



THINK SAFETY

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DIAMOND OFFSHORE



DIAMOND  
OFFSHORE

ANNUAL REPORT 2000



## ABOUT THE COMPANY

*Diamond Offshore Drilling, Inc. owns and operates one of the world's largest fleets of offshore drilling rigs—consisting of 30 semisubmersibles, 14 jack-up rigs, and one drillship.*

*Diamond Offshore provides comprehensive drilling services to the energy industry around the globe. Our rigs operate in waters off North America, South America, the United Kingdom, Africa, Asia, and Australia.*

*Headquartered in Houston, Texas, Diamond Offshore also maintains offices in Louisiana, Brazil, Scotland, West Africa, Singapore, China, Indonesia, and Australia. Approximately 4,000 men and women work on the company's drilling rigs and in its offices.*

*Diamond Offshore's common stock is traded on the New York Stock Exchange under the symbol "DO."*

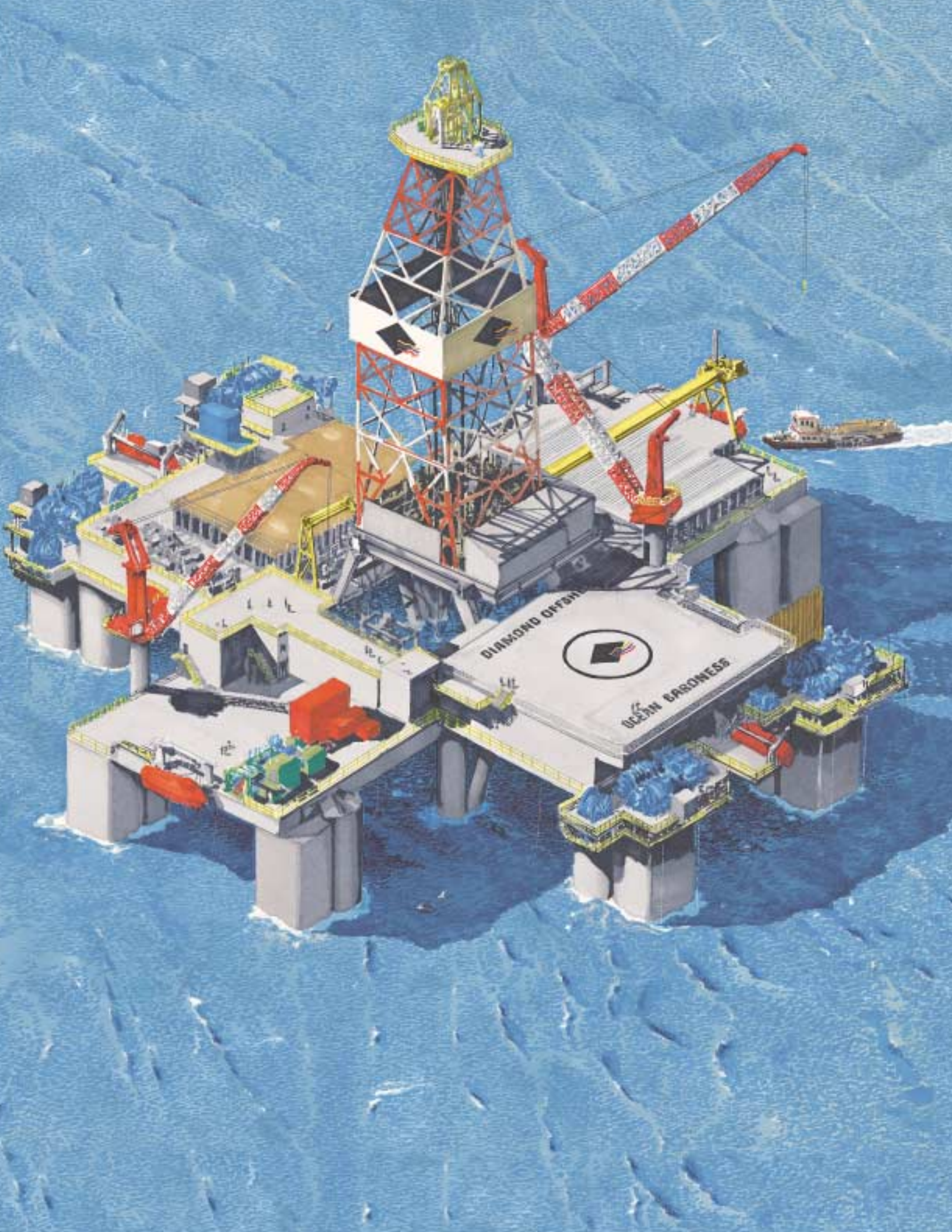
## ABOUT THE COVER

*As early as the first quarter of 2002, crew members will be helicoptered to the deck of the Ocean Baroness, a former intermediate water depth Victory Class rig now undergoing conversion in Singapore. Upon completion, the Ocean Baroness will be a 5th generation capable rig designed specifically to help develop the growing number of new oil and gas fields found in ultra-deep water.*

## FINANCIAL HIGHLIGHTS

(DOLLARS IN MILLIONS, EXCEPT PER SHARE DATA)

	2000	1999	1998
Revenues	\$ 659	\$ 821	\$ 1,209
Depreciation and Amortization	146	143	130
Operating Expenses	602	597	640
Earnings before Interest, Taxes, Depreciation, and Amortization (EBITDA)	203	367	699
Net Income	72	156	384
Capital Expenditures	324	324	224
Cash and Investments	\$ 862	\$ 641	\$ 637
Drilling and Other Property and Equipment, Net	1,902	1,738	1,552
Total Assets	3,080	2,681	2,610
Long-term Debt	857	400	400
Shareholders' Equity	1,768	1,842	1,755
Number of Offshore Active Rigs	45	46	46



## LETTER TO SHAREHOLDERS

In 2000, Diamond Offshore's revenues and net income declined significantly as a result of the sharp fall in oil prices in 1999. Still, by the second half of 2000, a recovery began to take hold, driven by oil prices averaging just above \$30 a barrel and natural gas prices soaring to historic highs. By year-end, all of our key rig markets were showing signs of strength, pointing to better times for our company and industry in 2001.

Our 2000 results reflected soft demand in our core market, intermediate water-depth semisubmersible rigs, which accounted for almost 50% of revenues. Dayrates declined in this market by 26% over those in 1999 as contracts negotiated in more favorable periods expired. Our intermediate water-depth business, largely confined to the Gulf of Mexico, was impacted by two trends in the offshore market—major oil companies focusing on more lucrative ultra-deepwater projects, and independent oil companies working shallower waters with jack-up rigs in the search for natural gas.

Fortunately, as we approached the end of 2000, the prospects for our intermediate water-depth fleet improved. Our backlog of work began to build and dayrates climbed to the \$40,000 range, versus \$25,000 during the trough of activity last summer. Rising dayrates for premium jack-ups also make our

intermediate rigs more attractive. In addition, there has been a dramatic increase in the number of mid-water depth drilling plans filed with the U.S. Minerals Management Service in recent months. Filings doubled between the first and fourth quarter 2000, signaling a growing demand for mid-water rigs in the months ahead.

Diamond Offshore participated in the vibrant demand for jack-ups in the Gulf of Mexico, spurred

by high natural gas prices, accelerating depletion rates, and increased demand for gas-fired electrical generation. By the end of the second quarter, all of our jack-ups were fully utilized. Dayrates more than doubled through the year. Dayrates for the *Ocean King*, one of our jack-ups in the Gulf of Mexico, soared from \$17,500 in early 2000 to \$54,000 in the fourth quarter.

We also saw strong demand and dayrate increases for our deepwater and ultra-deepwater semisubmersibles. Contract commitments for the *Ocean America*, a deepwater rig, climbed from \$67,000 per day at mid-year to \$117,500 per day by year-end. All of our deepwater contracts signed for first and second quarter 2001 reflect similar rate increases. We're delighted to see substantially higher dayrates in the North Sea and a recovery in the Southeast Asia market as well.

Diamond Offshore continually strives to expand its fleet capabilities. In December 2000, we

In the fourth quarter of 2000, major and independent oil and gas companies announced budget increases for exploration and production of as much as 20 percent over 2000 levels, the largest increase in two decades. The positive developments in all our markets, combined with high energy prices, give us optimism for improved results for Diamond Offshore in 2001.

completed the conversion of a former accommodation vessel into one of the most advanced deepwater semisubmersible rigs ever built, the *Ocean Confidence*. Despite cost overruns, the rig is expected to make significant profits during its initial contract—a five-year drilling program in the Gulf of Mexico that commenced January 2001.

In May 2000, we announced plans to invest \$180 million to convert the semisubmersible, *Ocean Baroness*, into a specialized rig for an emerging market—developing oil fields in ultra-deep water depths. The engineering for the rig has been completed, and we expect the project to be finished on time and on budget, just like our other successful Victory Class upgrades, the *Ocean Quest*, *Ocean Star*, and *Ocean Victory*. Slated for delivery from Singapore in the first quarter of 2002, the *Ocean Baroness* is designed to drill ultra-deep wells in ultra-deep water.

To better withstand—and prosper from—the industry's cyclical nature, Diamond Offshore has

worked to maintain a strong balance sheet. Cash and marketable securities held by the company amounted to \$862.1 million, while its total long-term debt was \$856.6 million. Prevailing market conditions made it attractive for Diamond Offshore to raise \$402 million of capital through the issuance of zero coupon convertible debentures. In addition, we spent \$93 million in 2000 repurchasing our shares when prices were low.

In the fourth quarter of 2000, major and independent oil and gas companies announced budget increases for exploration and production of as much as 20 percent over 2000 levels, the largest increase in two decades. The positive developments in all our markets, combined with high energy prices, give us optimism for improved results for Diamond Offshore in 2001.



We thank our shareholders, our customers, and dedicated employees worldwide who continue to help this remarkable company grow and prosper.

James S. Tisch  
Chairman of the Board and  
Chief Executive Officer

Lawrence R. Dickerson  
President and Chief  
Operating Officer



Since the mid-1990s, major oil companies have been combing the deeper waters of the Gulf of Mexico in search of “elephants”—huge reserves of oil and natural gas. Their efforts have paid off, with several newly discovered reservoirs containing potentially in excess of a billion barrels of oil.

In many cases, the discoveries have been found in virgin territories hundreds of miles offshore in water that is ultra-deep, over 5,000 feet. Currently, our customers are drilling test wells to determine the geologic structures in the fields and their contents. In the next 18 to 24 months, development drilling will get underway to produce these reservoirs. One of the few rigs in the world ideally suited to work in this challenging environment will be the *Ocean Baroness*, a Victory Class

# OCEAN

# BARONESS





mid-water semisubmersible now being converted into a massive, 5th generation capable ultra-deepwater rig.

