Can Noble Corporation’s Core Competency in Health, Safety, Environmental & Operational Excellence Be Extended to a Major Acquisition?

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Noble Corporation’s International Expansion

Introduction

As Jim Day, the CEO of Noble Corporation for 12 years, looked at the reports before him, he made a list of the many uncertainties inherent in the potential acquisition of Neddrill—the oil and gas drilling services subsidiary of Royal Nedlloyd N.V., a Dutch shipping company. First was the quality of the drilling assets. As far as his people could tell, the rigs would all require significant investment to bring them up to Noble standards. But the exact amount was unknown. Second was the industry’s inability to accurately forecast future dayrates (daily revenue for drilling on behalf of clients) for the rigs. Many insiders expected rates to rise but they had been wrong before with major consequences. Acquiring costly drilling assets could prove very risky if the dayrates went down instead. Third was the complexity introduced by buying a large international firm whose employees were not overly enthusiastic about joining a U.S. based driller. An inability to efficiently integrate the Neddrill assets and people into Noble would reduce the value of the acquisition as well as put Noble’s reputation at risk.

A number of factors, however, argued for continued growth through acquisition and by entering deepwater markets. Most analysts in the industry believed that expanding operations outside the U.S. was imperative. Over the past century, extensive land-based oil exploration activities had reduced the number of promising new on-shore wells. Decades of exploration and drilling in the shallow water (e.g., in the Gulf of Mexico) had a similar effect offshore. Further, new technology was increasing the probability of drilling productive deepwater wells using improved seismic information. Finally, the major exploration and production firms were quietly, but steadily, leasing the rights to drill on increasingly deep plots.

The CEO was well aware of these factors given his 30 years of service in the sector. He also knew there was considerable industry interest in Neddrill. Though their assets and skilled people could be instrumental in moving into harsh environment drilling, there was no denying the risks in the deal—aging assets, health and safety issues on the rigs, and potentially challenging labor relations.
Background

The oil and gas industry is not for the faint of heart. Exploration and production companies (E&Ps) as well as contract drillers take on considerable risks. Both are at constant financial risk in this capital-intensive industry notorious for its boom and bust cycles. They also share significant operating risk. Drilling wells in hostile environments deep below the earth involves significant safety issues and environmental risks. Major spills or blow outs can damage the firms’ reputations and financial statements.

While demand for oil has consistently risen since the introduction of the automobile, supply has fluctuated widely, causing frequent swings in the price for a barrel of black gold. Thus, not only do prospectors face uncertainty regarding the location of new oil deposits, they are hard pressed to predict their value once extracted. Consequently, many consider drilling for oil to be a roll of the dice multiplied by infinity.

The risks for the workforce are physical. There are significant dangers inherent in the exploration and extraction endeavor. In the early years the equipment was crude, speed was critical and the process had very little regulation and protection for workers. The upside was that a drilling crew dragging its rig across the muddy plains could earn significantly more than other workers with similar skills and education. Over time the equipment has improved, as have health, safety and environmental systems designed to mitigate risk, but the search for new oil deposits has been extended to some of the harshest environments known to man. Modern rigs operate in conditions ranging from the biting cold and harsh winds of the North Sea to the searing heat and sandy winds of the Arabian summer.

As major exploration and production companies expand their global search for promising new fields, additional complexity has been introduced for their drilling contractors. Moving or constructing rigs across the world frequently requires the acquisition of international talent to staff them, sometimes due to local laws and sometimes simply because of the natives’ ability to cope. Many of the countries currently being explored are fascinating but also challenging. For example, in Nigeria there are more than 200 tribal languages spoken and bloody territorial disputes are common. In short, international expansion brings with it new opportunities but also new risks—especially maintaining high safety standards and operating excellence in far-reaching locations.

Years of intense competition in the drilling segment of the industry has driven down operating margins, forcing drilling firms to acquire or be acquired. Noble chose the former path and has experienced some success. However, the current proposal—Project Windmill—was perplexing. The Health, Safety & Environmental (HSE) history of Neddrill was a major concern. Noble had built a reputation as an outstanding driller that delivered safely on time, without environmental incidents. They did not want to put this reputation at risk in the process of absorbing a major organization with such a different HSE culture.

