



World Energy interviews **Randall D. Stilley,** **CEO of Hercules Offshore**



Hercules Offshore (www.herculesoffshore.com) operates the largest liftboat fleet and sixth-largest jack-up rig fleet in the Gulf of Mexico. Through its two operating subsidiaries, Hercules Drilling Company and Hercules Liftboat Company, the company offers a range of services to oil and gas producers to meet their needs during drilling, well service, platform inspection, maintenance and decommissioning operations in the shallow waters of the Gulf of Mexico. The company's CEO, Randall D. Stilley, recently spoke to World Energy about the current environment in the highly competitive drilling arena.

World Energy: What is Hercules' overall strategy?

Stilley: At Hercules Offshore, we seek to provide efficient, safe and low-cost drilling and liftboat services, focusing on the Gulf of Mexico [GOM] and suitable international locations. Through these activities, Hercules strives to offer strong returns for its investors.

World Energy: Who are your primary customers?

Stilley: Hercules has a broad and diverse customer base that includes major, integrated oil and gas companies such as Chevron and independent exploration and production companies such as Apache, Bois d'Arc and Arena Resources.

World Energy: Hercules Offshore drives growth through acquisition. Why acquisition over building new assets?

Stilley: The cost to build new assets has materially increased in the present high-commodity price environment. Also, the delay between deciding to construct a new rig or liftboat and completion has increased as shipyard capacity is limited due to rig repairs from the hurricanes and new building activity. So in this economy, we believe acquiring assets provides superior returns over new-asset construction.

World Energy: What types of acquisitions do you review and consider?

Stilley: We consider assets that fit with our company's operations in the offshore drilling and liftboat/marine service segments. Hercules pursues only those acquisitions that meet our strict ROC [return on capital employed] criteria.

World Energy: Given Hercules Offshore's strong acquisition track record, are any other acquisitions in your near future?

Stilley: Well, we're continually monitoring acquisition opportunities and will pursue them if they meet the company's strict criterion. At this time, however, Hercules does not have any planned.

World Energy: But it's safe to assume you will have prospects in the future. When that happens, how will Hercules fund these acquisitions or capital projects?

Stilley: When that happens, we will evaluate all financing options, including using cash balances, issuing debt or issuing additional equity.

World Energy: What are Hercules' growth opportunities?

Stilley: We constantly monitor the market for acquisitions that provide complementary assets and offer an attractive return. In addition to acquisitions, Hercules also intends to expand in select international markets.

World Energy: How does management view the drilling environment going into 2006 and even further into 2007?

Stilley: The current environment is exceptionally strong for GOM drillers, as operators are currently more concerned with rig access than day rates. This is expected to continue as commodity prices are forecasted to remain high and exploration



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and production [E&P] companies have extensive inventories of wells to drill. As for beyond 2006, I'll have to pass on that question. Because we work in such a volatile industry, we at Hercules do not like to speculate on the drilling environment beyond a point.

World Energy: What's the impact of commodity price fluctuations on your business?

Stilley: Our business is directly dependent on the level of oil and gas exploration, as well as the development and production activity of our customers. And our customers' activity is directly dependent on market prices for oil and natural gas. So a weak commodity price environment curtails drilling activity, while a strong commodity price environment results in increased producer capex budgets and stimulates drilling activity.

Demand reduction may materially erode day rates and utilization. Conversely, enhanced demand or limited supply materially increases day rates and utilization, which is the environment Hercules operates in today.

World Energy: What is Hercules' drilling strategy?

Stilley: Hercules strives to provide efficient, low-cost drilling services to its customers in a safe manner, focusing on the GOM, but monitoring international opportunities selectively.

- Our smaller rigs and crew sizes make them less expensive to operate than higher specification assets.
- Our impressive acquisition track record demonstrates our intention of growing in a manner that offers superior returns to our investors.

World Energy: How does Hercules' fleet of jackup rigs compare to those of its competitors?

Stilley: Many of Hercules' competitors have jackup fleets with generally higher specification rigs than ours. However, our rigs were purpose built for the shallow waters of the GOM and have several differentiating features that make them highly attractive for this drilling environment:

- *Rig 11* is the largest workover rig in the GOM.

- *Rig 15* is the last from the Big Foot design and has the ability to drill in as shallow as nine feet of water.
- *Rig 21* and *Rig 22* have the ability to cantilever over larger platforms and approach a platform from all four sides.

World Energy: Who are your competitors in the jackup market?

Stilley: TODCO is our largest competitor due to its large presence in the GOM's shallow waters. Other competitors include Pride International, Ensco International, Diamond Offshore and Rowan Companies.

World Energy: There has been recent news about rigs leaving the Gulf of Mexico for higher day rates and longer contracts in international waters; how does this affect your company's strategy?

Stilley: Eight to ten rigs are planning to leave the GOM for international waters, but Hercules continues to view the operating environment in the GOM favorably for several reasons. For example, we have well-established relationships with GOM customers who have drilling programs in this region for the foreseeable future. Our rig and liftboat fleet is of sufficient size to achieve operational synergies within the region.

With our two most recently acquired rigs, *Rig 16* and *Rig 31*, we plan on pursuing international operations growth. We also own four liftboats that are operating in Nigeria.





World Energy: There has also been recent news about TODCO reactivating its stacked rigs. How does this, and other rig activations and mobilizations, affect Hercules' business?