Scheduled for completion in the first quarter of 2002, the *Ocean Baroness* will offer an array of drilling capabilities. It can be moored, with great stability, over an ultra-deep field and is designed to be highly efficient in running subsea trees and other production equipment. Because of the rig's powerful drilling package, well depths of 35,000 feet can be readily achieved.

In the center of the rig's cellar deck is a 25-foot by 90-foot moon pool that allows crews to deploy production equipment without going through the time-consuming procedure of retrieving a blow-out preventer and riser pipe.

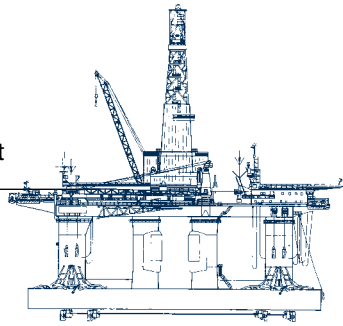
Astride a large oil field, this Diamond Offshore rig will be a showcase of ultra-deepwater development drilling.

# BARONESS

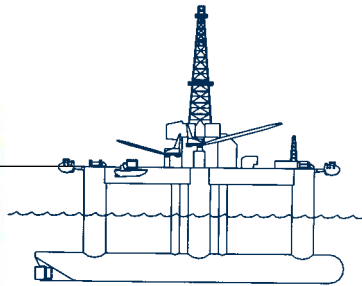




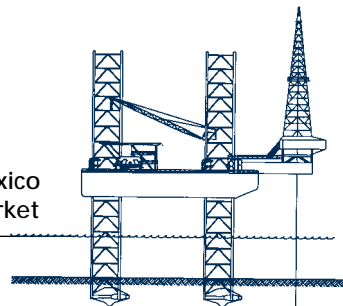
Deepwater Market



Gulf of Mexico Intermediate Semisubmersible Market



Gulf of Mexico Jackup Market



**Deepwater Market.** Worldwide demand for ultra-deepwater semisubmersibles and dynamically-positioned drillships is extremely high. Every unit in the industry with a deepwater rating exceeding 3,500 feet was under contract at year end. The majority of our deepwater fleet, including the *Ocean Confidence*, *Ocean America*, *Ocean Valiant*, *Ocean Victory*, *Ocean Star*, and *Ocean Quest*, is currently at work in the Gulf of Mexico. The limited availability of deepwater rigs is resulting in higher dayrates as operators, with larger exploration and production budgets, look to secure rigs for their 2001 drilling programs.

**Gulf of Mexico Intermediate Semisubmersible Market.** Diamond Offshore has 22 midwater semisubmersibles, 11 of which are in the Gulf. This segment of our fleet was slower to rebound than all other rig categories, but showed improvement by year-end. The increased business for our rigs stemmed primarily from both large independent oil and gas companies increasing their activity in intermediate waters and small independent oil and gas companies making their first forays into deeper waters.

Midwater drilling plans in the Gulf filed with the U.S. Minerals Management Service rose steeply throughout 2000, reaching at year-end their highest level since 1998. The strong filing trend indicates a more positive environment for our intermediate semisubmersibles in 2001.

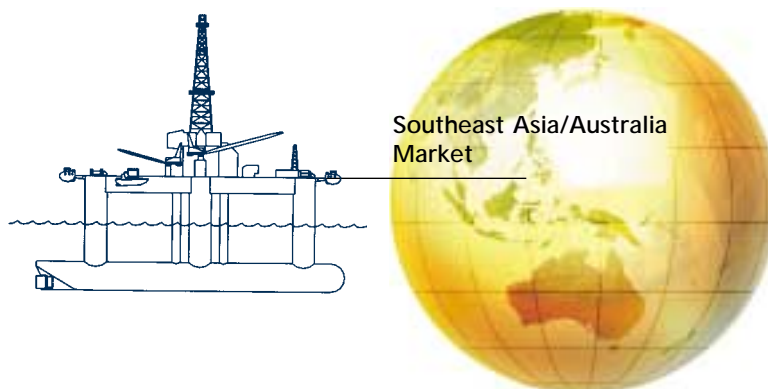
**Gulf of Mexico Jack-up Market.** The Gulf of Mexico remains the hottest offshore area for oil and gas exploration in the world. Sparked by robust natural gas prices and rapid depletion of reservoirs, jack-up utilization in the Gulf approached 100% during 2000, drilling primarily along the gas-rich, shallow-water continental shelf. Twelve of Diamond Offshore's 14 jack-up rigs operated in these waters. The market's strength is supported by the near \$20,000 per day increase in average day rates during 2000.



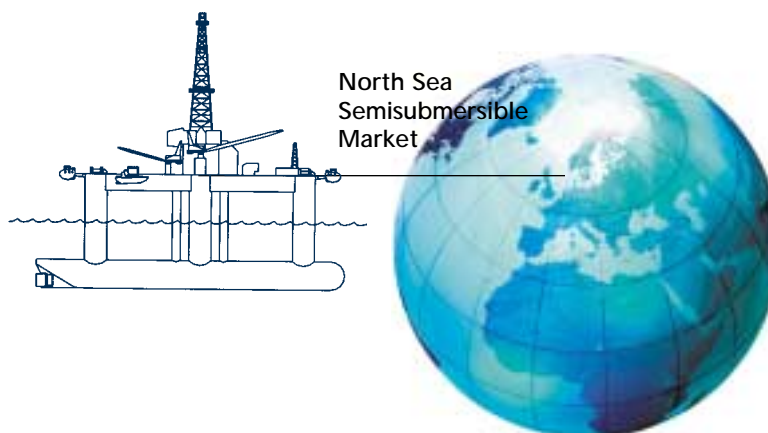
**Brazilian Market.** Brazil remains one of the most attractive deepwater offshore drilling markets in the world due to its sizeable reserves and the country's plan for complete energy self-sufficiency by 2005. Two years ago the country opened its doors to major and independent companies to operate in its waters. Diamond Offshore has four midwater semisubmersibles in Brazil—the *Ocean Winner*, *Ocean Yorktown*, *Ocean Yatzy*, *Ocean Whittington*—and the deepwater drillship, *Ocean Clipper*. Our newest arrival in Brazil is the deepwater semisubmersible *Ocean Alliance*, which mobilized to Brazil from Angola in July 2000 to begin a three-year contract with Petrobras.



**Southeast Asia/Australia Market.** Diamond Offshore has five rigs under various contracts in this recovering market—two jack-ups, the *Ocean Sovereign* and the *Ocean Heritage*, offshore Indonesia; a midwater semisubmersible, the *Ocean Epoch*, enroute to the South China Sea; and two additional midwater semisubmersibles, the *Ocean Bounty* and the *Ocean General*, offshore Australia. Dayrates for our semisubmersibles nearly doubled from the upper \$40,000 range in early 2000 to \$80,000 in the first quarter of 2001. We believe there is further upside potential in these dayrates in the months ahead.



**North Sea Semisubmersible Market.** The North Sea is a mature, but still very active market for both exploration and oil field development. We have three of our midwater semisubmersibles there—the *Ocean Guardian*, the *Ocean Princess*, and the *Ocean Nomad*. Higher oil prices are fueling a boost in dayrates as the spring offshore season gets underway. In the past year, the *Ocean Princess* has seen its contract commitments jump from the upper \$30,000 per day range to nearly \$70,000 per day. Higher oil prices are expected to sustain drilling activity in the market for at least the next two years.



# FLEET LIST

As of March 5, 2001

Type and Name	Water-Depth Capability (ft.)	Description	Location
<b>High Specification Floaters</b>			
<b>Semisubmersibles (7):</b>			
Ocean Confidence	7,500	Dynamically positioned	Gulf of Mexico
Ocean America	5,500		Gulf of Mexico
Ocean Valiant	5,500		Gulf of Mexico
Ocean Victory	5,500		Gulf of Mexico
Ocean Star	5,500		Gulf of Mexico
Ocean Alliance	5,000	Dynamically positioned	Brazil
Ocean Quest	3,500		Gulf of Mexico
<b>Drillship:</b>			
Ocean Clipper	7,500	Dynamically positioned	Brazil
<b>Undergoing Conversion:</b>			
Ocean Baroness	6,500		Singapore
<b>Other Semisubmersibles (22):</b>			
Ocean Winner	3,500		Brazil
Ocean Worker	3,500		Gulf of Mexico
Ocean Yatzy	3,300	Dynamically positioned	Brazil
Ocean Voyager	3,300		Gulf of Mexico
Ocean Yorktown	2,850		Brazil
Ocean Concord	2,200		Gulf of Mexico
Ocean Lexington	2,200		Gulf of Mexico
Ocean Saratoga	2,200		Gulf of Mexico
Ocean Endeavor	2,000		Gulf of Mexico
Ocean Rover	2,000		Gulf of Mexico
Ocean Prospector	1,700		Gulf of Mexico
Ocean Epoch	1,640		Enroute to China
Ocean General	1,640		Australia
Ocean Bounty	1,500		Australia
Ocean Guardian	1,500		North Sea
Ocean New Era	1,500		Gulf of Mexico
Ocean Princess	1,500		North Sea
Ocean Whittington	1,500		Brazil
Ocean Nomad	1,200		North Sea
Ocean Ambassador	1,100		Gulf of Mexico
Ocean Century	800		Gulf of Mexico
Ocean Liberator	600		Ivory Coast
<b>Jack-ups (14):</b>			
Ocean Titan	350	Independent-Leg Slot	Gulf of Mexico
Ocean Tower	350	Independent-Leg Slot	Gulf of Mexico
Ocean King	300	Independent-Leg Cantilever	Gulf of Mexico
Ocean Nugget	300	Independent-Leg Cantilever	Gulf of Mexico
Ocean Summit	300	Independent-Leg Cantilever	Gulf of Mexico
Ocean Warwick	300	Independent-Leg Cantilever	Gulf of Mexico
Ocean Champion	250	Mat-Supported Slot	Gulf of Mexico
Ocean Columbia	250	Independent-Leg Cantilever	Gulf of Mexico
Ocean Heritage	250	Independent-Leg Cantilever	Indonesia
Ocean Sovereign	250	Independent-Leg Cantilever	Indonesia
Ocean Spartan	250	Independent-Leg Cantilever	Gulf of Mexico
Ocean Spur	250	Independent-Leg Cantilever	Gulf of Mexico
Ocean Crusader	200	Mat-Supported Cantilever	Gulf of Mexico
Ocean Drake	200	Mat-Supported Cantilever	Gulf of Mexico

# financial review

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## SELECTED FINANCIAL DATA

The following table sets forth certain historical consolidated financial data relating to the Company. The selected consolidated financial data are derived from the financial statements of the Company as of and for the periods presented. The selected consolidated financial data below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Company's Consolidated Financial Statements (including the Notes thereto).