The Noble Way

Since its founding in 1921, Noble has been led by individuals committed to long-term, sustainable growth. Founder Lloyd Noble and subsequent leaders have guided the development of
“The Noble Way.” The Noble Way defines the character and culture of the organization and provides clear direction for making decisions in the face of uncertain markets and difficult operating conditions. The three interrelated pillars of long-term, sustainable growth for Noble are:

1. Outstanding health, safety and environmental practices
2. Operational excellence
3. Strong financial performance

As an employee-centered organization, the culture has always valued the acquisition, development and protection of its people. Because the oil services industry poses tremendous risks to employees, Noble has sought to differentiate itself from other drillers by developing a world-class reputation for its commitment to their health and safety. The benefits of such an approach are many. The first advantage is its status as a preferred employer. Workers and their families value the security that comes from Noble’s safe working environment. Consequently, Noble can select high-quality employees from large numbers of qualified applicants which in turn leads to industry-leading employee retention rates. A second advantage is the reduced downtime for the rigs. When accidents or “lost time incidents” (LTI) occur on a rig, many times they often lead to the operations being suspended for a time while the cause is diagnosed and remedied. Because the rig does not earn money when it is not operating, LTIs can have a major negative impact on a company. Moreover, high rates of LTIs also contribute to higher health care, insurance and legal costs. A third advantage from outstanding HSE practices is market reputation. The court of public opinion does not carefully differentiate between the acts of the E&Ps and their contract drillers. If a life is lost or the environment is damaged by extraction activities, all involved parties will suffer the consequences. Accordingly, E&Ps prefer to work with service providers who are likely to produce excellent results with the least possible risk exposure. In fact, many E&Ps are willing to pay dayrate premiums to obtain the services of firms with the best HSE records.

Pillars of the Noble Way

- **HSE Investment**
  - Comprehensive Management System
  - Behavioral Based Safety
  - Environmental Initiatives
  - Leadership Development Workshop
  - Safety Training Programs

- **Financial Performance**
  - High ROCE
  - Positive EPS
  - Positive Cash Flow
  - Strong Balance Sheet
  - Investor Satisfaction

- **Business Performance**
  - Reduced Incidents
  - High Rig Utilization
  - Reduced Downtime
  - Employee Retention
  - High Customer Satisfaction
Building on its foundation of high-quality employees, Noble has achieved high levels of customer satisfaction which have led to an increased number of contracts and, ultimately, high rig utilization rates. In the industry, utilization rate is critical given the extremely high cost of the rigs, which only generate revenue when they are drilling under contract. Moreover, a firm that takes a careful, data-driven approach to designing safety into the construction of its rigs is also likely to find additional ideas for improving operational performance from this analytical approach. Further, as noted above, a driller with lower amounts of downtime due to LTIs stands to make more money per rig per year. In short, operational excellence is inextricably intertwined with HSE excellence.

Strong financial performance not only follows strong HSE and operational results, but it also enables the next generation of investment in HSE and operations. Put simply, the relationship between the three pillars is a virtuous cycle with each point contributing positively to the achievement of the next. Noble’s strong balance sheet, which is a product of its conservative financial approach, has enabled it to purchase drilling assets and operations at a discount in industry downturns. Also, because of significant savings from safe operations its costs are often lower than its competitors, which allows Noble to make money even when competitors do not. In sum, Noble’s strong financial performance not only defines it in the industry, it enables continued innovation around and investment in key sources of competitive advantage—HSE and operational excellence.

**Historical roots of “The Noble Way”**

Throughout Noble’s history, its leaders have guided its growth and development against five core values which include:

- Employee-centric management—the care and development of its employees to maximize the value of their knowledge, skills and abilities
- Operational excellence—the achievement of high rates of customer satisfaction and rig utilization
- Social responsibility—the commitment to protect the environment and to promote the development of the communities in which it operates
- Open adoption of new technologies—the use of new techniques and tools to improve firm capabilities
- Long-term investment strategies—the careful investment of firm assets at strategic times (i.e., industry downturns) to promote long-term growth and financial stability

Together these have enabled the company to establish and maintain a competitive advantage in the volatile drilling industry.

**Noble Timeline**

1921 - Lloyd Noble founds Noble Drilling Co.
1950 - Lloyd Noble dies, son Sam Noble becomes Chairman of Board
1972 - Public Offering for Noble Affiliates (Noble Drilling and Samedan); Introduction of award winning safety program
1978 - Roy Butler becomes CEO of Noble Affiliates
1984 - Jim Day appointed CEO, Noble Drilling spun off, IPO

A 1920's drilling crew on Noble's first rig.
Employee-centric management

From the company’s first days, Lloyd Noble operated the company under the recognition that a drilling company’s most important asset is its people. Lloyd hired good people, provided them with industry-leading benefits, equipped them with a clear set of management standards that allowed them to operate safely, effectively and efficiently, and empowered them to make independent front-line decisions.

