HERCULES OFFSHORE, INC.
Form 10-K
February 28, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT of 1934

For the fiscal year ended December 31, 2006

Commission file number: 0-51582

Hercules Offshore, Inc.

(***Exact name of registrant as specified in its charter***)

Delaware	**56-2542838**
(***State or other jurisdiction of incorporation or organization***)	(***I.R.S. Employer Identification No.***)
11 Greenway Plaza, Suite 2950	
Houston, Texas	**77046**
(***Address of principal executive offices***)	(***Zip Code***)

Registrant s telephone number, including area code:

(713) 979-9300

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	**Name of Exchange on Which Registered**
Common Stock, $0.01 par value per share	**NASDAQ Global Select Market**
Rights to Purchase Preferred Stock	**NASDAQ Global Select Market**

Securities registered pursuant to Section 12(g) of the Act: None

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes þ No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 of the Act. Yes ¨ No þ

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ Accelerated filer ¨ Non-accelerated filer ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No þ

The aggregate market value of the registrant s common stock held by non-affiliates as of June 30, 2006, based on the closing price on the Nasdaq Global Select Market on such date, was approximately $720.0 million. (As of such date, the registrant s directors and executive officers, LR Hercules Holdings, LP and its affiliates and Greenhill & Co., Inc. and its affiliates were considered affiliates of the registrant for this purpose.)

As of February 23, 2007, there were 32,242,668 shares of the registrant s common stock, par value $0.01 per share, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s definitive proxy statement for the Annual Meeting of Stockholders to be held in April 2007 are incorporated by reference into Part III of this report.

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PART I

Item 1. ***Business***

In this Annual Report on Form 10-K, we refer to Hercules Offshore, Inc. and its subsidiaries as we, the Company or Hercules Offshore, unless the context clearly indicates otherwise. Hercules Offshore, Inc. is a Delaware corporation formed in July 2004, with its principal executive offices located at 11 Greenway Plaza, Suite 2950, Houston, Texas 77046. Hercules telephone number at such address is (713) 979-9300.

Overview

We provide shallow-water drilling and liftboat services to the oil and natural gas exploration and production industry in the U.S. Gulf of Mexico and internationally. We currently operate a fleet of nine jackup rigs that are capable of drilling in maximum water depths ranging from 85 to 250 feet and a fleet of 64 liftboats with leg lengths ranging from 105 to 260 feet. We provide these services to major integrated energy companies and independent oil and natural gas operators.

Our services are reported in four segments, Domestic Contract Drilling Services, International Contract Drilling Services, Domestic Marine Services and International Marine Services. Our Domestic Contract Drilling Services and Domestic Marine Services are conducted in the U.S. Gulf of Mexico, our International Contract Drilling Services are conducted offshore Qatar and India, and our International Marine Services are conducted in West Africa.

Our Fleet

Jackup Rigs

As of February 5, 2007, eight of our jackup rigs were operating under contracts ranging in duration from well-to-well to two years, at an average contract dayrate of approximately $93,757. The following table contains information regarding our jackup rig fleet as of February 5, 2007:

Rig Name	Type	Year Built	Maximum/Minimum Water Depth Rating (feet)	Rated Drilling Depth (feet) (1)	Location	Status
11	Mat-supported, cantilever	1980	200/21	20,000(2)	U.S. Gulf of Mexico	Contracted
15	Independent leg, slot	1982	85/9	20,000	U.S. Gulf of Mexico	Contracted
16	Independent leg, cantilever	1981	170/16	16,000	Middle East	Contracted
20	Mat-supported, cantilever	1980	100/20	25,000	U.S. Gulf of Mexico	Contracted
21	Mat-supported, cantilever	1980	120/22	20,000	U.S. Gulf of Mexico	Contracted
22	Mat-supported, cantilever	1971	173/22	15,000	U.S. Gulf of Mexico	Contracted
26	Independent leg, cantilever	1979	250/12	20,000	U.S. Gulf of Mexico	Shipyard
30	Mat-supported, slot	1979	250/25	20,000	U.S. Gulf of Mexico	Contracted
31	Mat-supported, slot	1979	250/25	20,000	Asia	Contracted

(1) Rated drilling depth means drilling depth stated by the manufacturer of the rig. Depending on deck space and other factors, a rig may not have the actual capacity to drill at the rated drilling depth.