	2000	1999	1998	1997	1996 <sup>(1)</sup>
(in thousands, except per share and ratio data)					
<b>Income Statement Data:</b>					
Total revenues	\$ 659,436	\$ 821,024	\$ 1,208,801	\$ 956,093	\$ 611,430
Operating income	56,946	223,661	568,581	418,859	178,369
Net income	72,281	156,071	383,659	278,605	146,388
Net income per share <sup>(2)</sup> :					
Basic	0.53	1.15	2.78	2.01	1.18
Diluted	0.53	1.11	2.66	1.93	1.18
<b>Balance Sheet Data:</b>					
Drilling and other property and equipment, net	1,902,415	1,737,905	1,551,820	1,451,741	1,198,160
Total assets	3,079,506	2,681,029	2,609,716	2,298,561	1,574,500
Long-term debt	856,559	400,000	400,000	400,000	63,000
<b>Other Financial Data:</b>					
Capital expenditures <sup>(3)</sup>	323,924	324,133	224,474	281,572	267,000
Cash dividends declared per share	0.50	0.50	0.50	0.14	—
Ratio of earnings to fixed charges <sup>(4)</sup>	4.97x	15.64x	37.57x	28.94x	31.56x

<sup>(1)</sup> The Company acquired all of the common stock of Arethusa (Off-Shore) Limited in consideration of 35.8 million shares of common stock on April 29, 1996.

<sup>(2)</sup> All per share amounts give retroactive effect to the Company's July 1997 two-for-one stock split in the form of a stock dividend.

<sup>(3)</sup> In addition to these capital expenditures, the Company expended \$81.0 million for rig acquisitions during the year ended December 31, 1997.

<sup>(4)</sup> For all periods presented, the ratio of earnings to fixed charges has been computed on a total enterprise basis. Earnings represent income from continuing operations plus income taxes and fixed charges. Fixed charges include (i) interest, whether expensed or capitalized, (ii) amortization of debt issuance costs, whether expensed or capitalized, and (iii) one-third of rent expense, which the Company believes represents the interest factor attributable to rent.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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Unless the context otherwise requires, references herein to the "Company" shall mean Diamond Offshore Drilling, Inc. and its consolidated subsidiaries. The following discussion should be read in conjunction with the Company's Consolidated Financial Statements (including the Notes thereto).

### RESULTS OF OPERATIONS

#### General

#### Revenues

The Company's revenues vary based upon demand, which affects the number of days the fleet is utilized and the dayrates earned. Revenues can also increase or decrease as a result of the acquisition or disposal of rigs. In order to improve utilization or realize higher dayrates, the Company may mobilize its rigs from one market to another. During periods of mobilization, revenues may be adversely affected. As a response to changes in demand, the Company may withdraw a rig from the market by stacking it or may reactivate a rig previously stacked, which may decrease or increase revenues, respectively.

Revenues from dayrate drilling contracts are recognized currently. The Company may receive lump-sum payments in connection with specific contracts. Such payments are recognized as revenues over the term of the related drilling contract. Mobilization revenues, less costs incurred to mobilize an offshore rig from one market to another, are recognized over the term of the related drilling contract.

Revenues from turnkey offshore drilling contracts are accrued to the extent of costs until the specified turnkey depth and other contract requirements are met. Income is recognized on the completed contract method. Provisions for future losses on turnkey contracts are recognized when it becomes apparent that expenses to be incurred on a specific contract will exceed the revenue from that contract.

#### Operating Income

Operating income is primarily affected by revenue fac-

tors, but is also a function of varying levels of operating expenses. Operating expenses generally are not affected by changes in dayrates and may not be significantly affected by fluctuations in utilization. For instance, if a rig is to be idle for a short period of time, the Company may realize few decreases in operating expenses since the rig is typically maintained in a prepared state with a full crew. In addition, when a rig is idle, the Company is responsible for certain operating expenses such as rig fuel and supply boat costs, which are typically charged to the operator under drilling contracts. However, if the rig is to be idle for an extended period of time, the Company may reduce the size of a rig's crew and take steps to "cold stack" the rig, which lowers expenses and partially offsets the impact on operating income. The Company recognizes as operating expenses activities such as inspections, painting projects and routine overhauls, which meet certain criteria, that maintain rather than upgrade its rigs. These expenses vary from period to period. Costs of rig enhancements are capitalized and depreciated over the expected useful lives of the enhancements. Increased depreciation expense decreases operating income in periods subsequent to capital upgrades.

#### YEARS ENDED DECEMBER 31, 2000 AND 1999

Comparative data relating to the Company's revenues and operating expenses by equipment type are listed below (eliminations offset (i) dayrate revenues earned when the Company's rigs are utilized in its integrated services and (ii) intercompany expenses charged to rig operations). Certain amounts applicable to the prior periods have been reclassified to conform to the classifications currently followed. Such reclassifications do not affect earnings.

## MANAGEMENT'S DISCUSSION & ANALYSIS OF FINANCIAL CONDITION & RESULTS OF OPERATIONS

	Year Ended		Increase/ (Decrease)
	December 31,		
	2000	1999	
(in thousands)			
<b>Revenues</b>			
High Specification			
Floaters	\$ 212,000	\$ 262,571	\$ (50,571)
Other Semisubmersibles	313,287	463,168	(149,881)
Jack-ups	118,885	74,484	44,401
Integrated Services	23,298	32,769	(9,471)
Other	140	—	140
Eliminations	(8,174)	(11,968)	3,794
Total Revenues	<u>\$ 659,436</u>	<u>\$ 821,024</u>	<u>\$ (161,588)</u>
<b>Contract Drilling Expense</b>			
High Specification			
Floaters	\$ 99,707	\$ 100,003	\$ (296)
Other Semisubmersibles	213,259	223,084	(9,825)
Jack-ups	98,880	84,830	14,050
Integrated Services	22,328	32,486	(10,158)
Other	7,091	3,088	4,003
Eliminations	(8,174)	(11,968)	3,794
Total Contract Drilling Expense	<u>\$ 433,091</u>	<u>\$ 431,523</u>	<u>\$ 1,568</u>
<b>Operating Income</b>			
High Specification			
Floaters	\$ 112,293	\$ 162,568	\$ (50,275)
Other Semisubmersibles	100,028	240,084	(140,056)
Jack-ups	20,005	(10,346)	30,351
Integrated Services	970	283	687
Other	(6,951)	(3,088)	(3,863)
Depreciation and Amortization Expense	(145,596)	(142,963)	(2,633)
General and Administrative Expense	(23,803)	(22,877)	(926)
Total Operating Income	<u>\$ 56,946</u>	<u>\$ 223,661</u>	<u>\$ (166,715)</u>

### High Specification Floaters

Revenues from high specification floaters during the year ended December 31, 2000 decreased \$50.6 million from 1999. Approximately \$65.3 million of the decline in revenues resulted from lower operating dayrates compared to 1999. The average operating dayrate for high specification floaters during the year ended December 31, 2000 was \$94,100 per day compared to \$122,700 per day during the year ended December 31, 1999. Revenues from high specification floaters were also lower in 2000 by approximately \$6.0 million due to the 1999 mobilizations of the *Ocean Alliance* from the North Sea to West Africa and the *Ocean Clipper* from the Gulf of Mexico to Brazil. The decline in revenues was partially offset by approximately \$20.7 million resulting from improved utilization during 2000. Utilization for the Company's high specification floaters was 88% during 2000 com-

pared to 84% during 1999. The Company's drillship, the *Ocean Clipper*, operated for most of 2000 under its three-year contract offshore Brazil. During most of 1999, this rig was in a shipyard for upgrades and repairs associated with this contract. Also contributing to the improved utilization in 2000 was the operation of the *Ocean Valiant*, which was in the shipyard during part of 1999 for stability enhancements and other repairs. The *Ocean Quest*, which was stacked during part of 2000, but worked all of 1999, partially offset these utilization improvements in 2000.

Contract drilling expense for high specification floaters during the year ended December 31, 2000 decreased \$0.3 million from 1999. Costs for the *Ocean Valiant* in 2000 were \$6.7 million lower than in 1999 primarily due to expenses of \$5.3 million incurred for repairs of the rig while it was in the shipyard during part of 1999. Costs of \$1.7 million for the 1999 mobilization of the *Ocean Alliance* from the North Sea to Angola also contributed to the decrease. The decline in 2000 costs was partially offset by higher contract drilling expenses of \$7.0 million incurred by the *Ocean Clipper* which began operating in 2000 under a three-year contract offshore Brazil. During most of 1999, the *Ocean Clipper* was in a shipyard for upgrades and repairs which were capitalized. Also offsetting the decrease in costs were expenses of \$1.3 million associated with the 2000 mobilization of the *Ocean Alliance* from Angola to Brazil.

### Other Semisubmersibles

Revenues from other semisubmersibles during the year ended December 31, 2000 decreased \$149.9 million from 1999. Approximately \$78.6 million of the decline in revenues resulted from lower operating dayrates compared to 1999. The average operating dayrate for the Company's other semisubmersibles was \$61,300 per day during the year ended December 31, 2000 compared to \$82,400 per day during the year ended December 31, 1999. In addition, revenues decreased by approximately \$71.3 million resulting from lower utilization compared to 1999. Utilization for the Company's other semisubmersibles during the year ended December 31, 2000 was 61% compared to 67% during the year ended December 31, 1999. The *Ocean Epoch* underwent an upgrade of its water depth capabilities and variable deckload and was idle during most of 2000 but worked for most of 1999. The *Ocean Rover*, *Ocean Endeavor*, *Ocean Guardian* and *Ocean Voyager* were idle during most of 2000 but worked during most of 1999. The *Ocean Baroness*, which was cold stacked during the first half of 2000 and

## MANAGEMENT'S DISCUSSION & ANALYSIS OF FINANCIAL CONDITION & RESULTS OF OPERATIONS

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then mobilized to Singapore for an upgrade to high specification capabilities, worked for most of the first half of 1999. See "—Capital Resources." The decline in utilization was partially offset by the *Ocean General* and *Ocean Winner*, which worked all of 2000, but were idle most of 1999.