“My hope is that when into other hands are placed the responsibility for the management of our mutually built enterprise, those in command will not lose sight of the fact that no individual builds anything worthwhile by his effort alone; that, though none of us can be totally fair, as we are human, our companies will continue down through the years to attempt to give to people associated with them an equitable portion of the fruits of their labor which, of course, bears with it the like responsibility on the part of the management to weed out those who do not want to make a sincere contribution, in order that room may be made for those who do. It has been my further belief that it was the duty of management, and to that end my mind has been constantly surcharged, to so build the organization that when men evidenced capabilities to give them a part of my work and find other tasks to do which might result in increased benefits to the organization, or step aside; and, on the other hand, should death intervene, to have matters so arranged that I would be missed personally, while the machinery continued to function smoothly.”

— from the Will of Lloyd Noble

Lloyd’s son, Sam Noble, carried this philosophy forward, ensuring that Noble Drilling consistently operated under a decentralized management system that gave its experienced field managers the freedom they needed to react quickly to the dynamic and highly unpredictable global drilling industry. This decentralized structure enabled operational efficiencies that sustained Noble during industry downtimes, allowing it to remain healthy when many of its competitors could not. Sam Noble wrote that “because Noble Drilling had delegated much of the responsibility for field operations and exploration activities to highly competent division managers, with the authority to act quickly and autonomously, (Noble) many times had an advantage over larger competitors.”

As U.S. demand for drilling contracts tapered off and competition increased in the 1980s and early 90s, responding quickly to market opportunities became critical to Noble’s survival and success. In Jim Day’s words, this required management’s ability to have “one foot on the gas and the other firmly planted on the brake so we can react to market changes.” Management recognized that experienced and extensively trained operating personnel would be central to Noble’s successful acquisition and execution of new contracts. Accordingly, Noble Drilling invested in building its operational competencies by instituting more on-the-job training, a year-long home study program, a full time safety and training coordinator position in each division, HSE and leadership training and performance appraisal programs. These initiatives had a tri-fold effect: they enabled Noble to retain their highly capable employees, improved operational efficiency, and built the company’s reputation for safety and excellence. During every year of the 1980s—a prolonged downturn in the industry—Noble won top honors from the International Association of Drilling Contractors (IADC) for their low LTI rates.
Operational Excellence

An ability to drill twice as fast and twice as deep as its closest competitors earned Noble a reputation for intelligent and innovative drilling in the early days – a reputation it has maintained. This willingness to embrace new technology, employ it across the organization and operate it in a disciplined fashion has enabled Noble to contain costs as well as drive revenue growth.

During the energy crisis of the 1970s, for example, oil exploration outside of the Middle East had become a strategic focus for U.S. oil producers. To meet this shifting demand and further the company’s abilities to drill deeper, faster, and more efficiently than ever before, Sam Noble implemented an award-winning safety program in 1972. Because of its reduced lost-time-incident rates coupled with strategic investments in drilling technology, Noble won contracts that drove revenues up from $5.9 million in 1974 to $9.9 million one year later, despite the lack of a set U.S. energy policy, changing tax laws and rates, and a depressed economy.

In 1990, Noble’s capabilities and operational excellence won it a contract with Shell Nigeria using four offshore rigs in the shallow delta waters of southern Nigeria where oil was plentiful at high pressures. Because Nigeria’s reserves accounted for ⅓ of Africa’s total, these contracts were critical to Noble’s future growth in this region.

Jim Day furthered Sam’s achievements by implementing advanced Quality Assurance systems in 1991 to ensure that Noble personnel performed in the safest and most efficient manner possible and sought to prevent problems before they happened. Because the industry itself had no formal quality system requirements, Noble’s formalized and proven commitment to safety and efficiency gave it an advantage over its competition during contract bids. Also in 1991, Noble Drilling implemented its PPMS (planned preventative maintenance system) to formalize its maintenance program and safely preserve its assets. Additionally, Noble Drilling (UK) Ltd. received the first ISO 9001 certification for a UK-based offshore drilling contractor in 1992. These operational improvements enabled Noble to focus more heavily on riskier offshore drilling opportunities that few of its competitors were equipped to handle.

Social Responsibility

Noble’s commitment to operational excellence has always been closely tied to its sense of responsibility and citizenship. From its earliest days, the company aspired to conduct business in a way that minimized environmental disruptions and supported positive community development. A prominent example of the company’s commitment to its social duty occurred during one of the most crucial decades of the social development in the United States – the 1940s.

