only down 15.0% since November 2008 and are 1.5x+ higher than the December 1999 price of $25.60/bbl. As mentioned earlier, once the market starts showing signs of stability from the financial crisis and oil prices continue to trade above $40.00/bbl we believe that investors cannot ignore the potential upside from our universe. **We are currently bullish on the sector and are recommending accumulating shares of ENSCO (ESV – Buy, Medium Risk), Diamond Offshore (DO – Buy, Speculative Risk), Pride International (PDE – Buy, Speculative Risk), Rowan Cos., (RDC – Buy, High Risk), Transocean (RIG – Buy, High Risk), and we are raising our rating on Noble Corp. (NE, High Risk) to Buy from Hold.**

Our raised investment rating on Noble Corp. is based on our thesis that the sector is poised to trade online with what we experienced during the 1997-1999 period. This momentum is mostly driven by the possibility that in case of continued negative outcomes in the global market as a result of the financial crisis, investors will more likely migrate to the defensive nature of the oil service sector which will reclaim that status as of this month, given that we believe that March (Q1 2009) could possibly be the bottom.

The only possible downside risk in the sector, in our view, would be an escalation of contracts cancellation from Super Major, National Oil and Independent Oil & Gas companies and capital spending declining much below Street estimates of 20%+. Part of this risk should be mitigated by a considerable upside in oil prices, the reduction of rigs supplies (which could help day rates) and Q1 2009 cap-x spending beating our sequential declined of 7.6%.

Longer-term, we recommend accumulating the sector and we see returns of 30% in the next 12-months.

Companies mentioned *As of March 13, 2009

Name	Ticker	Price*	Objective	Rating
Diamond Offshore	DO	$59.00	-	Buy Speculative Risk
ENSCO	ESV	25.37	-	Buy Medium Risk
Noble Corp.	NE	24.37	-	Buy High Risk
Pride International	PDE	18.05	-	Buy Speculative Risk
Rowan Cos.	RDC	12.60	-	Buy High Risk
Transocean Inc.	RIG	55.24	-	Buy High Risk

N/A = Not Applicable

IMPORTANT DISCLOSURE:

Rating System: BUY — The stock, securities or shares are expected to achieve a total return of 15% or more over the next 12-18 months, or are expected to outperform its industry peers and the S&P 500. HOLD — The stock, securities or shares are expected to achieve a total return of 10% or less, or are expected to perform in-line with its industry peers and the S&P 500 over the next 12-18 months. UNDERPERFORM/SELL — The stock, securities or shares are expected to underperform its industry peers and the S&P 500 over the next 12-18 months.

Risk Rating: LOW RISK (LR) — Return of 0-5%; MEDIUM RISK (MR) — Return of 0-10%; HIGH RISK (HR) — Return of 0-20% and SPECULATIVE RISK (SR) — Return of 0-30%. **Distribution of Rating:** Buy = 6 (100%); Hold = 0 (0%); Underperform/Sell = 0 (0%)

All of the recommendation and views about the securities and companies in this report accurately reflect the personal views of the research analyst named on the cover of this report.

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