Stilley: Because of planned rig mobilizations and rig losses from hurricanes Katrina and Rita, the current demand environment and backlog in the GOM is strong enough to withstand the reactivation of all seven TODCO rigs with little or no impact on day rates and utilization. Eight to ten rigs are to be mobilized out of GOM and nine rigs were lost due to Hurricanes Katrina and Rita; TODCO's seven rigs will not replace the lost supply.

World Energy: While we're on the subject – just what is a liftboat, and how does it differ from a jackup drilling rig?

Stilley: Liftboats are self-propelled vessels that can quickly reposition at a worksite or move to another location without third-party assistance and are primarily used in offshore inspection, maintenance, repair and construction activity. In contrast, jackup rigs require tugboat assistance to mobilize and are used primarily in offshore drilling activity. Both liftboats and jackup rigs utilize legs and a jacking system to lower the vessel's legs to the ocean floor until a foundation is established to support the elevated vessel.

World Energy: Utilization for the liftboat fleet appears low relative to the jackup rig fleet. What accounts for that?



Stilley: U.S. Coast Guard regulations require that liftboats undergo regulatory inspections on an annual basis and be dry-docked two out of every five years to ensure compliance standards for vessel safety and vessel maintenance. The annual inspection process typically results in liftboats being non-active for one month out of every year. As such, a liftboat is theoretically only available 80 to 90 percent of a year.

World Energy: What is your liftboat strategy?

Stilley: Our liftboat strategy resembles its drilling counterpart, with the intention of providing efficient, low-cost services to our customers in a safe manner. Hercules will continue to have a GOM focus but will also monitor international opportunities. We've developed into the largest liftboat operator in the GOM but now also have a presence in Nigeria.

Hercules views its liftboat operations not only as a buffer to the more volatile drilling segment but also as a real growth driver for the company.

World Energy: Who does Hercules view as its competitors in this market?

Stilley: Actually, we have the largest scale and presence in this market. We tend to view companies with a GOM liftboat presence as our competitors, though few companies have significant market share. Hercules' largest competitor is Superior Energy, which operates 26 liftboats, compared to Hercules' 47 liftboats overall and 43 in the GOM. Other competitors include Aries, Montco and Laborde.

World Energy: Can you speak to Hercules' safety record?

Stilley: At Hercules, safety is given the utmost importance, as it directly impacts the customers that choose to utilize our services. Our company's record is much better than the industry average, with zero lost time incidents throughout 2005.

World Energy: Why should investors purchase Hercules stock versus one of its competitors?

Stilley: We offer investors a company with several notable strengths: We're in the early stages of growth; we have management personnel that is experienced and incentivized; we have the potential to become

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a much larger drilling and marine service company; and historically we've offered a higher return on its investment than our competitors.

World Energy: TODCO, your most similar peer, has no debt; what is Hercules' approach to capital structure?

Stilley: Hercules believes the relative stability of the liftboat business provides us with the ability to carry more financial leverage than our competitors, who are focused solely on the jackup drilling market. Following the \$45 million repayment of debt in connection with our recent initial public offering, we have a conservative capital structure that provides flexibility to make our business grow.

World Energy: What kinds of insurance coverage does Hercules have?

Stilley: Hercules maintains insurance coverage that includes physical damage, third-party liability, maritime employers liability, pollution and more. Our primary marine package provides for hull and machinery coverage for rigs and liftboats up to a scheduled value for each asset.

- Rig coverage include a \$1.0 million deductible per occurrence.
- Liftboats deductibles vary from \$150K to \$500K depending on the insured value of the particular vessel.
- There is no deductible in the event of a constructive total loss.

World Energy: How does Hercules manage its credit exposure to its drilling and liftboat customers?

Stilley: Hercules provides services for a diversified group of customers in the oil and natural gas exploration and production industry. Credit is extended based on an evaluation of each customer's financial condition.

The company maintains an allowance for doubtful accounts based on expected collectibility and establishes a reserve when required payment is unlikely to occur.

World Energy: Does Hercules have an independent board of directors?

Stilley: Yes, our board consists of seven members. The board has determined each of its directors, other than me, is independent under applicable NASDAQ marketplace rules.

World Energy: Talk to me about mitigating the environmental risks associated with Hercules' operations.

Stilley: Existing regulations require Hercules and its drilling competitors to obtain and maintain specified permits and other approvals, control the discharge of materials into the environment, and manage the removal and cleanup of materials that may harm the environment.

Under these regulations, both our company and our competitors are monitored by government agencies including the U.S. Coast Guard and the National Transportation Safety Board, as well as private organizations such as the American Bureau of Shipping.

World Energy: Who are Lime Rock Partners and Greenhill Capital Partners?

Stilley: Lime Rock Partners and Greenhill Capital Partners are private equity firms that own approximately 35 percent and 17 percent of our company, respectively. Lime Rock Partners is one of the premier private equity funds focused on the energy sector and manages over \$850 million of equity capital. Greenhill Capital Partners manages over \$1 billion in capital and has made a number of investments in the energy sector.

World Energy: Any future plans by these two firms in regard to their holdings in Hercules?

Stilley: Lime Rock Partners and Greenhill Capital Partners have not communicated any specific plans to the company with respect to their investment holding period. At a minimum holding period, both sponsors will be subject to a 180-day lock-up period following our initial public offering.

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