In 1942, despite the company’s financial hardships, Lloyd Noble committed its support to the Allied war effort by leading the extraction of oil reserves in England’s Sherwood Forest. Noble helped meet England’s fuel and energy needs for the duration of the war by boosting the nation’s oil production from 700 barrels to 3,000 barrels/day. At the same time, in the U.S., Lloyd ramped up the company’s environmental efforts by creating the Noble Foundation. This environmental focus has helped differentiate Noble from its competitors. For example, when the Oil Pollution Act was passed following the Exxon Valdez oil tanker spill in 1989, Noble was able to comply quickly with minimal
additional investment because it already had well established policies regarding environmentally responsible operations.

**Open Adoption of New Technology**

Lloyd Noble was proud of his company’s reputation for intelligent and innovative drilling. One of Noble’s earliest operational innovations was an improved patented cone-drilling bit in 1929 that enabled the company to set depth and speed records while reducing drilling costs by 20%. Under the direction of Sam Noble in the 1950s, the company led the development and construction of one of the first-ever offshore rigs capable of drilling multiple wells, offsetting the disproportionately high expense of offshore drilling. Of the many other innovations adopted by Noble over the next few decades, the development of air-drilling techniques provided substantial speed and depth advantages for Noble. This consistent organizational commitment to new technology adoption has contributed to Noble’s business success throughout its history.

**Flexible, Long Term Investment Strategy**

Lloyd Noble’s fiscally responsible approach to business was evident in the company’s initial inception and early growth. Lloyd invested in oil drilling because he believed it was the most stable means of extracting value from the lucrative oil industry, and he nurtured growth by aggressively re-investing profits to upgrade Noble’s drilling capabilities. This approach made it possible for the company to prosper through the Great Depression. Following in his father’s footsteps, Sam Noble acquired a number of companies during industry down cycles. The assets and people that came from these acquisitions dramatically increased Noble’s drilling capability.

After taking over as CEO in 1984, Jim Day observed U.S. drilling opportunities collapsing. So, he led the company through a major strategic shift, focusing on offshore drilling, which required more capital and technical expertise than land drilling but involved fewer competitors, and longer term contracts.

> “The company’s roots were in land drilling. But we could see that land drilling was, at least from our perspective, a fragmented business. Anyone could get in it. There was too much capacity, too many people involved, and the prospects, at least over the next several years, did not look good.” — Jim Day, Chairman and CEO

For the remainder of the 1980s and into the early 90s the company focused on building its offshore capabilities. In order to do this, Noble shed debt and, given its small size in the industry, sought out smaller acquisitions. Noble Drilling acquired General Electric Capital Corporation (GECC)’s drilling assets in 1988, using an investment banking firm and drawing upon their leverage as a debt-free publicly traded company. Later that year, they bought the eager-to-sell Peter Bawden Drilling Ltd. which provided a few land rigs and access to the North Sea platform drilling market. Subsequently, Noble relocated corporate headquarters closer to their customer base in Houston to save an estimated $1.2m per year. As a result, by 1988 Noble had one of the newest fleets of drilling rigs in the industry and its losses were decreasing dramatically.
The company continued to pursue expansion opportunities and improvements during the industry downturns of the early 1990s, which included the acquisition of 12 Gulf of Mexico offshore rigs from Transworld Drilling Company in 1991. A stock offering in 1991 helped reduce the debt from the Transworld acquisition, bringing the company’s long term debt down 40% from 1991 to 1992. In 1993, Noble acquired Western Oceanic for $150 million in cash, a deal which enabled Noble to expand into the Zaire and Venezuela markets and expand its reach in the U.S., Nigeria, and the Gulf of Mexico. That same year, Noble’s UK division also partnered with BP Exploration to expand its offshore opportunities. At the same time, Noble cut costs by consolidating its Gulf administrative offices in Lafayette, Louisiana – a move that contributed to a 29% division overhead decrease. Noble’s strategic investments, the avoidance of debt, and efforts to cut costs solidified its position as a major player in the industry.

