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Valaris Ltd. (VAL)

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MANAGEMENT DISCUSSION SECTION

Operator: Good day and welcome to the Valaris Third Quarter 2022 Earnings Call. All participants will be in a listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Darin Gibbins, Vice President of Investor Relations and Treasurer. Please go ahead.

Darin Gibbins

Vice President-Investor Relations & Treasurer, Valaris Ltd.

Welcome, everyone, to the Valaris third quarter 2022 conference call. With me today are our President and CEO, Anton Dibowitz; Senior Vice President and CFO, Chris Weber; and other members of our executive management team.

We issued our press release, which is available on our website at valaris.com. Any comments we make today about expectations are forward-looking statements and are subject to risks and uncertainties. Many factors could cause actual results to differ materially from our expectations. Please refer to our press release and SEC filings on our website that define forward-looking statements and list risk factors and other events that could impact future results. Also, please note that the company undertakes no duty to update forward-looking statements.

During this call, we will refer to GAAP and non-GAAP financial measures. Please see the press release on our website for additional information and required reconciliations. As a reminder, yesterday, we issued our most recent fleet status report, which provides details on contracts across our rig fleet. An updated investor presentation and ARO Drilling presentation will be available on our website after the call.

Now, I'll turn the call over to Anton Dibowitz, President and CEO.

Anton Dibowitz

President, Chief Executive Officer & Director, Valaris Ltd.

Thanks, Darin, and good morning and afternoon to everyone. During today's call, I will start by providing an overview of our performance during the quarter. I'll then provide commentary on the outlook for the offshore drilling market and discuss our strategy for maximizing shareholder value during the unfolding industry upcycle. After that, I'll hand the call over to Chris to discuss our financial results and guidance.

We continue to deliver strong operational performance to our customers, with revenue efficiency of 96% in the third quarter and 97% year-to-date. We are committed to maintaining high levels of safety performance, which is particularly important given increasing activity levels. Our safety performance is the result of the focus and dedication of the Valaris team and several programs that we have implemented.

These include our BOLD leadership training courses that we run every other week, a behavior-based safety program with supervisors, mentor and engage with junior crews to ensure that they understand and are adhering to our safe systems of work. And a new format for our basic training program in the US Gulf of Mexico utilized at one of our stacked rigs in the US Gulf.

We believe that this format for basic training will help new employees, especially those who are new to the industry, to be better prepared for the offshore working and living environment and deployment on board our working rigs. Since its inception, we have averaged 18 new hire employees graduating every two weeks.

I'm pleased that these efforts have been recognized by our customers, with Valaris recently being rated the number one offshore driller in EnergyPoint Research's 2022 customer satisfaction survey. Valaris was number one in nine categories, including total satisfaction, health, safety in environment and job quality. These awards are a testament to the exceptional work that our dedicated offshore crews and onshore support teams perform in partnership with our customers. And we are grateful to our customers for recognizing our performance.

I'm extremely proud of the entire Valaris team for continuing to deliver high levels of operational performance during the challenging period for the industry and the organization. Since the beginning of the year, we have successfully executed four major floater reactivations, with all four rigs returning to work largely on time and within our reactivation cost guidance. This achievement speaks volumes about the operational execution capabilities of our organization and positions us well for future opportunities that require the reactivation of stacked rigs.

The return of these four floaters to the active fleet over the past several months has contributed to a meaningful improvement in our third quarter operating results, demonstrating the operational leverage inherent in our business. Adjusted EBITDA increased to $76 million from $29 million in the second quarter, and adjusted EBITDAR, which adds back one-time reactivation costs, increased to $94 million from $54 million in the second quarter.

Turning now to the market, the fundamental outlook for our industry remains highly constructive, a lack of investment in new sources of production over the past several years has contributed to a tight supply picture that has been exacerbated by geopolitical instability and an increased focus on energy security. A significant increase in investment will be required to rebuild global supplies, irrespective of near-term demand volatility. And offshore production is expected to continue to play an important role in meeting the world's need for secure and affordable energy.

We believe that these factors and the significant reduction in the rig fleet, especially floaters, over the past several years, lay the foundation for sustained industry upcycle. Despite recent downward pressure on oil prices due to fears of a global economic recession and strong US dollar, commodity prices remain at levels that are highly supportive of continued investment in offshore oil and gas projects. Two-year forward Brent crude prices are currently around $75 per barrel, and five-year forward prices are just below $70 per barrel, levels at which almost all undeveloped offshore resources are expected to be profitable.

As a result of the supportive commodity environment, CapEx for offshore project approvals in 2023 and 2024 are expected to be at the highest levels in more than a decade. And these project approvals should help drive capital expenditures for several years to come.

The constructive macro environment and increased upstream spending have led to an increase in both contracting and tendering activity across both floaters and jackups. On a trailing 12-month basis, rig years awarded for benign environment floaters are approximately 40% higher than the previous 12 months. In addition, rig years of open demand at tender or pre-tender stage, which represents the visible customer demand that is expected to formally come to market soon were approximately 40% and 25% higher than six months ago and 12 months ago, respectively.