Contract drilling expense for other semisubmersibles during the year ended December 31, 2000 decreased \$9.8 million from 1999. This decline resulted partially from a \$6.8 million reduction of cost as a result of the *Ocean Baroness*, which was cold stacked during the first half of 2000 and then mobilized to Singapore for an upgrade, but worked for most of the first half of 1999. See "—Capital Resources." Contract drilling expense was further reduced by \$5.3 million as a result of stacking the *Ocean Epoch* in late 1999 and \$4.2 million associated with mandatory inspections and repairs of the *Ocean New Era* in 1999. Costs in 2000 also decreased by \$3.6 million from 1999 due to the inspection and repair of the *Ocean Winner* and its mobilization from the Gulf of Mexico to Brazil in 1999. Cost increases in 2000 which were partially offsetting included higher operating costs of \$7.5 million in 2000 for the *Ocean General*, which was stacked throughout 1999, and \$2.4 million associated with the mandatory inspection and repairs of the *Ocean Lexington* in 2000.

### Jack-Ups

Revenues from jack-ups during the year ended December 31, 2000 increased \$44.4 million from 1999. Approximately \$35.1 million of the increase in revenues resulted from improvements in utilization compared to 1999. Utilization of the Company's jack-ups during the year ended December 31, 2000 was 89% compared to 61% during the year ended December 31, 1999. In addition, revenues increased approximately \$26.4 million due to higher operating dayrates compared to 1999. The average operating dayrate for the Company's jack-ups was \$26,000 per day during the year ended December 31, 2000 compared to \$22,400 per day during the year ended December 31, 1999. The revenue improvement in 2000 was partially offset by a decrease in revenues of \$17.1 million from the *Ocean Scotian*, which was sold in January 2000 but worked for most of 1999.

Contract drilling expense for jack-ups during the year ended December 31, 2000 was \$14.0 million higher than for the same period in 1999. An increase of \$18.4 million was due to rigs returning to work in 2000, which were idle for all or part of 1999. In addition, contract drilling

expense was \$4.0 million higher in 2000 due to major repairs to the *Ocean Heritage*. Higher contract drilling expense in 2000 was partially offset by a decrease of \$8.4 million due to the January 2000 sale of the *Ocean Scotian*.

### Integrated Services

Revenues and contract drilling expense for integrated services decreased as a result of the differences in number, type and magnitude of projects during the year ended December 31, 2000 as compared to the same period in 1999.

### Other

Other contract drilling expense of \$7.0 million for the year ended December 31, 2000 increased \$3.9 million from the same period in 1999. This increase resulted primarily from higher expenditures during 2000 for crew training programs and various other non-recurring charges.

### Depreciation and Amortization Expense

Depreciation and amortization expense of \$145.6 million for the year ended December 31, 2000 increased \$2.6 million from \$143.0 million for the year ended December 31, 1999. This increase resulted primarily from higher depreciation for the *Ocean Clipper*, *Ocean General*, *Ocean Concord* and *Ocean King*, which completed various upgrades in the third and fourth quarters of 1999. In addition, depreciation expense was up due to expenditures associated with the Company's continuing rig enhancement program. This increase was partially offset by reduced depreciation in 2000 due to the January 2000 sale of the *Ocean Scotian* and a decrease in goodwill amortization resulting from adjustments to goodwill related to tax benefits not previously recognized for the excess of tax deductible goodwill over the book amount. See Note 5 to the Company's Consolidated Financial Statements.

### General and Administrative Expense

General and administrative expense of \$23.8 million for the year ended December 31, 2000 increased \$0.9 million from \$22.9 million for the year ended December 31, 1999. Higher expenses in 2000 were primarily due to an increase in legal and personnel costs. Expenses in 2000 also included costs associated with the Company's participation in the Subsea Mudlift Drilling Joint Industry Project.

## MANAGEMENT'S DISCUSSION & ANALYSIS OF FINANCIAL CONDITION & RESULTS OF OPERATIONS

### Gain on Sale of Assets

Gain on sale of assets for the year ended December 31, 2000 was \$14.3 million compared to \$0.2 million for the year ended December 31, 1999. Gain on sale of assets in 2000 included the sale of the Company's jack-up drilling rig, *Ocean Scotian*, for \$32.0 million in cash resulting in a gain of \$13.9 million (\$9.0 million after tax). The rig had been cold stacked offshore The Netherlands prior to the sale.

### Interest Income

Interest income of \$49.5 million for the year ended December 31, 2000 increased \$14.5 million from \$35.0 million for the year ended December 31, 1999. This increase resulted primarily from the investment of excess cash generated by the sale of 20-year zero coupon convertible debentures (the "Debentures") on June 6, 2000. See "— Liquidity."

### Interest Expense

Interest expense of \$10.3 million for the year ended December 31, 2000 increased \$1.1 million from \$9.2 million for 1999. Interest costs in 2000 were \$8.6 million higher than in 1999 primarily as a result of the issuance of the Debentures on June 6, 2000. This amount was partially offset by a \$7.5 million increase in interest capitalized for the conversion of the *Ocean Confidence* and the deepwater upgrade of the *Ocean Baroness*. Interest cost capitalized in 2000 was \$13.8 million compared to \$6.3 million in 1999. See "—Liquidity" and "—Capital Resources."

### Other Income

Other income of \$0.3 million for the year ended December 31, 2000 increased \$9.6 million from other expense of \$9.3 million for the year ended December 31, 1999. In 1999, a pre-tax impairment loss of \$10.7 million was recorded as the result of the decline in fair market value, judged to be other than temporary, in the Company's investment in equity securities.

### Income Tax Expense

Income tax expense for the year ended December 31, 2000 was \$38.6 million as compared to \$84.3 million for 1999. This change resulted primarily from a decrease of \$129.5 million in the Company's income before income tax expense.

### YEARS ENDED DECEMBER 31, 1999 AND 1998

Comparative data relating to the Company's revenues and operating expenses by equipment type are listed below (eliminations offset (i) dayrate revenues earned when the Company's rigs are utilized in its integrated services and (ii) intercompany expenses charged to rig operations). Certain amounts applicable to the prior periods have been reclassified to conform to the classifications currently followed. Such reclassifications do not affect earnings.

	Year Ended		Increase/ (Decrease)
	December 31, 1999	1998	
(in thousands)			
<b>Revenues</b>			
High Specification			
Floaters	\$ 262,571	\$ 286,875	\$ (24,304)
Other Semisubmersibles	463,168	707,227	(244,059)
Jack-ups	74,484	209,134	(134,650)
Integrated Services	32,769	26,876	5,893
Eliminations	(11,968)	(21,311)	9,343
<b>Total Revenues</b>	<b>\$ 821,024</b>	<b>\$ 1,208,801</b>	<b>\$(387,777)</b>
<b>Contract Drilling Expense</b>			
High Specification			
Floaters	\$ 100,003	\$ 88,293	\$ 11,710
Other Semisubmersibles	223,084	276,633	(53,549)
Jack-ups	84,830	104,490	(19,660)
Integrated Services	32,486	26,472	6,014
Other	3,088	10,048	(6,960)
Eliminations	(11,968)	(21,311)	9,343
<b>Total Contract Drilling Expense</b>	<b>\$ 431,523</b>	<b>\$ 484,625</b>	<b>\$(53,102)</b>
<b>Operating Income</b>			
High Specification			
Floaters	\$ 162,568	\$ 198,582	\$ (36,014)
Other Semisubmersibles	240,084	430,594	(190,510)
Jack-ups	(10,346)	104,644	(114,990)
Integrated Services	283	404	(121)
Other	(3,088)	(10,048)	6,960
Depreciation and Amortization Expense	(142,963)	(130,271)	(12,692)
General and Amortization Expense	(22,877)	(25,324)	2,447
<b>Total Operating Income</b>	<b>\$ 223,661</b>	<b>\$ 568,581</b>	<b>\$(344,920)</b>



### High Specification Floaters

Revenues from high specification floaters during the year ended December 31, 1999 decreased \$24.3 million from 1998. This decrease resulted primarily from (i) a \$13.4 million reduction in revenues from the *Ocean Valiant* due to lower utilization while the rig was in the shipyard for stability enhancements and other repairs performed during 1999 and (ii) a \$14.9 million decrease due to rig downtime associated with the upgrade of and repairs performed in 1999 on the *Ocean Clipper*. Revenues were also reduced by approximately \$10.9 million due to lower operating dayrates in 1999 compared to 1998 and reduced by \$6.8 million due to rig downtime associated with the 1999 mandatory inspection and repairs of the *Ocean America*. The average operating dayrate for high specification floaters was \$122,700 per day during 1999, compared to \$130,500 per day during 1998. These decreases were partially offset by higher revenues of approximately \$14.2 million from the *Ocean Victory*, which was in the shipyard during part of 1998 for repairs required as a result of the February 1998 engine room fire. The decrease in revenue was also partially offset by an increase of approximately \$4.6 million from mobilization revenues for the *Ocean Alliance* to locations offshore West Africa during 1999 and \$2.0 million from mobilization revenues for the *Ocean Clipper* from the Gulf of Mexico to Brazil in 1999.

Contract drilling expense for high specification floaters during the year ended December 31, 1999 increased \$11.7 million from 1998. This increase resulted in part from an increase of \$5.3 million for repairs performed on the *Ocean Valiant*, which was in the shipyard for part of 1999. Also contributing to this increase was \$3.0 million associated with costs for the 1999 mandatory inspection and repairs of the *Ocean America* and \$3.1 million due to the capitalization of costs associated with 1998 shipyard repairs on the *Ocean Victory*.

### Other Semisubmersibles

Revenues from other semisubmersibles during the year ended December 31, 1999 decreased \$244.1 million from 1998. In part, revenues decreased \$124.3 million due to a decline in utilization in 1999 compared to 1998 and \$39.3 million due to rigs removed from service in late 1998 and 1999. In addition, revenues were reduced by \$37.0 million due to rig downtime during 1999 for mandatory inspections and repairs of the *Ocean New Era*, the *Ocean Yatzy*, the *Ocean Concord*, the *Ocean Winner*, and the *Ocean Guardian*. Also contributing to

the decrease in revenues was a \$73.8 million decline from lower operating dayrates in 1999 compared to 1998. The average operating dayrate for other semisubmersibles was \$82,400 per day in 1999, compared to \$93,500 per day in 1998. These decreases were partially offset by revenue improvements in 1999 of approximately \$29.1 million from nine other rigs which were undergoing mandatory inspections during 1998.

Contract drilling expense for other semisubmersibles during the year ended December 31, 1999 decreased \$53.5 million from 1998. This decrease resulted primarily from expense reductions of approximately \$38.7 million due to a 1999 decline in utilization and from rigs that were idle for all or part of 1999. Contract drilling expense also decreased by approximately \$19.9 million due to fewer mandatory inspections and repairs performed during 1999 compared to 1998. Partially offsetting these decreases was an increase in 1999 costs of \$3.2 million associated with the mobilization of the *Ocean Winner* from the Gulf of Mexico to Brazil during the first half of 1999.