**Strategic Vision and Acquisitions**

Noble Drilling’s investments in the 1980s and early 1990s as well as its reputation as a safe and effective drilling contractor positioned the company to reap great rewards as the oil drilling market began to stabilize in 1993. For the first time since 1982, the company posted positive earnings, achieving its highest ever revenues of $195 million and positive cash flows. The company had survived what Jim Day called “the toughest and longest downturn the oil service industry has ever experienced,” while improving its capabilities and keeping its debt low. Though the drilling industry had stabilized and contracts became more abundant, energy prices had not yet fully recovered and overcapacity in drilling assets produced a fiercely competitive environment. Despite this, Noble Drilling continued to enhance its organizational capabilities and competitive position through the 1990s by aligning its strategy, culture, people, and systems.

**Noble Offshore Acquisition History**

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<td>57M</td>
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<tr>
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<td>Chiles</td>
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Strategy

Noble Drilling continued to focus on improvement in safety, environmental, operational and economic performance to reinforce its advantages, and recognized the interdependence of these factors. To meet financial goals, Noble shifted its development efforts to deepwater drilling as there was growing customer demand in this market niche with few other drillers having the technical expertise to compete. Although there was an overcapacity of drilling capabilities in shallow water drilling, there was no real dominant player in the higher margin area of deepwater drilling. In spite of the high costs associated with deepwater exploration, Noble continued to build its operational, HSE and engineering capabilities to meet this demand. Using a systems approach, HSE was carefully integrated with the management and measurement of Noble's business from the top level down to the daily rig management level. The dividends from HSE excellence were many. Clients are justifiably anxious to avoid the spills and blowouts that can result when there is an incident at one of their sites. Consequently, clients prefer safe operators over unsafe operators. Investors prefer predictability in earnings; but safety and environmental incidents are anything but predictable.

Culture

The successful implementation of this strategy was supported by the management team and their ability to nurture a culture of responsible, healthy, safe, and environment-conscious conduct aimed at continuous operational improvement. Senior management, guided by Lloyd Noble's Legacy for Management, continued to provide strong, visible leadership and commitment to HSE initiatives as the main means by which the corporate strategy was to be achieved. Guided by an internal Code of Business Conduct, employees were expected to accept responsibility for their individual impact on safety, environmental, and financial performance. Employees were charged with seeking continuous improvement and given the autonomy and guidance necessary to do so. To emphasize that safety is not secondary, but in fact essential, to achieving their strategic goals, Noble's management implemented a “Right to Refuse Work” Policy. By obligating employees to stop any job they feel is inherently unsafe, this policy reinforced HSE as a driving force in maintaining a competitive advantage in their deepwater drilling.

People

Supported by this culture and driven by the clear strategic direction of the CEO, Noble Drilling's employees remained the company's greatest asset in facing the challenges of the 1990s. Noble's recruiting efforts became even more selective to ensure that new employees possessed values congruent with Noble's culture as well as the skills (e.g., technical, quantitative, communication, problem solving) that were required to operate successfully in new environments. Once hired, operational staff completed enhanced competency-based entry-level training to ensure that they could do their jobs safely and to the best of their abilities. An example is the DuPont STOP (Safety Training Observation Program) which teaches workplace safety auditing skills for observing people while they work, reinforcing safe work practices and correcting unsafe acts and conditions.

Personality assessments were used to fit the right people to the right jobs on the Noble team. Post-hire these assessments were also used to help individuals understand their beliefs and behaviors and how these could affect their own safety and leadership potential. These assessments also enabled management to better match people with jobs that would maximize the use of their skills and position them for future opportunities.
The company also used Noble’s Short Term Incentive Plan to motivate employees to act safely, in a manner that improved shareholder value. Noble developed this plan further to focus on quantifiable and measurable financial and operational targets, offering bonuses of 5% to 75% of base salaries to qualifying employees. Tellingly, safety results were given the highest weight in calculating bonuses, followed by net income, thus emphasizing safety as the primary means for Noble’s achieving its strategic objectives.

To further their relentless pursuit of safe and efficient operations, Noble Drilling created a Safety Training Supervisor (STS) position in the rig management career advancement path. This role enabled operations employees to gain safety experience, enticed good safety candidates to enter operations, and fostered an appreciation for behavior-based safety processes. In fact, in order to be promoted to assistant driller or driller, an employee had to first spend time in the STS role — further reinforcing HSE as a fundamental responsibility of line management.

Safety was critical to career advancement in other areas of the company as well. Noble’s Competency Assurance Program was started in its European operations to establish a formal process to document the competency of employees up to the level of rig manager. This program established clear criteria for advancement that reinforced the strategic significance of safe, value-conscious employees. And externally, the HSE department coordinated with the Risk Management department to ensure the safety compliance of all subcontractor work.