The increase in contracting and tendering activity has seen utilization for active drillship sustained at around 90% for the past 12 months, which has led to meaningful improvements in day rates. Average day rates for drillship fixtures signed in the third quarter 2022 were approximately $400,000 per day, with some leading-edge rates in certain regions above this level, as compared to less than $200,000 per day in the fourth quarter of 2020, when active utilization was around 75%.

A meaningful portion of the recent increase in tendering activity was attributable to the recent Petrobras tender, which is expected to see seven rigs contracted for long-term work offshore Brazil commencing in 2023. Subsequently, Petrobras have launched a new RFI for up to three further ultra-deepwater rigs on the Buzios development starting in late 2023 or early 2024.

We continue to expect that Brazil will be a significant driver of floater demand over the next several years and we are well-positioned to benefit, given our presence in the country with VALARIS DS-4 and DS-15 already working offshore Brazil for Petrobras and TotalEnergies respectively and VALARIS DS-17 currently being reactivated to work on Equinor's Bacalhau project beginning in the middle of 2023.

We continue to see a mix of shorter-term exploration and longer-term development programs offshore West Africa, including in Ivory Coast and Namibia, which have both seen large commercial discoveries this year that could lead to increased rig demand for the floater market going forwards. We have a strong footprint in the region with three drillships currently operating offshore Angola, Nigeria and Mauritania, and a further three stacked drillships nearby in the Canary Islands.

We also see several opportunities in the Gulf of Mexico, both on the US and Mexican side. The US opportunities primarily require drillships, while the Mexican opportunities are well suited for our active semi-submersible in the region, VALARIS DPS-5, which was awarded a three-well contract with Eni Mexico in the third quarter at an attractive day rate.

On the jackup side of the business, we have seen a meaningful increase in activity since the start of the year, primarily driven by increased demand in the Middle East. On a trailing 12-month basis, jackup rig years awarded are more than double the previous 12 months, and rig years of open demand at tender or pre-tender stage, as of the quarter end, were approximately 20% and 45% higher than 6 months ago and 12 months ago respectively.

As a result, active utilization for jackups reached approximately 90% at the beginning of the third quarter. Day rates also continue to trend upwards, with average day rates for benign environment jackup fixtures signed in the third quarter of 2022 of nearly $100,000 per day, with several recent fixtures above $120,000 as compared to approximately $70,000 per day in the fourth quarter 2020, when active utilization was below 80%.

Recently, we were awarded jackup contracts or extensions in the Middle East, the North Sea, Latin America, Australia and New Zealand, highlighting the increase in activity we are seeing across most regions in which we operate. While the benign environment jackup market has improved meaningfully this year, the harsh environment jackup market in Norway continues to show little sign of recovery in the near term. Our harsh environment jackup fleet includes three Keppel FELS N-Class rigs capable of operating in Norway.

We already have one of these rigs operating in the UK North Sea and expect to relocate a second rig outside Norway following completion of its current contract in the fourth quarter. Our third rig operating offshore Norway is expected to end its existing contract in the first quarter of next year and prospects for follow-on work in Norway are limited. We expect some rigs working in the North Sea outside of Norway to go idle later this year as we enter the seasonally weaker winter months and rigs complete their current programs.

While utilization during the first half of 2023 may be somewhat challenging, we see an improving pipeline of activity in the UK North Sea for work commencing in the second half of the year. This coupled with an expected improvement in demand offshore Norway in 2024 leaves us hopeful for a more balanced, harsh environment jackup market in future years.

Moving now to our fleet strategy, we will continue to employ a disciplined fleet management strategy, with a focus on driving long-term shareholder value. Our first priority is to ensure that the active fleet remains highly utilized, while having a large fleet means that we can pursue a portfolio approach to contracting with a mix of longer and shorter duration contracts, ideally with staggered rollovers.

We also aim to have a critical mass of rigs in priority basins to benefit from economies of scale. For example, once we have reactivated VALARIS DS- 17 for its contract offshore Brazil, we will have three active floaters at each point of the Golden Triangle. A second priority is the reactivation of our high-quality stacked fleet. We have proven our ability to win work for and reactivate our preservation stacked assets. And we still have 11 high-quality modern assets remaining, including three uncontracted high spec drillships, VALARIS DS-7, DS-8 and DS-11. These rigs are well-suited for many of the attractive opportunities we see in the market today that we will remain disciplined in exercising our operational leverage by only returning additional stacked rigs to the active fleet for opportunities that provide meaningful returns.

Based on current day rates, reactivation economics are highly attractive. The remaining supply of modern stacked drillships, it's largely held by Valaris and two of our competitors. We anticipate that stacked rigs will only be reactivated for opportunities that provide strong returns.