(2) Rated workover depth. *Rig 11* is currently configured for workover activity, which includes maintenance and repair or modification of wells that have already been drilled and completed to enhance or resume the well s production.

Jackup rigs are mobile, self-elevating drilling platforms equipped with legs that can be lowered to the ocean floor until a foundation is established to support the drilling platform. Once a foundation is established, the drilling platform is jacked further up the legs so that the platform is above the highest expected waves. The rig

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hull includes the drilling rig, jackup system, crew quarters, loading and unloading facilities, storage areas for bulk and liquid materials, helicopter landing deck and other related equipment.

Jackup rig legs may operate independently or have a lower hull referred to as a mat attached to the lower portion of the legs in order to provide a more stable foundation in soft bottom areas, similar to those encountered in certain of the shallow-water areas of the U.S. Gulf of Mexico. Mat rigs generally are able to more quickly position themselves on the worksite and more easily move on and off location than independent leg rigs.

Our rigs are used primarily for exploration and development drilling in shallow waters. Six of our jackup rigs are mat-supported. Six have a cantilever design that permits the drilling platform to be extended out from the hull to perform drilling or workover operations over some types of preexisting platforms or structures. Three have a slot-type design, which requires drilling operations to take place through a slot in the hull. Slot-type rigs are usually used for exploratory drilling rather than development drilling, in that their configuration makes them difficult to position over existing platforms or structures. Historically, jackup rigs with a cantilever design have maintained higher levels of utilization than rigs with a slot-type design. However, one of our slot-type rigs has a competitive advantage in very shallow water as it is one of the few jackup rigs in the world that can drill in water depths as shallow as nine feet.

Liftboats

As of February 5, 2007, we owned 47 liftboats operating in the U.S. Gulf of Mexico and 12 liftboats operating in West Africa. In addition, we operated five liftboats in West Africa. The following table contains information regarding our liftboats as of February 5, 2007:

Liftboat Name(1)	Year Built	Leg Length (feet)	Deck Area (square feet)	Maximum Deck Load (pounds)	Location	Gross Tonnage
Whale Shark	2005	260	8,170	729,000	U.S. Gulf of Mexico	99
Tigershark	2001	230	5,300	1,000,000	U.S. Gulf of Mexico	469
Kingfish	1996	229	5,000	500,000	U.S. Gulf of Mexico	188
Man-O-War	1996	229	5,000	500,000	U.S. Gulf of Mexico	188
Wahoo	1981	215	4,525	500,000	U.S. Gulf of Mexico	491
Blue Shark	1982	215	3,800	400,000	Cameroon	484
Amberjack	1981	205	3,800	500,000	U.S. Gulf of Mexico	417
Bullshark	1998	200	7,000	1,000,000	U.S. Gulf of Mexico	859
Creole Fish	2001	200	5,000	798,000	U.S. Gulf of Mexico	192
Cutlassfish	2006	200	5,000	798,000	U.S. Gulf of Mexico	183
Swordfish	2000	190	4,000	700,000	U.S. Gulf of Mexico	189
Mako	2003	175	5,074	654,000	U.S. Gulf of Mexico	168
Leatherjack	1998	175	3,215	575,850	U.S. Gulf of Mexico	168
Oilfish	1996	170	3,200	590,000	Nigeria	194
Manta Ray	1981	150	2,400	200,000	U.S. Gulf of Mexico	194
Seabass	1983	150	2,600	200,000	U.S. Gulf of Mexico	186
F.J. Leleux	1982	150	2,600	200,000	Nigeria	407
Black Marlin	1983	150	2,600	200,000	Nigeria	407
Hammerhead	1980	145	1,648	150,000	U.S. Gulf of Mexico	178
Pilotfish	1990	145	2,400	175,000	Nigeria	190
Rudderfish	1991	145	3,000	200,000	Nigeria	183
Blue Runner	1980	140	3,400	300,000	U.S. Gulf of Mexico	174
Starfish	1978	140	2,266	150,000	U.S. Gulf of Mexico	99
Rainbow Runner	1981	140	3,400	300,000	U.S. Gulf of Mexico	174
Pompano	1981	130	1,864	100,000	U.S. Gulf of Mexico	196
Sandshark	1982	130	1,940	150,000	U.S. Gulf of Mexico	196
Stingray	1979	130	2,266	150,000	U.S. Gulf of Mexico	99