**Systems**

Noble Drilling’s internal systems were maintained and augmented to motivate and enable employees to meet the organization’s strategic goals of the 1990s. The company’s HSE department worked closely with engineering, human resources, training, risk management, and other relevant staff to design equipment, tools, and processes that improved the health, safety, and environmental impact of all company operations. This centralized department, supported by many line managers who had previously been assigned to HSE, was charged with recommending policy; ensuring compliance with all applicable regulatory and client requirements; supporting corporate goals and objectives; measuring and reporting key performance indicators; and providing feedback mechanisms to continually improve performance. Under this guiding structure, systems aimed at continuous improvement were effectively implemented.

NDOR (Noble Daily Operations Report) was implemented as a computerized system for tracking detailed operations information, including all safety downtime. I.D.E.A.S.™ (Improved Drilling Efficiency Accountability System) was introduced as a complementary program to NDOR. This system was designed to encourage and document activities that improve the efficiency of drilling operations. I.D.E.A.S. established benchmarks based on past performance, utilizing an adopted measurement system to track progress against benchmarks, and improving performance through pre-planning, critical path analysis, and personnel training. The program stressed that the actions required to increase efficiency – pre-planning, communications and teamwork – also promote and enhance safety.

At the same time, Noble’s risk assessment procedures became even more robust allowing risks to be mitigated substantially before new activities were undertaken. Informal audits were expected to occur daily aboard drilling units to ensure that operational and HSE policies, metrics, and engineering
design standards were being consistently met. The HSE Committee, which included the Chairman and CEO and senior management from each function in the organization, met quarterly to review results and assess operational performance. Weekly worldwide operations conference calls were always kicked off with a business unit report on divisional HSE results. During the budgeting process, operations management was required to highlight and document their budget for HSE equipment and initiatives in order to ensure that expenditures targeting HSE excellence were never short-changed. HSE concerns were given priority at all levels in the company.

As Noble Drilling aligned its strategy, culture, people, and systems to achieve competitive advantage, the company continued to grow primarily through acquisition. In 1994, Noble acquired Triton to build its capabilities for turnkey drilling and engineering services in order to assist customers who would otherwise outsource these initiatives to reduce operating costs. Triton also possessed extensive engineering and historical operations information about all of Noble’s major competitors. Thus, the acquisition also provided helpful benchmarking and best practices information. In 1994, Noble also expanded its rig fleet by more than one third by merging with Chiles Offshore.

Chiles Offshore Corporation
Chiles Offshore built up its own network of 13 jack-up rigs primarily with investor equity. Chiles’ rigs were concentrated in the Gulf of Mexico and West Africa. The rigs were supported by experienced operations and engineering people. Chiles Offshore, however, had taken a number of risks that led to financial difficulties. Specifically, it built four new rigs. Given this tremendous capital outlay, the dayrates for the rigs would have had to hit historic highs in order to produce the 10 percent return on the invested capital expected by investors.

Unfortunately, the dayrates did not escalate as Chiles expected and they were forced to consider merging or selling. Given this context, Noble management believed that Chiles’ rigs could be purchased for less than it would cost Noble to build new rigs. These purchases would enhance Noble’s balance sheet and provide them with financial flexibility that would enable greater international expansion in the future.

In September 1994, Chiles merged with Noble’s Noble Offshore Corporation subsidiary to collectively form one of the largest drilling contractors in the Gulf of Mexico. Chief among the advantages of this merger was Noble’s greater access to the drilling market on the continental shelf of the Gulf.

Over the years, Noble had learned a number of lessons about how to integrate a new company into the organization. The people from Chiles Offshore commented that Noble had a very people-oriented approach. “Noble was very tolerant, very patient, very forgiving, and very understanding when it came to Chiles people learning to do things the Noble way. When acquiring, it is very easy to lose focus on operations, safety and maintenance. Noble has tried to manage these types of problems that are involved in acquisitions and has become very experienced in it” said Danny Adkins, Chiles vice president of operations. Noble also placed its own rig and safety managers on the new rigs in order to see how others were doing things, like safety and maintenance, to improve its own rig operations.
Bringing the two firms together was not completely without problem. During the transition from Chiles to Noble, LTIs actually increased on the Chiles rigs. The primary explanations for this increase were twofold. First, Chiles employees were initially anxious regarding the security of their jobs that caused them to be less focused on careful operations. Second, Noble introduced a more rigorous reporting process than had been in place previously. However, over time, the incident rates on the Chiles rigs began to converge toward the overall Noble rate as can be seen below.