In addition to our stacked fleet, we have options to take delivery of newbuild drillships VALARIS DS-13 and DS-14 by year-end 2023, for a shipyard price of approximately $119 million and $218 million, respectively. Compared to recent market transactions and broker NAVs for similar assets in the high-200s to mid-350s (sic) [mid-300s].

We will continue to evaluate our options regarding these rigs, as we see the market evolve over the next 12 months. Importantly, we believe it is unlikely that we will see another floater to newbuild cycle, given high build costs, long lead times, and limited shipyard availability. Therefore, we anticipate that the current rig fleet will form the basis of supply for the foreseeable future.

As part of our fleet strategy, we continue to actively assess our fleet for retirement and divestiture candidates. Recently, we executed a sales agreement on 40-year old jackup VALARIS 54 for $28.5 million, which is expected to close in March 2023, upon completion of its existing contract. VALARIS 54 is approaching a special survey and would have required meaningful capital investment in the near term. This value accretive sale will provide capital that can be deployed on opportunities, with more attractive return profiles. We will continue to take a disciplined approach to fleet management and capital allocation to maximize long-term shareholder value.

Another important part of the Valaris value proposition is our ARO Drilling, our unconsolidated 50/50 joint venture with Saudi Aramco. ARO is an important strategic asset for Valaris, providing a unique partnership with the largest customer for jackups in the world.

During the third quarter, we received the payment of $40 million from ARO, representing a partial early repayment of our shareholder notes receivable, with the remaining balance of $403 million after the repayment. The partial early repayment of our shareholder notes demonstrates ARO's confidence in its earnings profile, contract structure and that the newbuild rigs will be financed by third-party financing and cash from ARO operations.

ARO is actively exploring financing options for its newbuild rigs and expects financing to be secured prior to delivery of its first two newbuilds next year. As a reminder, each of the newbuilds will be backed by an initial eight-year contract with Saudi Aramco and a day rate set to achieve a six-year EBITDA payback on the total price of the rig. Following the initial contract, each newbuild will be contracted for at least eight more years in aggregate, with pricing set every three years utilizing a market pricing mechanism.

We see significant investor interest in the region for drilling businesses. Recently, a local driller with both onshore and offshore rigs successfully completed its IPO, raising more than $700 million in a substantially oversubscribed offering at an attractive valuation. We remain focused on highlighting what we believe is significant value inherent in ARO and recent asset transactions and IPOs in the region help to support this view. Further information on ARO can be found in the separate investor presentation on the Valaris website.

I will conclude by reiterating some of the key points from my prepared remarks. First, we continue to deliver strong safety and operational performance, and these efforts continue to be recognized by our customers, including by being rated as the number one offshore driller in the 2022 EnergyPoint Research Survey.

Second, despite the current macroeconomic uncertainty, the fundamental outlook for our industry remains highly constructive, as evidenced by increase in contracting and tendering activity across both floaters and jackups.

And third, we continue to take a disciplined approach to fleet management and recently executed on a value accretive sale, which positions us to redeploy capital on opportunities with more attractive return profiles.

In summary, Valaris is well positioned to capitalize on opportunities that arise during an industry upcycle. And the Valaris management team and board remain laser focused on maximizing earnings and driving meaningful free cash flow by following our strategy of being value driven, focused and responsible in our decision making.

With that, I'll hand the call over to Chris to take you through the financials.

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Christopher T. Weber

Chief Financial Officer & Senior Vice President, Valaris Ltd.

Thanks, Anton, and good morning and afternoon, everyone. I am pleased to be speaking to you all today on my first conference call as CFO of Valaris, an exciting time for our business in the offshore drilling industry as a whole. We believe that the positive outlook for commodity supply and demand and the meaningful reduction in rig capacity over the past several years, provide the backdrop for a multi-year industry upcycle.

In my prepared remarks today, I'll provide an overview of third quarter results and our outlook for the fourth quarter. In addition, I will briefly review our financial position and capital structure. I would also highlight our third quarter results press release, which includes our trailing five-quarter analysis for the income statement, balance sheet and cash flows, as well as various supplemental data in our latest Fleet Status Report that we published yesterday.

Moving now to the third quarter results, as Anton mentioned earlier, the return of four reactivated floaters to the active fleet over the past several months has contributed to a meaningful improvement in our third quarter operating results. Adjusted EBITDA was $76 million, compared to $29 million in the prior quarter and adjusted EBITDAR, adding back one-time reactivation costs, was $94 million compared to $54 million in the prior quarter.

Revenues were $437 million compared to $413 million in the prior quarter. Excluding reimbursable items, revenues increased to $415 million from $385 million, primarily due to higher utilization for floaters and higher average day rates for both the floater and jackup fleets, partially offset by a $51 million termination fee related to the termination of a contract for Valaris DS-11 recognized during the prior quarter.

Floater revenues increased primarily due to the impact of reactivated rigs returning to work as VALARIS DS-4 and DS-9 started contracts early in the third quarter, following VALARIS DS-16 and DPS-1, which commenced contracts during the second quarter.