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Liftboat Name(1)	Year Built	Leg Length (feet)	Deck Area (square feet)	Maximum Deck Load (pounds)	Location	Gross Tonnage
Albacore	1985	130	1,764	150,000	U.S. Gulf of Mexico	171
Moray	1980	130	1,824	130,000	U.S. Gulf of Mexico	178
Skipfish	1985	130	1,116	110,000	U.S. Gulf of Mexico	91
Sailfish	1982	130	1,764	137,500	U.S. Gulf of Mexico	179
Mahi Mahi	1980	130	1,710	142,000	U.S. Gulf of Mexico	99
Triggerfish	2001	130	2,400	150,000	U.S. Gulf of Mexico	195
Scamp	1984	130	2,400	150,000	Nigeria	195
Rockfish	1981	125	1,728	150,000	U.S. Gulf of Mexico	192
Gar	1978	120	2,100	150,000	U.S. Gulf of Mexico	98
Grouper	1979	120	2,100	150,000	U.S. Gulf of Mexico	97
Sea Robin	1984	120	1,507	110,000	U.S. Gulf of Mexico	98
Tilapia	1976	120	1,280	110,000	U.S. Gulf of Mexico	97
Charlie Cobb	1980	120	2,000	100,000	Nigeria	210
Durwood Speed	1980	120	2,000	100,000	Nigeria	210
James Choat	1980	120	2,000	100,000	Nigeria	210
Solefish	1978	120	2,000	100,000	Nigeria	229
Tigerfish	1980	120	2,000	100,000	Nigeria	210
Zoal Albrecht	1982	120	2,000	100,000	Nigeria	213
Barracuda	1979	105	1,648	110,000	U.S. Gulf of Mexico	93
Carp	1978	105	1,648	110,000	U.S. Gulf of Mexico	98
Cobia	1978	105	1,648	110,000	U.S. Gulf of Mexico	94
Dolphin	1980	105	1,648	110,000	U.S. Gulf of Mexico	97
Herring	1979	105	1,648	110,000	U.S. Gulf of Mexico	97
Marlin	1979	105	1,648	110,000	U.S. Gulf of Mexico	97
Corina	1974	105	953	100,000	U.S. Gulf of Mexico	98
Pike	1980	105	1,360	130,000	U.S. Gulf of Mexico	92
Remora	1976	105	1,179	100,000	U.S. Gulf of Mexico	94
Wolffish	1977	105	1,044	100,000	U.S. Gulf of Mexico	99
Seabream	1980	105	1,140	100,000	U.S. Gulf of Mexico	92
Sea Trout	1978	105	1,500	100,000	U.S. Gulf of Mexico	97
Tarpon	1979	105	1,648	110,000	U.S. Gulf of Mexico	97
Palometa	1972	105	780	100,000	U.S. Gulf of Mexico	99
Jackfish	1978	105	1,648	110,000	U.S Gulf of Mexico	99
Bonefish	1977	105	1,344	90,000	Nigeria	97
Croaker	1977	105	1,344	72,000	Nigeria	82
Gemfish	1978	105	2,000	100,000	Ghana	223
Tapertail	1980	105	1,392	100,000	Nigeria	100

(1) The *Pike* is currently stacked. We have commenced the reactivation of this liftboat and expect it to be available by the first quarter of 2007. All other liftboats are either available or operating.