### Jack-Ups

Revenues from jack-ups during the year ended December 31, 1999 decreased \$134.7 million from 1998. This decrease was primarily due to reductions in revenues of \$81.8 million from lower 1999 operating dayrates and \$52.9 million from 1999 decreased utilization as well as the removal of rigs from service in late 1998 and the first quarter of 1999. The average operating dayrate for jack-ups was \$22,400 per day during 1999 compared to \$46,300 per day in 1998.

Contract drilling expense for jack-ups during the twelve months ended December 31, 1999 decreased \$19.7 million for the same period in 1998. This decrease resulted primarily from expense reductions for rigs that were removed from service in late 1998 and the first quarter of 1999.

### Integrated Services

Revenues and contract drilling expense for integrated services increased primarily due to four turnkey wells completed during 1999. In 1998, the Company performed primarily project management services on a dayrate basis.

### Other

Other contract drilling expense of \$3.1 million during 1999 decreased \$7.0 million from \$10.1 million during 1998. This decrease resulted primarily from higher expenditures during 1998 for crew training programs and various other non-recurring charges.

### Depreciation and Amortization Expense

Depreciation and amortization expense of \$143.0 million for the year ended December 31, 1999 increased \$12.7 million from \$130.3 million for the year ended December 31, 1998. This increase resulted primarily from depreciation expense associated with expenditures for the Company's continuing rig enhancement program in 1999. Partially offsetting this increase was a 1999 \$1.2 million decline in amortization expense as compared to 1998 resulting from a 1999 adjustment to goodwill related to tax benefits not previously recognized for the excess of tax deductible goodwill over the book amount. See Note 5 to the Company's Consolidated Financial Statements.

### General and Administrative Expense

General and administrative expense of \$22.9 million for the year ended December 31, 1999 decreased \$2.4 million from \$25.3 million for the year ended December 31, 1998 primarily due to a decrease in legal and personnel costs.

### Interest Income

Interest income of \$35.0 million for the year ended December 31, 1999 increased \$4.4 million from \$30.6 million for the year ended December 31, 1998. This increase resulted primarily from an increase in average cash invested throughout 1999. See "— Liquidity."

### Interest Expense

Interest expense of \$9.2 million for the year ended December 31, 1999 decreased \$5.3 million from \$14.5 million for 1998. Interest expense for 1999 consisted of \$15.5 million interest associated with the Company's convertible subordinated notes, partially offset by \$6.3 million of interest capitalized for the conversion of the *Ocean Confidence*. The decrease of \$5.3 million resulted primarily from a 1999 increase in capitalized interest cost based on the average amount of accumulated expenditures for the *Ocean Confidence*. See "— Capital Resources."

### Other Expense

Other expense of \$9.3 million for the year ended December 31, 1999 increased \$14.5 million from other income of \$5.2 million for the year ended December 31, 1998. This increase resulted primarily from an impairment loss recorded in 1999 as the result of the decline in fair market value, judged to be other than temporary, in the Company's investment in equity securities. See Note 3 to the Company's Consolidated Financial Statements.

### Income Tax Expense

Income tax expense for the year ended December 31, 1999 was \$84.3 million as compared to \$206.6 million for 1998. This change resulted primarily from a decrease of \$349.9 million in the Company's 1999 income before income tax expense.

### Outlook

During 2000, oil and natural gas prices remained significantly above historical averages. However, market recovery for various classes of equipment within the offshore drilling industry was inconsistent as oil producers waited to see if the high level of product prices would continue. The Company believes that current expectations are for higher than average product prices to persist as world energy demand is increasing and short-term oil supplies are below historical averages. The growth in the offshore drilling industry, anticipated because of these favorable market fundamentals, is dependent on confidence by the Company's customers that current levels of oil and gas prices will be sustained.

Utilization and dayrates for the Company's domestic jack-up market improved significantly in 2000 as independent producers acted quickly to take advantage of the high natural gas prices which prevailed throughout the year. Although the improvement in the jack-up market leveled off during the fourth quarter of 2000, it remains strong. The Company's outlook for this market is for continued strength, especially if the recovery of the international jack-up market creates a tighter supply of jack-ups in the Gulf of Mexico.

During 2000, there was increased interest in the Company's deepwater high specification rig fleet with both utilization and dayrates increasing. The Company believes that prospects are good for further improvement in this market, as most recent dayrates are greater than rates under current contracts. Most of the existing contracts are for short-term, well-to-well work and the Company anticipates upward pressure on rates as these existing contracts are renewed or replaced.

For the Company's domestic other semisubmersible

rig fleet, the market began to experience growth in the latter half of 2000 with both dayrates and utilization increasing. Currently, all of the domestic marketed rigs in this class are working or have commitments. If the backlog for these rigs continues to build, the Company expects further increases in dayrates.

The Company believes that the international markets are also strengthening for all classes of equipment. Dayrates are increasing and that trend is expected to continue into the second half of the year. All three of the Company's rigs located in the North Sea have recently committed for work at dayrates that are well above their previously contracted dayrates. Five of the Company's six rigs operating in Brazil are committed under long-term contracts ranging from 18 months to approximately three years.

Historically, the offshore drilling industry has been highly competitive and cyclical, and the Company cannot predict the extent to which the current favorable conditions may continue. However, many oil and gas companies have increased planned expenditures for 2001 and other current indicators appear to be positive. The Company is currently cautiously optimistic about the near-term future of the offshore drilling industry and its place in it.

### Liquidity

At December 31, 2000, the Company's cash and marketable securities totaled \$862.1 million, up from \$641.4 million at December 31, 1999. Cash provided by operating activities for the year ended December 31, 2000 decreased by \$197.1 million to \$201.0 million, as compared to \$398.1 million for the prior year. This decrease was primarily attributable to a \$166.7 million reduction in operating income and various other related changes, primarily in accounts receivable and taxes payable.

Investing activities used \$459.7 million of cash during the year ended December 31, 2000, compared to \$319.1 million in 1999. Cash usage for capital expenditures during 2000 of \$323.9 million was primarily due to the conversion of the *Ocean Confidence*, and to a lesser extent, upgrades of the *Ocean Baroness* and *Ocean Epoch*. See "—Capital Resources." Cash usage increased \$173.4 million primarily due to the Company's investment in marketable securities purchased with a portion of the proceeds from the issuance of the Debentures. A \$33.3 million increase in cash was provided by proceeds from the sale of assets, primarily the sale of the *Ocean Scotian* in January 2000.

Cash provided by financing activities for the year ended December 31, 2000 increased \$358.7 million to \$290.8 million, compared to \$67.9 million cash used in

financing activities in 1999. Sources of financing during 2000 consisted primarily of the Company's issuance of the Debentures, which resulted in net proceeds of approximately \$392.6 million. The Company intends to use the net proceeds generated by the issuance of the Debentures for general corporate purposes. The Debentures were issued in June 2000 at a discount from their value at maturity on June 6, 2020. The Debentures are convertible at the option of the holder at any time prior to maturity, unless previously redeemed, into the Company's common stock at a fixed conversion rate of 8.6075 shares of common stock per Debentures, subject to adjustments in certain events. The Company will not pay interest on the Debentures prior to maturity unless it elects to convert the Debentures to interest-bearing debentures upon the occurrence of certain tax events. The Company has the right to redeem the Debentures, in whole or in part, after June 6, 2005 for a price equal to the issuance price plus accrued original issue discount through the date of redemption. Holders have the right to require the Company to repurchase the Debentures on the fifth, tenth and fifteenth anniversaries of issuance at the accreted value through the date of repurchase. The Company may pay such repurchase price with either cash or shares of the Company's common stock or a combination of cash and shares of common stock.

On March 7, 2001, the Company announced its decision to redeem, on April 6, 2001, all of its outstanding 3.75% convertible subordinated notes due 2007 (the "Notes") at a redemption price of 102.08% of the principal amount thereof, together with interest accrued to (but not including) the redemption date. These Notes are convertible on or before the close of business on April 5, 2001 into shares of the Company's common stock at a conversion price of \$40.50 per share, subject to adjustment in certain circumstances. If none of the Notes outstanding are converted into common stock prior to April 6, 2001, the redemption of all of the outstanding Notes would result in a charge of \$7.9 million after-tax and reported as an extraordinary loss in the second quarter of 2001.

Additional sources of financing during 2000 included a lease-leaseback agreement (the "Agreement"), which resulted in net proceeds of approximately \$54.7 million. The Agreement between the Company and a European bank was entered into in December 2000. The Agreement provided for the Company to lease the *Ocean Alliance*, one of the Company's high specification semisubmersible drilling rigs, to the bank for a lump-sum payment of \$55.0 million plus an origination fee of \$1.1 million and for the bank to then sub-lease the

rig back to the Company. Under the Agreement, which has a five-year term, the Company is to make five annual payments of \$13.7 million. This financing arrangement has an effective interest rate of 7.13% and is an unsecured subordinated obligation of the Company.

Also contributing to cash provided by financing activities in 2000 were premiums received of \$3.9 million for the August 2000 sale of put options covering 750,000 common shares. The options gave the holders the right to require the Company to repurchase shares of its common stock at an exercise price of \$37.85 per share at anytime prior to expiration through February 2001. The Company had the option to settle in cash or shares of its common stock. All of these options were unexercised and expired by the end of February 2001. On February 27, 2001, the Company received premiums of \$3.1 million for the sale of put options covering 500,000 common shares. The options give the holders the right to require the Company to repurchase shares of its common stock at an exercise price of \$40.00 per share at anytime prior to expiration in February 2002. The Company has the option to settle in cash or shares of common stock.

Cash used in financing activities for the year ended December 31, 2000 of \$160.5 million resulted primarily from the purchase of treasury stock and from dividends paid to stockholders. Depending on market conditions, the Company may, from time to time, purchase shares of its common stock in the open market or otherwise. During 2000, the Company purchased 2.7 million shares of its common stock at an aggregate cost of \$93.0 million, or at an average cost of \$34.36 per share. The Company did not purchase any of its common stock during 1999. Effective December 31, 2000, the Company retired all 6,223,200 shares of its treasury stock at an aggregate cost of \$181.7 million. See Note 1 to the Company's Consolidated Financial Statements.

Other sources of liquidity include the Company's \$20.0 million short-term revolving credit agreement with a U.S. bank. The agreement provides for borrowings at various interest rates and varying commitment fees dependent upon public credit ratings. In April 2000, the credit agreement was amended to revise these interest rates and commitment fees. The Company intends to use the facility primarily for letters of credit that the Company must post, from time to time, for bid and performance guarantees required in certain parts of the world. The agreement contains certain financial and other covenants and provisions that must be maintained by the Company for compliance. As of December 31,

2000, there were no outstanding borrowings under this agreement and the Company was in compliance with each of the covenants and provisions.