Jackup revenues increased primarily due to more operating days for VALARIS Viking and 107, which experienced some idle time between contracts in the second quarter and higher average earned day rates for the fleet. This was partially offset by idle time between contracts for VALARIS 118 and out of service time for a special survey on VALARIS 92.

Contract drilling expense was $337 million compared to $362 million in the prior quarter. Excluding reimbursable items, contract drilling expense decreased to $316 million from $334 million in the prior quarter, primarily due to costs associated with the VALARIS DS-11 contract termination and increased cost of certain claims in the second quarter, as well as lower reactivation costs, which decreased to $18 million from $24 million in the second quarter. This was partially offset by higher rig operating costs in the third quarter related to an increase in operating days across the fleet.

Moving to our shore base costs, general and administrative expense of $19 million and onshore support costs of $30 million were both in line with the prior quarter. As a reminder, onshore support costs are included within contract drilling expense in the income statement.

Depreciation expense was also in line with the prior quarter. Other income decreased to $30 million from $149 million in the prior quarter due to gain on sale of assets of $135 million primarily related to the sale of jackups VALARIS 113, 114 and 36 in the prior quarter. This was partially offset by non-cash interest income of $15 million recognized in the third quarter for a write-off of the discount attributable to the $40 million of shareholder notes receivable repaid by ARO.

We reported a discount on the ARO shareholder notes receivable as part of fresh start accounting, which is being amortized over the life of the notes. Upon partial early repayment of the notes, we wrote off part of that discount to interest income.

Tax expense was $14 million compared to $20 million in the second quarter. The second quarter tax provision included approximately $6 million of discrete tax expense, primarily attributable to income associated with the contract termination. Adjusted for discrete items, tax expense decreased to $12 million from $14 million in the second quarter.

Moving now to our fourth quarter 2022 outlook, we expect total revenues will be in the range of $420 million to $430 million as compared to $437 million in the third quarter. Revenues are expected to decrease primarily due to lower activity in the North Sea with our harsh environment jackup fleet. We have three rigs rolling off contract in the region during the fourth quarter: the VALARIS Stavanger, which is operating in Norway and the 121 and the 247, which are both operating in the UK sector of the North Sea. While these rigs are currently being marketed for new work, we think it is unlikely they will commence a new contract before year end as we are entering the seasonally weaker winter months.

In addition, the VALARIS 123 will have more idle time in the fourth quarter before going back to work in November. Given the anticipated lack of customer activity offshore Norway through 2023, the VALARIS Stavanger will be relocated to the UK upon completion of its current contract and warm stacked in Dundee.

The lower expected activity in the North Sea should be partially offset by the VALARIS 118 starting a new contract offshore Trinidad early in the fourth quarter. VALARIS 92 returning to work after recently undergoing its special periodic survey in a full quarter of revenues for the reactivated drillships VALARIS DS-4 and DS-9.

We anticipate that contract drilling expense will be in the range of $345 million to $355 million, as compared to $337 million in the third quarter, primarily due to more operating days for the floater fleet and mobilization costs for several harsh environment jackups following contract completions.

General and administrative expense is expected to be $21 million to $23 million compared to $19 million in the prior quarter. Adjusted EBITDA is expected to be $50 million to $55 million compared to $76 million in the third quarter. And adjusted EBITDAR is expected to be $65 million to $70 million compared to $94 million in the third quarter. This implies full year 2022 adjusted EBITDA of $124 million to $129 million and adjusted EBITDAR of $243 million to $248 million.

Full year adjusted EBITDA is expected to be just below the lower end of our prior guidance range of $130 million to $150 million, primarily due to the timing of reactivation costs for the VALARIS DS-17. Reactivation costs that were previously outlooked in 2023 are being brought forward into the fourth quarter ahead of its anticipated contract start-up in the middle of next year.

Moving now to capital expenditures, third quarter CapEx was $53 million, of which $23 million was maintenance CapEx and $30 million was related to enhancements and upgrades primarily for reactivations, contract-specific upgrades on reactivated rigs and steel replacement for VALARIS 92.

Fourth quarter CapEx is expected to be approximately $52 million to $57 million, of which approximately $20 million is expected to be maintenance CapEx and the remainder is expected for enhancements and upgrades. Enhancement and upgrade are primarily related to reactivation CapEx and contract-specific upgrades for VALARIS DS-17 as well as steel replacement for VALARIS 92.

As a result, full year 2022 CapEx is anticipated to be approximately $205 million to $210 million. This is at the high end of our prior guidance range, primarily due to accelerating certain work scopes on the VALARIS DS-17 reactivation project.

Now, I'll move to the third quarter results as well as fourth quarter and full year 2022 outlook for ARO Drilling, our 50/50 joint venture with Saudi Aramco. As a reminder, ARO is not consolidated in the financial results of Valaris.