Our liftboats are self-propelled, self-elevating vessels with a large open deck space, which provides a versatile, mobile and stable platform to support a broad range of offshore maintenance and construction services throughout the life of an oil or natural gas well. Once a liftboat is in position, typically adjacent to an offshore production platform or well, third-party service providers perform:

production platform construction, inspection, maintenance and removal;

well intervention and workover;

well plug and abandonment; and

pipeline installation and maintenance.

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Unlike larger and more costly alternatives, such as jackup rigs or construction barges, our liftboats are self-propelled and can quickly reposition at a worksite or move to another location without third-party assistance. Our liftboats are ideal working platforms to support platform and pipeline inspection and maintenance tasks because of their ability to maneuver efficiently and support multiple activities at different working heights. Diving operations may also be performed from our liftboats in connection with underwater inspections and repair. In addition, our liftboats provide an effective platform from which to perform well-servicing activities such as mechanical wireline, electrical wireline and coiled tubing operations. Technological advances, such as coiled tubing, allow more well-servicing procedures to be conducted from liftboats. Moreover, during both platform construction and removal, smaller platform components can be installed and removed more efficiently and at a lower cost using a liftboat crane and liftboat-based personnel than with a specialized construction barge or jackup rig.

The length of the legs is the principal measure of capability for a liftboat, as it determines the maximum water depth in which the liftboat can operate. The U.S. Coast Guard restricts the operation of liftboats to water depths less than 180 feet, so boats with longer leg lengths are useful primarily on taller platforms. Ten of our liftboats in the U.S. Gulf of Mexico have leg lengths of 190 feet or greater, which allows us to service approximately 83% of the 3,800 existing production platforms in the U.S. Gulf of Mexico. Liftboats are typically moved to a port during severe weather to avoid the winds and waves they would be exposed to in open water.

Competition

The shallow-water business is highly competitive. Drilling and liftboat contracts are traditionally short term in nature and are awarded on a competitive bid basis. Pricing is often the primary factor in determining which qualified contractor is awarded a job, although technical capability of service and equipment, unit availability, unit location, safety record and crew quality may also be considered. Many of our competitors in the shallow-water business have greater financial and other resources than we have and may be better able to make technological improvements to existing equipment or replace equipment that becomes obsolete.

Customers

Our customers primarily include major integrated energy companies and independent oil and natural gas operators. Chevron Corporation accounted for 35% of our consolidated revenues for the year ended December 31, 2006. Chevron and Bois d Arc Energy accounted for 31% and 12%, respectively, of our consolidated revenues for the year ended December 31, 2005 and 31% and 15%, respectively, of our consolidated revenues for the period from inception (July 27, 2004) to December 31, 2004, which we refer to as the period from inception to December 31, 2004 . No other customer accounted for more than 10% of our consolidated revenues in any period.

Contracts

Our contracts to provide services are individually negotiated and vary in their terms and provisions. We obtain most of our contracts through competitive bidding against other contractors. In general, dayrate drilling contracts provide for payment on a dayrate basis, with higher rates while the unit is operating and lower rates for periods of mobilization or when operations are interrupted or restricted by equipment breakdowns, adverse weather conditions or other factors.