**Noble vs. Chiles Safety Incident Rates 1994-1996**

Overall, the acquisition of Chiles Offshore enhanced Noble’s financial performance, improved its engineering and design capabilities, and gave it strong position from to continue to expand its international offshore operations.

**Project Windmill**

The offshore drilling industry has always been highly fragmented. Many small and medium sized drillers operate from bases in the U.S. and Europe. The largest players are frequently in talks regarding the acquisition of smaller rivals. Given past successes, Noble is also looking to expand its capabilities and operations. Overcapacity in shallow water drilling and increasing demand for deepwater exploration has led Jim Day to focus on building Noble’s deepwater capabilities to take advantage of this higher margin niche market. There is little doubt that analysts and investors would like to see Noble’s profit margins expand. Moreover, international deepwater expansion will allow Noble to spread its international overhead expenses across a larger fleet and diversify its portfolio to mitigate the uncertainties associated with drilling for oil in any given geographic region. Additionally, contract risks are reduced because deepwater contracts tend to be longer (average 2 years) than shallow water contracts (average 2-3 months). Assuming successful operations in deepwater, a significant positive impact on Noble’s long-term profitability and stock performance can be expected.

“Our management team felt like the deepwater market provided us with a niche opportunity. There were competitors that were in shallower water, but in deepwater, there was really no one dominant player. When we looked at the market, we saw an opportunity for Noble to step up, particularly with our engineering expertise, and move into that important sector.” — Jim Day
At the same time as Noble is focused on expanding its global reach in offshore drilling to perpetuate continual organizational growth it is also looking to acquire greater engineering and operational abilities, and to diversify its portfolio over a broader set of markets and sectors. The company’s management team believes that the greatest market prospects for further development are in Africa (Nigeria), South America (Brazil and Venezuela), and the North Sea (the UK, the Netherlands, and Denmark). Drilling activity in Nigeria had been on the rise, especially for jackups that can operate in up to 300 feet of water, a market sector in which Noble has excelled. Similarly, an increasing number of oil and natural gas producers are drilling in Venezuela’s Lake Maracaibo, along the coast of Brazil, and in the North Sea region. While Noble has assets located in Nigeria, the UK, Brazil, and Venezuela, its reach is limited by the number of rigs it has in these markets as well as its current client base.

While some of this expansion can be supported by constructing new assets internally—this approach has a number of inherent risks. First is the significant cost and time required to build new rigs. For example, converting a shallow water rig to a deepwater rig takes half the time and about half the expense of building a new deepwater rig. When dayrates average $150,000 for a deepwater rig and cost $250 million to build, these economies are significant. Second is the need to staff them with a mix of qualified local and Noble people. Third is the risk introduced to the market by adding to the existing drilling capacity. Concerned about these factors, Noble has identified a couple of possible acquisition targets as a means of achieving growth in its geographic presence and drilling capabilities quickly and cost-effectively. Neddrill, a Dutch drilling contractor with a strong presence in the North Sea, is favored for acquisition by a number of U.S. and European companies.

Neddrill

Neddrill is the drilling subsidiary of Royal Nedlloyd N.V., a large shipping company headquartered in Rotterdam, the Netherlands. As Neddrill is not core to Nedlloyd’s business, the division struggles to obtain sufficient capital support to invest in developing their infrastructure and assets. An example of this battle for resources comes from Mr. Cees Van Diemen, a long-time Neddrill employee. During a due diligence interview with an official from Noble he said, “I asked Nedlloyd for one anchor chain each year. I never got one. Their response was always the same, 'If it is working now, it will work for another year.”’ His colleague Ronald Hoope further offered, “Nedlloyd always has a plan. But it never executes. We are always negotiating over a new strategy, but lack the discipline to put it into practice.” This lack of resources and focus has impacted the company’s HSE performance. A safety audit uncovered 150 items needing attention—on just one rig. The government auditor threatened to shut down the operation if changes were not made. A major customer, Royal Dutch Shell, was considering not renewing contracts with Neddrill because of safety
concerns. Other customers were requesting discounted dayrates to compensate for the inherent safety risks.

The upside of the underinvestment by Nedlloyd is that the Neddrill people are highly skilled at fixing the rigs. The employees were largely trained in technical schools and generally had a long tenure in the organization. They know how to drill in deep water and succeed under less than ideal conditions in harsh environments.