ARO EBITDA decreased to $17 million from $31 million in the second quarter, primarily due to an increase in out-of-service time related to planned maintenance on certain rigs, which resulted in lower revenues and higher contract drilling expense during the third quarter. ARO's fourth quarter EBITDA is expected to increase to approximately $24 million to $26 million from $17 million in the third quarter, primarily due to higher revenues resulting from those rigs returning to work and a full quarter revenues for VALARIS 141 following its contract start-up in August. ARO's full year 2022 EBITDA is expected to be approximately $94 million to $96 million.

Finally, I'll provide a brief overview of our financial position and recent steps we've taken to increase the options available to us with regard to capital allocation decisions. As of quarter end, we had cash and cash equivalents of $406 million, plus $18 million of restricted cash and a further $220 million of short-term investments. As a result, we have total liquidity of $644 million, representing an increase of $67 million during the quarter. This was driven by lower working capital and the $40 million receipt from ARO as a partial early repayment of our shareholder notes receivable.

I do want to note that in October we received a $55 million refund payment from the IRS related to the CARES Act. We still have a further $64 million outstanding. However, the timing of this receipt is uncertain.

As Anton mentioned earlier, we recently executed a sales agreement for the 40-year old jackup VALARIS 54 for $28.5 million, which is expected to close in March 2023 upon completion of its existing contract. VALARIS 54 would have required meaningful capital investment in the near term [ph] that are (00:29:46) approaching a significant special survey. This value accretive sale will provide capital that can be deployed in opportunities with more attractive return profiles.

During the third quarter, we completed a consent solicitation on our senior notes, which added a standard net income builder basket for restricted payments and increased the size of our general restricted payments and investment baskets. These changes provide customary and greater flexibility over time and better position us to take advantage of strategic or other opportunities, should they arrive.

We also authorized a $100 million share repurchase program during the quarter, which allows us the flexibility to opportunistically return capital to shareholders. These two actions provide us with enhanced capital allocation and strategic flexibility, and we believe they are valuable tools at our disposal to create shareholder value.

In closing, we remain focused on executing our key priorities of first, winning additional backlog for the active fleet; and second, reactivating our high quality stack rigs for opportunities that provide meaningful returns versus their reactivation costs.

We also look to act opportunistically to create shareholder value through M&A, additional asset transactions or other potential investments. And we will maintain our focus on having an industry-leading cost structure and a strong balance sheet. By executing on these priorities, we'll maximize earnings and drive meaningful free cash flow over time, as we employ a disciplined approach to capital allocation.

We now reached the end of our prepared remarks. Operator, please open the line for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question-and-answer session [Operator Instructions] And our first question will come from Greg Lewis with BTIG. Please go ahead.

Gregory Lewis
Analyst, BTIG LLC

Q

Yeah. Hey, thank you and good morning, good afternoon, everybody. I guess the first question, more of market question, clearly, US Gulf of Mexico got day rates going higher earlier this year, you've seen a pick-up now in the overall pace and that it seems like market rates are moving high pretty much everywhere, really, other than the North Sea. As we think about that and see that continue to unfold, realizing budget seasons are being set, as we look out into 2023 and beyond, it seems like customers have been – contract drilling customers seem to be willing to pay up more for short-term contracts than kind of [ph] extend (00:32:53) taking a rig for longer term or just given the fact that rates continue to go up on a, I don't know, weekly, monthly basis, are we starting to see customers coming into the market looking to get longer rates than maybe they have been recently?

Anton Dibowitz
President, Chief Executive Officer & Director, Valaris Ltd.

A

Yeah. Hi, Greg. Yeah, I can take that. Look, I think it's a fair observation. I think a couple of observations about what we're seeing on contract durations and day rates. And the first thing is to remember, as I said in my prepared remarks that contract leading-edge day rates for ships have almost doubled or have doubled over the last two years from 2020 to 2022 from around $200,000 to $400,000 a day.

As we went through the beginning of the last down cycle, there were a lot of our customers who were "very long rigs", I'll call it that way. And there was a significant amount of money that was spent on terminations. I think there is a general reluctance from customers to contract for longer than they know they need a rig for the program that they have in place.

So, shorter exploration programs, although those have stretched out a little bit as supply – available supply of rigs has diminished, kind of pushing towards a year and development programs in that kind of one to three year. And I think we're going to see that for a period going forward.

That being said, even if we look at reactivation economics, as we did on the DS-17, being able to get an 18-month or 2-year contract, the day rates are – that are in the high 300s, low 400s makes for an attractive program. But while there is some available stacked capacity that can still be brought to market at those rates and some stranded assets at the yard, I think, that's going to be a feature of the market for a period going forward, but not a market that we can't make good business at.

Operator: Our next question will come from Fredrik Stene with Clarksons Platou Securities. Please go ahead.