The Company has the ability to issue an aggregate of approximately \$117.5 million in debt, equity and other securities under a shelf registration statement. In addition, the Company may issue, from time to time, up to eight million shares of common stock, which shares are registered under an acquisition shelf registration statement (upon effectiveness of an amendment thereto reflecting the effect of the two-for-one stock split declared in July 1997), in connection with one or more acquisitions by the Company of securities or assets of other businesses.

The Company believes it has the financial resources needed to meet its business requirements in the foreseeable future, including capital expenditures for rig upgrades and continuing rig enhancements, and working capital requirements.

### Capital Resources

Cash required to meet the Company's capital commitments is determined by evaluating rig upgrades to meet specific customer requirements and by evaluating the Company's continuing rig enhancement program, including water depth and drilling capability upgrades. It is management's opinion that operating cash flows and the Company's cash reserves will be sufficient to meet these capital commitments; however, periodic assessments will be made based on industry conditions. In addition, the Company may, from time to time, issue debt or equity securities, or a combination thereof, to finance capital expenditures, the acquisition of assets and businesses, or for general corporate purposes. The Company's ability to effect any such issuance will be dependent on the Company's results of operations, its current financial condition, current market conditions, and other factors beyond its control.

During the year ended December 31, 2000, the Company expended \$250.9 million, including capitalized interest expense, for rig upgrades, primarily for the conversion of the *Ocean Confidence*. Also included in this amount was approximately \$16.0 million expended for variable deckload and water depth capability upgrades on the *Ocean Epoch*. The Company expects to spend approximately \$144.8 million for rig upgrade capital expenditures during 2001 which are primarily costs associated with the deepwater upgrade of the *Ocean Baroness*. Included in this amount is approximately \$20.0 million for accommodations and stability enhance-

ment upgrades on the *Ocean Nomad*.

The significant upgrade of the Company's semisubmersible, the *Ocean Baroness*, to high specification capabilities will be an enhanced version of the Company's previous Victory-class upgrades. The upgrade includes the following enhancements: capability for operation in 6,500 foot water depths; approximately 5,590 metric tons variable deckload; a 15,000 psi blow-out prevention system; and riser with a multiplex control system. Additional features including a high capacity deck crane, significantly enlarged cellar deck area and a 25 foot by 90 foot moon pool will provide enhanced subsea completion and development capabilities. Water depths in excess of 6,500 feet should be achievable utilizing preset taut-leg mooring systems on a case by case basis. The initial estimated cost for the deepwater upgrade of the *Ocean Baroness* is approximately \$180.0 million with an expected delivery date of February 2002. During the year ended December 31, 2000, the Company expended \$21.9 million for the deepwater upgrade of the *Ocean Baroness*.

The conversion of the *Ocean Confidence* from an accommodation vessel to a semisubmersible drilling unit was completed and the rig was accepted by the customer on January 5, 2001 at which time it began a five-year drilling program in the Gulf of Mexico. The following enhancements were made to the drilling unit: the capability for operation in 7,500 foot water depths; approximately 6,000 metric tons variable deckload; a 15,000 psi blow-out prevention system; and four mud pumps to complement the existing Class III dynamic-positioning system. The net cost of conversion for this rig was approximately \$450.0 million. Future revenues to be generated by the *Ocean Confidence* under its five-year contract are estimated to be \$311.5 million including the effect of the \$8.1 million reduction that resulted from the late delivery of the rig. Additional revenue reductions could occur during the first two wells under the drilling contract based on the nature of any downtime. The rig was evaluated for impairment in accordance with Statement of Financial Accounting Standards ("SFAS") No. 121, "Accounting for the Impairment of Long-Lived Assets and Long-Lived Assets to be Disposed Of", and no instance of impairment was noted.

During the year ended December 31, 2000, the Company expended \$73.0 million in association with its continuing rig enhancement program and to meet other corporate requirements. These expenditures included purchases of king-post cranes, anchor chain, riser, and other drilling equipment. The Company has budgeted

\$106.0 million for 2001 capital expenditures associated with its continuing rig enhancement program and other corporate requirements.

The Company continues to consider transactions, which include, but are not limited to, the purchase of existing rigs, construction of new rigs and the acquisition of other companies engaged in contract drilling or related businesses. Certain of these potential transactions reviewed by the Company would, if completed, result in its entering new lines of business. In general, however, these opportunities have been related in some manner to the Company's existing operations. Although the Company does not, as of the date hereof, have any commitment with respect to a material acquisition, it could enter into such an agreement in the future and such acquisition could result in a material expansion of its existing operations or result in the Company entering a new line of business. Some of the potential acquisitions considered by the Company could, if completed, result in the expenditure of a material amount of funds or the issuance of a material amount of debt or equity securities.

### Integrated Services

The Company's wholly owned subsidiary, DOTS, from time to time, selectively engages in drilling services pursuant to turnkey or modified-turnkey contracts under which DOTS agrees to drill a well to a specified depth for a fixed price. In such cases, DOTS generally is not entitled to payment unless the well is drilled to the specified depth. Profitability of the contract is dependent upon its ability to keep expenses within the estimates used in determining the contract price. Drilling a well under a turnkey contract therefore typically requires a greater cash commitment by the Company and exposes the Company to risks of potential financial losses that generally are substantially greater than those that would ordinarily exist when drilling under a conventional dayrate contract. DOTS also offers a portfolio of drilling services including overall project management, extended well tests, and completion operations. During 2000, DOTS contributed operating income of \$1.0 million to the Company's consolidated results of operations primarily from the completion of four turnkey projects in the Gulf of Mexico, one international turnkey project and integrated services provided in Aberdeen, Scotland. During 1999, DOTS contributed operating income of \$0.3 million to the Company's consolidated results of operations primarily from four turnkey wells completed in the Gulf of Mexico and integrated services in Aberdeen, Scotland.

### OTHER

#### Currency Risk

Certain of the Company's subsidiaries use the local currency in the country where they conduct operations as their functional currency. Currency environments in which the Company has material business operations include the U.K., Australia, Brazil and Indonesia. The Company generally attempts to minimize its currency exchange risk by seeking international contracts payable in local currency in amounts equal to the Company's estimated operating costs payable in local currency and in U.S. dollars for the balance of the contract. Because of this strategy, the Company has minimized its unhedged net asset or liability positions denominated in local currencies and has not experienced significant gains or losses associated with changes in currency exchange rates. At present, only contracts covering the Company's six rigs currently operating in Brazil are payable both in U.S. dollars and the local currency. The Company has not hedged its exposure to changes in the exchange rate between U.S. dollars and the local currencies in the U.K., Australia or Indonesia for operating costs payable in these currencies, although it may seek to do so in the future.

Currency translation adjustments are accumulated in a separate section of stockholders' equity. When the Company ceases its operations in a currency environment, the accumulated adjustments are recognized currently in results of operations. The effect on results of operations from these translation gains and losses has not been material and they are not expected to have a significant effect in the future.

#### Accounting Standards

In June 1998, the Financial Accounting Standards Board ("FASB") issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." In June 2000, the FASB issued SFAS No. 138, which amended certain provisions of SFAS No. 133 to clarify four areas causing difficulties in implementation. The amendment included expanding the normal purchase and sale exemption for supply contracts, permitting the offsetting of certain intercompany foreign currency derivatives and thus reducing the number of third party derivatives, permitting hedge accounting for foreign currency denominated assets and liabilities, and redefining interest rate risk to reduce sources of ineffectiveness. The Company adopted SFAS No. 133 and the corresponding amendments under SFAS No. 138 on January 1, 2001. Adoption of SFAS No. 133, as amended by SFAS No. 138, has not had nor is it

expected to have a material impact on the Company's consolidated results of operations, financial position or cash flows.

In December 1999, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition in Financial Statements." The bulletin summarizes certain of the SEC Staff's view in applying generally accepted accounting principles to revenue recognition in financial statements. This bulletin through its subsequent revised releases SAB No. 101A and SAB No. 101B was effective for registrants no later than the fourth fiscal quarter of fiscal years beginning after December 15, 1999. The implementation of this bulletin did not have any impact on the results of operations or equity of the Company.

#### Forward-Looking Statements

Certain written and oral statements made or incorporated by reference from time to time by the Company or its representatives are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include, without limitation, any statement that may project, indicate or imply future results, performance or achievements, and may contain the words "expect," "intend," "plan," "anticipate," "estimate," "believe," "will be," "will continue," "will likely result," and similar expressions. Statements by the Company in this report that contain forward-looking statements include, but are not limited to, discussions regarding future market conditions and the effect of such conditions on the Company's future results of operations (see "— Outlook"), future uses of and requirements for financial resources, including but not limited to, expenditures related to the deepwater upgrade of the *Ocean Baroness* (see "— Liquidity" and "— Capital Resources"), and the impact of currency risk to the Company's future results of operations (see "— Other"). Such statements inherently are subject to a variety of risks and uncertainties that could cause actual results to differ materially from those projected. Such risks and uncertainties include, among others, general economic and business conditions, casualty losses, industry fleet capacity, changes in foreign and domestic oil and gas exploration and production activity, competition, changes in foreign, political, social and economic conditions, regulatory initiatives and compliance with governmental regulations, customer preferences and various other matters, many of which are beyond the Company's control. The risks included here are not

## MANAGEMENT'S DISCUSSION & ANALYSIS OF FINANCIAL CONDITION & RESULTS OF OPERATIONS

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exhaustive. Other sections of this report and the Company's other filings with the SEC include additional factors that could adversely impact the Company's business and financial performance. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements. The Company expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statement to reflect any change in the Company's expectations with regard thereto or any change in events, conditions or circumstances on which any forward-looking statement is based.

### QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information included below is considered to constitute "forward-looking statements" for purposes of the statutory safe harbor provided in Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Forward-Looking Statements."

The Company's financial instruments that are potentially sensitive to changes in interest rates include the Company's convertible subordinated notes, the Debentures and investments in debt securities, including U.S. Treasury securities, treasury inflation-indexed protective bonds ("TIP's"), and collateralized mortgage obligations ("CMO's").

The Company's convertible subordinated notes, which are due February 15, 2007, have a stated interest rate of 3.75% and an effective interest rate of 3.93%. At December 31, 2000, the fair value of these notes, based on quoted market prices, was approximately \$440.2 million, compared to a carrying amount of approximately \$400.0 million. At December 31, 2000, the fair value of the Company's Debentures, based on quoted market prices, was approximately \$406.2 million, compared to a carrying amount of \$410.2 million.

At December 31, 2000, the fair market value of the Company's investment in debt securities issued by the U.S. Treasury, excluding TIP's and CMO's, was approximately \$149.1 million, which includes an unrealized holding gain of \$0.1 million. These securities bear interest rates ranging from 6.0% to 6.5% and are U.S. government-backed, generally short-term, and readily marketable.