Neddrill has a notable presence in the North Sea and in the deepwater offshore Brazil. The company owns two drillships, six harsh-environment jack-up drilling units, and one semisubmersible. Drillships have ship-shaped hulls and are self-propelled; their mobility and ability to carry a lot of equipment make them ideal for drilling in remote locations. Both of Neddrill's drillships are equipped with dynamic positioning, where computer controlled sensors and thrusters maintain the rigs' location without the need to anchor. Neddrill's jack-ups are harsh environment capable. Noble's North Sea operations are currently conducted using client-owned platforms on which Noble acts as a drilling contractor. The Neddrill acquisition would increase Noble's size by about 25%, making it one of the largest offshore drilling contractors in the world, adding 500 employees in Brazil, Argentina, Denmark, the UK and the Netherlands. Neddrill has established global credibility in their deepwater operations and engineering capabilities that could likely be leveraged to boost Noble’s expansion into deepwater drilling.


Neddrill would bring with it greater access to the Brazil and North Sea markets and clients. In the North Sea, this acquisition would allow Noble to expand beyond its current platform drilling contracts in the UK and into mobile offshore drilling units in the UK, Dutch and Danish sectors. Noble's HSE capabilities, global reputation for safety, and positive relationship with the British government from their interactions during World War II might enable it to expand the drillable area of Neddrill's assets within the North Sea offshore market. If so, it is expected that Noble's prospects in this region would increase substantially.
Neddrill maintains its deepwater drill ships in Brazil. While most of these assets are old (17-20 years) and require overhauling, their low book value and high dayrates would yield a higher return on capital for Noble than would newly constructed assets. The acquisition of Neddrill is expected to enhance Noble’s deepwater drilling capabilities and credibility, increase its market presence in the North Sea and Brazil, and improve its engineering and design capabilities. Notwithstanding these attractive features, this acquisition posed unique challenges, including:

1. **Valuation** – as a division of a public company with a business not related to that of its parent, it was difficult to value. Competitors that had looked to acquire Neddrill experienced significant difficulty negotiating the price and ultimately concluded that the operation had too many unknowns to justify the high asking price. Further, the pension liabilities were large and complex because so many nations were involved. Finally, to keep its rigs busy and lock in longer term contracts to provide predictable cash flow to Nedlloyd, Neddrill had signed a number of below-market contracts, which an acquirer would have to fulfill.

2. **Cultural** – as a European company, operating philosophies were quite different. The European employees were from many different countries but they generally shared a skeptical view of a U.S. employer; employees were specifically concerned about work hours changing and local rules about work times or hiring and firing decisions not being respected. The possible loss of “European” jobs was a significant concern.

3. **Social** – labor unions and the Workers Council would have a significant influence in the negotiation discussion and integration process. It was not clear that these bodies would support the types of changes that would need to be made to bring the rigs and operations up to Noble’s standards. Further, the oil drilling business is one that favors companies with low overhead and a high degree of operating flexibility. If negotiations on work time and practices didn’t go well with the unions or Workers Council, the workforce could essentially shut down operations.

4. **Governance** – as a company, Neddrill had not been shareholder value focused. Though the Neddrill management team was encouraged about the prospect of being divested by a shipping company and becoming integrated with a drilling company, they were concerned about pressures to hit operating targets.

5. **Safety** – there were questions about the accuracy of incident reporting which created considerable concern to a company as focused on health and safety as Noble. Just a few major incidents could turn operating profits into losses. Further, significant investments would be required to bring the rigs up to Noble standards.

As can be seen from the estimates on the next page, this acquisition offers an excellent opportunity to acquire valuable assets that are expected to provide a good return on capital—a fact not lost on your competitors. These estimates are well grounded. The finance experts have modeled the deal using a variety of analytical tools. Their dispassionate analysis is solid.
In an industry that is often slow to adapt, this acquisition could accelerate Noble’s deepwater drilling strategy. It would now have people with deepwater experience and rigs that could be quickly deployed. There was little overlap with current operations and rather than adding to industry capacity, this deal would simply move the capacity under the Noble umbrella. However, concerns about cultural, social, governance and valuation issues loomed large as did the health and safety issues, which represent a massive risk — one that could potentially derail this deal.

After all of Jim Day’s colleagues and advisors offered their insights, the list of pros and cons seemed to be evenly balanced. Some were strongly in favor of the deal while others were strongly opposed. Now it was time for the CEO to decide.

### Project Windmill Estimates
(all amounts in millions US$)

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<td>Operating Revenues</td>
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<td>Gross Profit</td>
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<td>Other expense</td>
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<td>Net Income</td>
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