Fredrik Stene
Analyst, Clarksons Securities AS

Q

Hey, guys. Hope you're well and nice to see the stacked capacity coming online and in boosting that performance. So, I have a few questions, but I'll try to be short. I think in terms of the supply side there, I think I agree with you that for now it doesn't really seem like there will be a newbuild cycle here. And with some of the, call it, easy reactivations out of the way both from you and some of your peers, we've seen that the threshold for that cold stacked or smart stacked capacity to come back, if that discipline is being reflected into bid – day rates.

And I think I've seen the DS-7 and the DS-8 show up in some of the Brazil tenders here and the rates that you've put forth there seems to be around $500,000 over three and four years. So, do you think that's where it needs to be for this to come out or are you looking at other opportunities for that capacity elsewhere outside of Brazil as well?

Anton Dibowitz
President, Chief Executive Officer & Director, Valaris Ltd.

A

Perfect. Some good observations and obviously not going to get into the specifics of our commercial strategy and where we're heading. But what I will say is that there are attractive economics to bring rigs out. I think we're looking at it all-in day rates. Some of the numbers that you're referring to includes, as we've done on previous reactivations, where we're getting the customer to contribute partly to our reactivation, which was not a feature of the markets 9, 12 months ago. And those get added into the day rates. There are attractive opportunities where the market is right now for us to reactivate assets.

But, as we've said all along, we see the demand picking up growth year-over-year and projected kind of 7%, 8% compound annual growth in demand for deepwater offshore floaters. If you look at the Rystad numbers over the next few years and we're going to be disciplined in finding the right opportunities to bring our remaining stacked capacity.

Now, there are many factors that go into that. Obviously, day rate is an important part of it. But it's also what location are we putting the rig into, is there an expectation of follow-on work in that basin. We've been very focused on concentrating our rigs in the Golden Triangle so that we can get efficiency and benefit of scale in there. What is – who is the customer? What are the other contract terms beyond just the headline day rate and the go-forward program that we can get from there? So, yes, I think the day rates are attractive and we see opportunities for 7, 8 and 11 and not bidding them in a number of programs, but we'll be patient and disciplined in putting them back to work in the right basin, with the right customers and in the right market.

Fredrik Stene
Analyst, Clarksons Securities AS

Q

Yeah. Thank you. Very helpful. And just a follow-up on that for, I guess, the way I see it, in the Golden Triangle, I'm really worried about it being enough supply with what's currently warm. But there's also when you compare the backlog now versus where we were 2012, 2013, 2014, the forward coverage is still kind of lackluster. There's still overall a lack of term on average versus where we were in the previous cycle. And I guess that's also something you would consider when bringing things back that you don't end up probably cannibalizing your current warm fleet when you do that?

Anton Dibowitz
President, Chief Executive Officer & Director, Valaris Ltd.

A

Absolutely. I think you have it precisely right. I think both Chris and I mentioned, our first priority is to keep our active fleet highly utilized and to bring out our stack fleet back for the right opportunities. And the kind of your question and Greg's question before, there are – there is not, as we've seen in previous cycles, we haven't gotten to that point in the cycle at least yet, where there is long-term multi-year, four, five-year contract backlog coverage on the floater fleet in general, which means we need to be very thoughtful about how we manage our fleet profile and how we manage our business. But given the right opportunities, given that, an initial program, including a reactivation provides meaningful returns. We do see place an incremental demand coming through for us to do additional reactivations. But, yes, we have to manage the business, the business where we are in the cycle, it needs to be managed carefully.

Fredrik Stene
Analyst, Clarksons Securities AS

Q

Perfect. And then just two super quick ones. Short-term investments, can you comment on exactly what that is? Or if you said it, I didn't catch it. And second, the rig sale of the VALARIS 54. What – would you consider that an arm's length sale because the price points for a 40-year old rig is, in my view, fantastic? So, I just need to make sure that I understand it or see it correctly? Thanks.

Christopher T. Weber
Chief Financial Officer & Senior Vice President, Valaris Ltd.

A

Yeah. Hey, Fredrik, this is Chris. On short-term investments, that was just a time deposit that went over 90 days. So, just trying to get a little extra yield on the cash. So nothing more than that.

Anton Dibowitz
President, Chief Executive Officer & Director, Valaris Ltd.

A

Yeah, and on the rig sale, absolutely an arm's length transaction. I mean, for us, we operate a high spec fleet. Most of our fleet is in the top quartile, in the top half, and that's what we do well and serve those customers, 54 is a 40-year old asset, needs significant capital and we have more opportune places to invest that capital. But for somebody else who wants to operate in a different market, that may make sense for him. So, absolutely an arm's length transaction, I think, just speaks to how the jackup market has strengthened, broad based, over the last six, nine months.

Fredrik Stene
Analyst, Clarksons Securities AS

Q

Perfect. Thank you so much. I'll...

Anton Dibowitz
President, Chief Executive Officer & Director, Valaris Ltd.

A

Thank you.

Operator: Our next question will come from David Smith with Pickering Energy Partners. Please go ahead.