The fair market value of the Company's investment in

TIP's at December 31, 2000 was approximately \$267.0 million, which includes an unrealized holding gain of \$1.0 million. These securities bear a fixed interest rate of 3.625% and have an inflation-adjusted principal. The amount of each semiannual interest payment is based on the securities' inflation-adjusted principal amount on an interest payment date and, at maturity, the securities will be redeemed at the greater of their inflation-adjusted principal or par amount at original issue. The TIP's are short-term and readily marketable.

The fair market value of the Company's investment in CMO's at December 31, 2000 was approximately \$301.2 million, which includes an unrealized holding gain of \$3.8 million. These securities bear interest rates ranging from 7.0% to 8.0%. The CMO's are also short-term and readily marketable with an implied AAA rating backed by U.S. government guaranteed mortgages.

At December 31, 2000, the fair value of the Company's investment in equity securities was approximately \$0.4 million, which includes an unrealized holding gain of \$0.2 million.

Based on the nature of these financial instruments and in consideration of past market movements and reasonably possible near-term market movements, the Company does not believe that potential near-term gains and/or losses in future earnings, fair values, or cash flows are likely to be material.

Other than trade accounts receivable and trade accounts payable, the Company does not currently have financial instruments that are sensitive to foreign currency exchange rates.

## CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

	December 31,	
	2000	1999
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 144,456	\$ 112,316
Marketable securities	717,678	529,042
Accounts receivable	153,452	143,569
Rig inventory and supplies	40,698	38,760
Prepaid expenses and other	44,673	36,605
Total current assets	<b>1,100,957</b>	860,292
Drilling and other property and equipment, net of accumulated depreciation	1,902,415	1,737,905
Goodwill, net of accumulated amortization	55,205	73,174
Other assets	20,929	9,658
Total assets	<b>\$ 3,079,506</b>	<b>\$ 2,681,029</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Current portion of long-term debt	\$ 9,732	\$ —
Accounts payable	59,021	72,630
Accrued liabilities	53,923	44,051
Taxes payable	337	18,720
Total current liabilities	<b>123,013</b>	135,401
Long-term debt	856,559	400,000
Deferred tax liability	316,627	291,213
Other liabilities	15,454	12,193
Total liabilities	<b>1,311,653</b>	838,807
Commitments and contingencies		
Stockholders' equity:		
Preferred stock (par value \$0.01, 25,000,000 shares authorized, none issued and outstanding)	—	—
Common stock (par value \$0.01, 500,000,000 shares authorized, 133,150,477 issued and outstanding at December 31, 2000 and 139,342,381 shares issued and 135,824,281 outstanding at December 31, 1999)	1,332	1,393
Additional paid-in capital	1,248,665	1,302,841
Retained earnings	517,186	635,943
Accumulated other comprehensive gains (losses)	670	(9,229)
Treasury stock, at cost	—	(88,726)
Total stockholders' equity	<b>1,767,853</b>	1,842,222
Total liabilities and stockholders' equity	<b>\$ 3,079,506</b>	<b>\$ 2,681,029</b>

The accompanying notes are an integral part of the consolidated financial statements.



## CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

	Year Ended December 31,		
	2000	1999	1998
Revenues	\$ 659,436	\$ 821,024	\$ 1,208,801
Operating expenses:			
Contract drilling	433,091	431,523	484,625
Depreciation and amortization	145,596	142,963	130,271
General and administrative	23,803	22,877	25,324
Total operating expenses	<u>602,490</u>	<u>597,363</u>	<u>640,220</u>
Operating income	56,946	223,661	568,581
Other income (expense):			
Gain on sale of assets	14,324	231	418
Interest income	49,525	34,985	30,565
Interest expense	(10,272)	(9,212)	(14,487)
Other, net	344	(9,302)	5,154
Income before income tax expense	110,867	240,363	590,231
Income tax expense	<u>(38,586)</u>	<u>(84,292)</u>	<u>(206,572)</u>
Net income	<u>\$ 72,281</u>	<u>\$ 156,071</u>	<u>\$ 383,659</u>
Net income per share:			
Basic	<u>\$ 0.53</u>	<u>\$ 1.15</u>	<u>\$ 2.78</u>
Diluted	<u>\$ 0.53</u>	<u>\$ 1.11</u>	<u>\$ 2.66</u>
Weighted average shares outstanding:			
Shares of common stock	135,164	135,822	138,020
Dilutive potential shares of common stock	<u>9,876</u>	<u>9,876</u>	<u>9,876</u>
Total weighted average shares of common stock outstanding	<u>145,040</u>	<u>145,698</u>	<u>147,896</u>

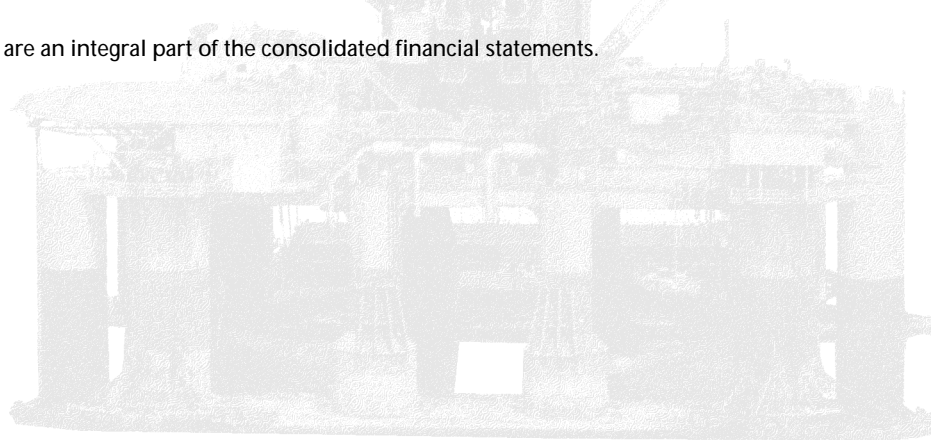
The accompanying notes are an integral part of the consolidated financial statements.

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In thousands, except number of shares)

	Common Stock		Additional Paid-in Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Gains (Losses)	Treasury Stock		Total Stockholders' Equity
	Shares	Amount				Shares	Amount	
<b>December 31, 1997</b>	139,309,948	\$ 1,393	\$ 1,302,712	\$ 233,350	\$ (1,928)	—	—	\$1,535,527
Net income	—	—	—	383,659	—	—	—	383,659
Treasury stock purchases	—	—	—	—	—	3,518,100	\$ (88,726)	(88,726)
Dividends to stockholders	—	—	—	(69,226)	—	—	—	(69,226)
Stock options exercised	23,687	—	94	—	—	—	—	94
Exchange rate changes, net	—	—	—	—	(291)	—	—	(291)
Loss on investments, net	—	—	—	—	(5,779)	—	—	(5,779)
<b>December 31, 1998</b>	139,333,635	1,393	1,302,806	547,783	(7,998)	3,518,100	(88,726)	1,755,258
Net income	—	—	—	156,071	—	—	—	156,071
Treasury stock purchases	—	—	—	—	—	—	—	—
Dividends to stockholders	—	—	—	(67,911)	—	—	—	(67,911)
Stock options exercised	8,746	—	35	—	—	—	—	35
Exchange rate changes, net	—	—	—	—	(983)	—	—	(983)
Loss on investments, net	—	—	—	—	(248)	—	—	(248)
<b>December 31, 1999</b>	139,342,381	1,393	1,302,841	635,943	(9,229)	3,518,100	(88,726)	1,842,222
Net income	—	—	—	72,281	—	—	—	72,281
Treasury stock purchases								
Purchases	—	—	—	—	—	2,705,100	(92,959)	(92,959)
Retirement	(6,223,200)	(62)	(58,193)	(123,430)	—	(6,223,200)	181,685	—
Dividends to stockholders	—	—	—	(67,608)	—	—	—	(67,608)
Stock options exercised	30,803	1	122	—	—	—	—	123
Put option premiums	—	—	3,875	—	—	—	—	3,875
Conversion of long-term debt	493	—	20	—	—	—	—	20
Exchange rate changes, net	—	—	—	—	506	—	—	506
Gain on investments, net	—	—	—	—	9,393	—	—	9,393
<b>December 31, 2000</b>	133,150,477	\$ 1,332	\$ 1,248,665	\$ 517,186	\$ 670	—	\$ —	\$1,767,853

The accompanying notes are an integral part of the consolidated financial statements.

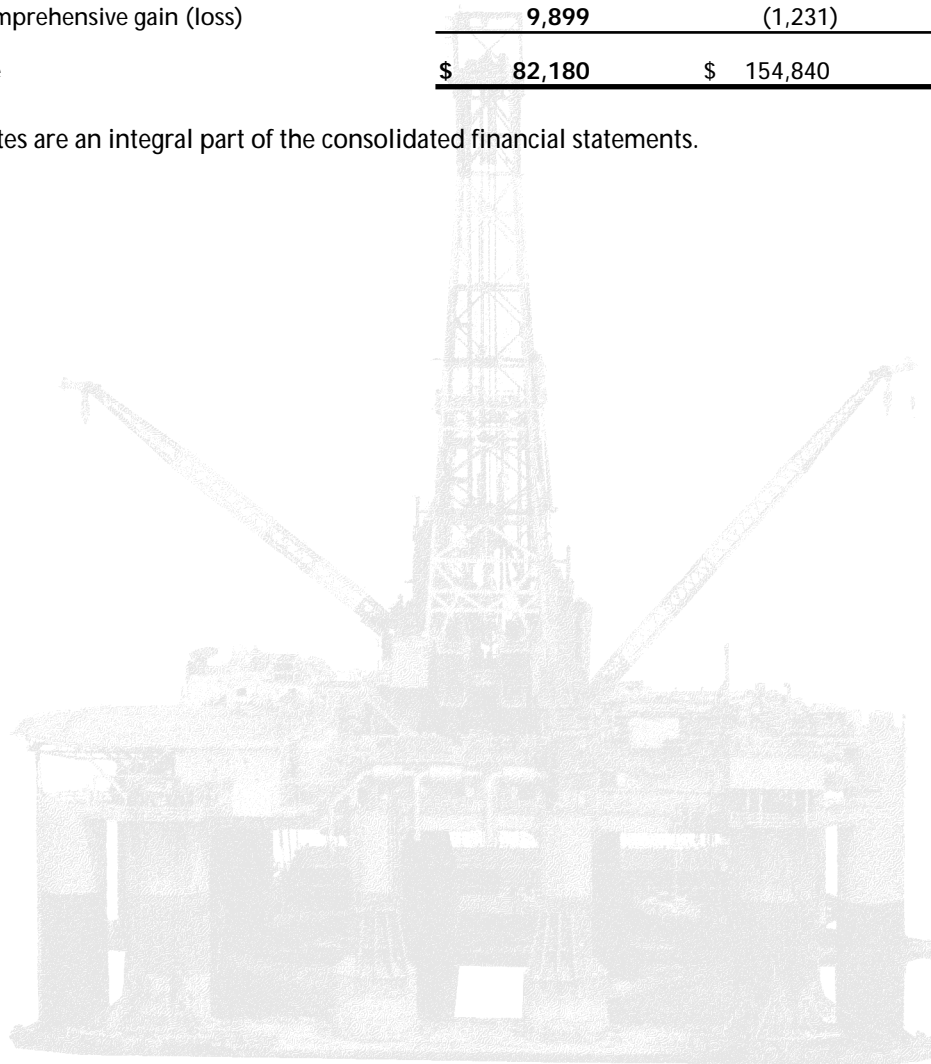


## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

	Year Ended December 31,		
	2000	1999	1998
Net income	\$ 72,281	\$ 156,071	\$ 383,659
Other comprehensive gains (losses), net of tax:			
Foreign currency translation gain (loss)	506	(983)	(291)
Unrealized holding gain (loss) on investments	3,259	(5,903)	(5,797)
Reclassification adjustment for losses included in net income	6,134	5,655	18
Total other comprehensive gain (loss)	9,899	(1,231)	(6,070)
Comprehensive income	\$ 82,180	\$ 154,840	\$ 377,589