A dayrate drilling contract generally extends over a period of time covering the drilling of a single well or group of wells or covering a stated term. These contracts typically can be terminated by the customer under various circumstances such as the loss or destruction of the drilling unit or the suspension of drilling operations for a specified period of time as a result of a breakdown of major equipment. In addition, customers generally have the right to terminate our contracts with little or no prior notice, and without penalty. The contract term in some instances may be extended by the customers exercising options for the drilling of additional wells or for an

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additional term, or by exercising a right of first refusal. To date, most of our contracts in the U.S. Gulf of Mexico have been on a short-term basis of less than one year. Our contracts in international locations have been longer-term, with contract terms of up to two years.

A liftboat contract generally is based on a flat dayrate for the vessel and crew. Our liftboat dayrates are determined by prevailing market rates, vessel availability and historical rates paid by the specific customer. Under most of our liftboat contracts, we receive a variable rate for reimbursement of costs such as catering, fuel, oil, rental equipment, crane overtime and other items. Liftboat contracts in the U.S. Gulf of Mexico generally are for shorter terms than are drilling contracts. Some of our liftboat contracts in West Africa have initial contract terms of one year, whereas others are for shorter terms similar to the U.S. Gulf of Mexico contracts.

On larger contracts, particularly outside the United States, we may be required to arrange for the issuance of a variety of bank guarantees, performance bonds or letters of credit. The issuance of such guarantees may be a condition of the bidding process imposed by our customers for work outside the United States. The customer would have the right to call on the guarantee, bond or letter of credit in the event we default in the performance of the services. The guarantees, bonds and letters of credit would typically expire after we complete the services.

In certain countries, we also may be required to post bonds or letters of credit in order to temporarily import equipment, including our drilling rigs and liftboats, into the country. These temporary importation bonds would secure the amount of the import duty that is payable if the equipment fails to leave the country within the time frame permitted by the local jurisdiction for the temporary importation of equipment. When the equipment is exported out of the local jurisdiction, the bond or letter of credit generally would be returned to us. Currently, we have arranged for a bank in Nigeria to issue a letter of credit valued at approximately $430,000, at December 31, 2006, with respect to our liftboats in that country, and we have executed a counter-indemnity agreement with the Nigerian bank for any liability incurred by the bank under that letter of credit.

Employees

As of December 31, 2006, we had approximately 920 employees. We require skilled personnel to operate and provide technical services and support for our rigs and liftboats. As a result, we conduct extensive personnel recruiting, training and safety programs. As of December 31, 2006, certain of our employees in West Africa were working under collective bargaining agreements. Additionally, efforts have been made from time to time to unionize portions of the offshore workforce in the U.S. Gulf of Mexico. We believe that our employee relations are good.

Insurance

We maintain insurance coverage that includes coverage for physical damage, third-party liability, maritime employers liability, general liability, vessel pollution and other coverages. Our primary marine package provides for hull and machinery coverage for our rigs and liftboats up to a scheduled value for each asset. The maximum coverage for these assets is $580.0 million; however, coverage for U.S. Gulf of Mexico named windstorm damage is subject to an annual aggregate limit on liability of $75.0 million. The policies are subject to deductibles and other conditions. Deductibles for events that are not U.S. Gulf of Mexico named windstorm events are $1.5 million per occurrence for drilling rigs, and range from $250,000 to $1.0 million per occurrence for liftboats, depending on the insured value of the particular vessel. The deductibles for drilling rigs in a U.S. Gulf of Mexico named windstorm event are $1.5 million per rig for each occurrence plus an additional $5.0 million for each U.S. Gulf of Mexico named windstorm. The protection and indemnity coverage under the primary marine package has a $5.0 million limit per occurrence with excess liability coverage up to $100.0 million. The primary marine package also provides coverage for cargo and charterer s legal liability. Vessel pollution is covered under a Water Quality Insurance Syndicate policy. In addition to the marine package, we have separate policies providing coverage for general domestic liability, employer s liability, domestic auto liability and non-owned aircraft liability, with customary deductibles and coverage. Insurance premiums and fees

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for coverage of our operations, assets and personnel base (as the same existed at June 30, 2006) are expected to be approximately $2