Dave Smith
Vice President, Pickering Energy Partners LP

Q

Thanks. Good morning. Good afternoon and thank you for taking my question.

Anton Dibowitz
President, Chief Executive Officer & Director, Valaris Ltd.

A

[ph] Good morning (00:41:48), David.

Dave Smith
Vice President, Pickering Energy Partners LP

Q

Thanks. I wanted to circle back to the Norwegian jackup market. You mentioned moving the Stavanger to UK, I think to put it up in Dundee I think. Is that in anticipation of a potential UK work? Is that mostly to lower the warm stack costs?

Anton Dibowitz
President, Chief Executive Officer & Director, Valaris Ltd.

A

Yeah. So, [ph] well, I'll say (00:42:07) about Norway, and I think we've tried to be quite upfront and clear about the Norway market. This is a market that historically has carried at some points in time, up to close to 15 rigs operating at its height and is down almost a third.

Relocating the rig, we have already relocated one of the N-Class onto a contract in the UK. We don't see the opportunities and the near-term demand in Norway. Generally, Norway is featured by having very long lead times in their contracting process. So, you can see 9, 12 months out what the demand is going to be. And we just don't see the demand from the operators in the North Sea. I'm not going to get into the commercials of what we're looking at for all those rigs, but there are opportunities.

The great thing – I mean, these assets are mobile. They can operate in the UK or in the remainder of the North Sea just as easily as they can operate in Norway. And if we don't see the future demand in Norway and we don't see it, then we will look for opportunities elsewhere and wait for the Norway market to be better and stronger. And obviously they will remain capable of operating Norway. They have the suits and we will bring them back to the Norwegian market when there's a better market there.

Dave Smith
Vice President, Pickering Energy Partners LP

Q

It's perfectly clear. Wondering – I guess the two quick follow-ups to that, could you talk about potential opportunities to deploy N-Class jackups outside of the North Sea? And then related, how should we think about idle costs for these jackups? And I hate to ask them, maybe what you might need to see before you would consider preservation stack in one.

Anton Dibowitz
President, Chief Executive Officer & Director, Valaris Ltd.

A

Absolutely. the N-Class as opposed to some of the bigger Norway jackups is it can work outside the North Sea. Obviously we'd like to keep it – it's better utilized in harsh environment. The rigs were built for harsh environments. So, we're going to find attractive opportunities in the North Sea and not take it too far afield. But absolutely, if it makes sense for the right contract, we will absolutely move it outside the North Sea if there's an attractive opportunity there.

As far as the stacking costs, I wouldn't put the stacking cost of a jackup, they're relatively small. And I wouldn't put the stacking cost of an N-Class much different from a -any other jackup kind of in that $3,000 to $5,000 a day range.

Dave Smith
Vice President, Pickering Energy Partners LP

Q

Very helpful. Thank you. If I could sneak one more in, Anton, I don't want to read too much into your introductory comments, but I did want to revisit your remark about the unlikelihood. I think you said specifically seeing another floater newbuild cycle. So, I wanted to ask outside of ARO, would you make the same comment about jackups?

Anton Dibowitz
President, Chief Executive Officer & Director, Valaris Ltd.
A

For the medium term, absolutely, yes. I think that there is a difference between building jackups and building floaters. There's a lower investment cost. There are a lot more yards that could potentially build jackups if the market gets very high and stays that way for a significant period of time. Look, I think we're a long way away from that today. But if you ask me as a comparison between the two, the chances of a newbuild cycle in jackups versus in floaters, I think there is a relative difference, but I do think we're quite a ways away from that.

Dave Smith
Vice President, Pickering Energy Partners LP
Q

Great. Thank you very much. I'll circle back.

Anton Dibowitz
President, Chief Executive Officer & Director, Valaris Ltd.
A

Sure.

Operator: [Operator Instructions] Our next question will come from Samantha Hoh with Evercore ISI. Please go ahead.

Samantha Kay Hoh
Analyst, Evercore Group LLC
Q

Hey, guys, congrats on the nice quarter. Anton, I thought it was interesting that you kicked off your prepared remarks about – talking about your new training facility, and pretty impressive that you graduated 18 new candidates every two weeks. I was just wondering if you could talk about where you're finding these, I guess, new employees or how are you – and what are you thinking in terms of the pace at which you need to keep adding new graduates? Is this – I mean, are you putting them out to work in like your fleet worldwide? Like, how is this? Oh, and then the other thing, is this being expense or is this capitalized?

Anton Dibowitz
President, Chief Executive Officer & Director, Valaris Ltd.
A

Okay. Hi, Samantha.

Samantha Kay Hoh
Analyst, Evercore Group LLC
Q

Hi.

Anton Dibowitz
President, Chief Executive Officer & Director, Valaris Ltd.
A

Yeah. No problem. No, look, obviously, as the fleet, as the whole business activity levels increase, there is increasing competition for people and attracting people. Now, the facility we're talking about in the Gulf of Mexico is really for entry-level people coming in kind of floor hands kind of at the bottom level as we're training them up. And we've lost a lot of people from the industry through the down cycle. And some of those folks aren't coming back. So, for us, it's about bringing new entry-level people who maybe never worked offshore, before and getting them used to what the offshore working environment is. And it's one thing to learn it in a training facility on land and then go out offshore and have to deal with that environment.

And we just thought this was a great way to actually have people live on a rig for a couple of weeks while they're doing training, be able to see what a rig floor looks like to be able to practice lifting operations with real cranes and really get into the environment partly so they could see whether they liked the environment and they – it wasn't a surprise to them and they felt comfortable on the rig when they got out there. And we've had great response from the folks who are doing that.

So, for us, we went through this period of reactivating four floaters, which was a huge lift for the organization. And we will continue to reactivate rigs, but that will be a kind of a more measured pace, that we'll have four going on simultaneously. But let's see. But this is really about building out pipeline and having the people working on our rigs understand our culture, understand our safe systems of work and be safe and successful when they get out on to a working facility, yeah.

Christopher T. Weber
Chief Financial Officer & Senior Vice President, Valaris Ltd.

A

And this is Chris. It is expense. But I mean, when we look at this, as Anton mentioned, this is about a pipeline and with turnover, you're always needing to bring crews in, especially with these junior-level positions. So, we think it's a really cost effective solution to manage that.

Anton Dibowitz
President, Chief Executive Officer & Director, Valaris Ltd.

A

To be clear, these are people who are we know are going off to a working asset, so they're hired, we would be doing the training. This is part of normal business. This isn't an incremental amount that we're adding to the cost base. This is about where and how we do our training for our people [indiscernible] (00:49:12).

Christopher T. Weber
Chief Financial Officer & Senior Vice President, Valaris Ltd.

A

And also trying to – if it's not the right fit for someone, we want to know sooner rather than later.

Samantha Kay Hoh
Analyst, Evercore Group LLC

Q

Okay. Thank you. I think if I could squeeze one more. It was interesting to see what you guys bid for the, I think, DS-8 and DS-9 into the Petrobras 3 lot tender. It's probably assumed that there is the reactivation costs in there, maybe some upgrades and then also all kind of rolled up into that bid. And then I also thought it was kind of interesting that [ph] BP (00:49:51) noted this morning that they plan on adding two more deepwater rigs in the Gulf of Mexico. But I'm just kind of wondering, with all your cold stacked floaters in the Canary Islands, how are you thinking about balancing where you add that incremental reactivation, like between the Golden Triangle? How should we think about that difference between what you need on the day rates side versus what it costs incrementally working in each of those three basins? And like where you would really like to add more scale on your floater operations geographically?

Anton Dibowitz
President, Chief Executive Officer & Director, Valaris Ltd.

A

Well, right now, we have three rigs at each points of the Golden Triangle, and we have three high spec stacked drillships, so in a perfect world, put one in each corner. But look, we will see where the most attractive opportunities are and deploy them to those. There are quite different requirements in each of the markets. Brazil and Petrobras in particular have very specific requirements about how they like their rigs set up, as do most operators, but Brazil, in particular, Petrobras, certain equipment being set up a certain way. So, there is an upgrade and CapEx components to those rates.

One of the features of that contract structure is also that for each bid that comes out, they limit the upfront, you can call that mobilization and upfront payments to a number of days, times the day rate that you bid normally in order of about 70 days. So, your day rate needs to reflect, if there is an amount that you can't recover under that upfront payment. So, it's a kind of a function of how that market operates versus others.

But, to your question, I think there are opportunities at all corners of the Golden Triangle. There's incremental work coming in in Africa, West Africa, North Africa that are attractive opportunities for our cold stacked assets. We obviously talked about the incremental demand, we've just had the seven rig tender, the Buzios tenders out. There's still a couple of rigs that need to be secured for [ph] BMS-11 (00:52:11), which haven't been secured yet.

And I think when you look at the day rates that were bid into that Petrobras tender, without getting into specifics, you saw a clear delineation between folks who already had a rig in market and were wanting to make sure that they continued to be operating there versus the folks who were bringing rigs from outside the market into the market and seeking compensation for the upgrades, the CapEx and the mobilization that would be required to bring a rig into the market.

Christopher T. Weber
Chief Financial Officer & Senior Vice President, Valaris Ltd.

A

I think as Anton – I'm sorry, the nice thing is we already have three rigs in each of the three basins. And so, we've already got a scale position there. So, it gives us flexibility.

Operator: This concludes our question-and-answer session. I would like to turn the conference back over to Darin Gibbins for any closing remarks.

Darin Gibbins
Vice President-Investor Relations & Treasurer, Valaris Ltd.

Thanks, Matt. And thank you to everyone on the call for your interest in Valaris. We look forward to speaking with you again when we report our fourth quarter 2022 results. Have a great rest of your day.

Operator: The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.