The accompanying notes are an integral part of the consolidated financial statements.



## CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Year Ended December 31,		
	2000	1999	1998
<b>Operating activities:</b>			
Net income	\$ 72,281	\$ 156,071	\$ 383,659
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	145,596	142,963	130,271
Gain on sale of assets	(14,324)	(231)	(418)
(Gain) loss on sale of investment securities	2,397	522	(1,116)
Impairment write-down of investment securities	—	10,671	—
Deferred tax provision	26,155	38,529	61,403
Accretion of discount on investment securities	(7,535)	(9,316)	(14,568)
Amortization of debt issuance costs	864	541	521
Amortization of discount on zero coupon convertible debentures	8,033	—	—
Changes in operating assets and liabilities:			
Accounts receivable	(9,883)	90,279	(26,153)
Rig inventory and supplies and other current assets	(9,190)	(7,527)	(21,911)
Other assets, non-current	(604)	(2,639)	(705)
Accounts payable and accrued liabilities	(4,592)	(30,540)	40,534
Taxes payable	(12,658)	11,193	(3,867)
Other liabilities, non-current	3,261	(881)	835
Other, net	1,234	(1,513)	(1,301)
Net cash provided by operating activities	<u>201,035</u>	<u>398,122</u>	<u>547,184</u>
<b>Investing activities:</b>			
Capital expenditures	(323,924)	(324,133)	(224,474)
Proceeds from sale of assets	33,279	662	1,011
Net change in marketable securities	(169,048)	4,343	(167,818)
Net cash used in investing activities	<u>(459,693)</u>	<u>(319,128)</u>	<u>(391,281)</u>
<b>Financing activities:</b>			
Acquisition of treasury stock	(92,959)	—	(88,726)
Proceeds from sale of put options	3,875	—	—
Payment of dividends	(67,608)	(67,911)	(69,226)
Proceeds from stock options exercised	123	35	289
Issuance of zero coupon convertible debentures	402,178	—	—
Debt issuance costs-zero coupon convertible debentures	(9,556)	—	—
Lease-leaseback agreement	55,000	—	—
Arrangement fees-lease-leaseback agreement	(255)	—	—
Net cash provided by (used in) financing activities	<u>290,798</u>	<u>(67,876)</u>	<u>(157,663)</u>
Net change in cash and cash equivalents	<u>32,140</u>	<u>11,118</u>	<u>(1,760)</u>
Cash and cash equivalents, beginning of year	<u>112,316</u>	<u>101,198</u>	<u>102,958</u>
Cash and cash equivalents, end of year	<u>\$ 144,456</u>	<u>\$ 112,316</u>	<u>\$ 101,198</u>

The accompanying notes are an integral part of the consolidated financial statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Organization and Business

Diamond Offshore Drilling, Inc. (the "Company") was incorporated in Delaware on April 13, 1989. Loews Corporation ("Loews"), a Delaware corporation of which the Company had been a wholly owned subsidiary prior to the initial public offering in October 1995 (the "Common Stock Offering"), owns 52.6 percent of the outstanding common stock of the Company.

The Company, through wholly owned subsidiaries, engages in the worldwide contract drilling of offshore oil and gas wells and is a leader in deep water drilling. Currently, the fleet is comprised of 30 semisubmersible rigs, 14 jack-up rigs, and one drillship.

#### Principles of Consolidation

The consolidated financial statements include the accounts of the Company after elimination of significant intercompany transactions and balances.

#### Cash and Cash Equivalents

Short-term, highly liquid investments that have an original maturity of three months or less and deposits in money market mutual funds that are readily convertible into cash are considered cash equivalents.

#### Marketable Securities

The Company's investments are classified as available for sale and stated at fair value under the terms of Statement of Financial Accounting Standards ("SFAS") No. 115, "Accounting for Certain Investments in Debt and Equity Securities." Accordingly, any unrealized gains and losses, net of taxes, are reported in the Consolidated Balance Sheets in "Accumulated other comprehensive gains (losses)" until realized. The cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity and such adjustments are included in the Consolidated Statements of Income in "Interest income." The cost of debt securities sold is based on the specific identification method and the cost of equity securities sold is based on the average cost method. Realized gains or losses and declines in value judged to be other than temporary, if any, are reported in the Consolidated Statements of Income in "Other income (expense)."

#### Supplementary Cash Flow Information

Cash payments made for interest on long-term debt, including commitment fees, were \$15.0 million during each of the years ended December 31, 2000, 1999 and 1998. Cash payments made for income taxes, net of

refunds, during the years ended December 31, 2000, 1999, and 1998 were \$25.8 million, \$35.0 million, and \$151.3 million, respectively.

#### Rig Inventory and Supplies

Inventories primarily consist of replacement parts and supplies held for use in the operations of the Company. Inventories are stated at the lower of cost or estimated value.

#### Drilling and Other Property and Equipment

Drilling and other property and equipment is carried at cost. Maintenance and repairs are charged to income currently while replacements and betterments are capitalized. Costs incurred for major rig upgrades are accumulated in construction work in progress, with no depreciation recorded on the additions, until the month the upgrade is completed and the rig is placed in service. Upon retirement or other disposal of fixed assets, the cost and related accumulated depreciation are removed from the respective accounts and any gains or losses are included in the results of operations. Depreciation is provided on the straight-line method over the remaining estimated useful lives from the date the asset is placed in service.

#### Capitalized Interest

Interest cost for construction and upgrade of qualifying assets is capitalized. The Company incurred interest cost, including amortization of debt issuance costs, of \$24.1 million during the year ended December 31, 2000, and \$15.5 million during each of the years ended December 31, 1999 and 1998. Interest cost capitalized during the years ended December 31, 2000, 1999, and 1998 was \$13.8 million, \$6.3 million, and \$1.0 million, respectively.

#### Impairment of Long-Lived Assets

The Company reviews its long-lived assets for impairment when changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Company evaluated its high-specification semisubmersible, the *Ocean Confidence*, for impairment in accordance with SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and Long-Lived Assets to be Disposed Of", and no instance of impairment was noted.

#### Goodwill

Goodwill from the merger with Arethusa (Off-Shore) Limited ("Arethusa") is amortized on a straight-line basis over 20 years. Amortization charged to operating expense during the years ended December 31, 2000,

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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1999, and 1998 totaled \$4.5 million, \$5.3 million, and \$6.5 million, respectively.

### Debt Issuance Costs

Debt issuance costs are included in the Consolidated Balance Sheets in "Other assets" and are amortized over the term of the related debt.

### Deferred Income Taxes

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The Company's non-U.S. income tax liabilities are based upon the results of operations of the various subsidiaries and foreign branches in those jurisdictions in which they are subject to taxation.

### Treasury Stock

Depending on market conditions, the Company may, from time to time, purchase shares of its common stock in the open market or otherwise. The purchase of treasury stock is accounted for using the cost method which reports the cost of the shares acquired in "Treasury stock" as a deduction from stockholders' equity in the Consolidated Balance Sheets. During the year ended December 31, 2000, the Company purchased 2.7 million shares of its common stock at an aggregate cost of \$93.0 million, or at an average cost of \$34.36 per share. The Company did not repurchase any of its common stock during the year ended December 31, 1999. Effective December 31, 2000, the Company retired all 6,223,200 shares of its treasury stock at an aggregate cost of \$181.7 million.

### Common Equity Put Options

In August 2000, in connection with its ongoing stock repurchase program, the Company sold put options covering 750,000 common shares. The options gave the holders the right to require the Company to repurchase shares of its common stock at an exercise price of \$37.85 at anytime prior to expiration through February 2001. The Company had the option to settle in cash or shares of common stock. Premiums received for these options of \$3.9 million are recorded in "Additional paid-in capital" in the Consolidated Balance Sheets. All of these options were unexercised and expired by the end of February 2001.

On February 27, 2001, the Company received premiums of \$3.1 million for the sale of put options covering 500,000 common shares. The options give the

holders the right to require the Company to repurchase shares of its common stock at an exercise price of \$40.00 at anytime prior to expiration in February 2002. The Company has the option to settle in cash or shares of common stock.

### Revenue Recognition

Income from dayrate drilling contracts is recognized currently. In connection with such drilling contracts, the Company may receive lump-sum fees for the mobilization of equipment and personnel. The net of mobilization fees received and costs incurred to mobilize an offshore rig from one market to another is recognized over the term of the related drilling contract unless there is a net mobilization cost in which case the cost is recognized currently. Absent a contract, mobilization costs are also recognized currently. Lump-sum payments received from customers relating to specific contracts are deferred and amortized to income over the term of the drilling contract.

Income from offshore turnkey drilling contracts is recognized on the completed contract method, with revenues accrued to the extent of costs until the specified turnkey depth and other contract requirements are met. Provisions for future losses on turnkey drilling contracts are recognized when it becomes apparent that expenses to be incurred on a specific contract will exceed the revenue from that contract.

### Currency Translation

The Company's primary functional currency is the U.S. dollar. Certain of the Company's subsidiaries use the local currency in the country where they conduct operations as their functional currency. These subsidiaries translate assets and liabilities at year-end exchange rates while income and expense accounts are translated at average exchange rates. Translation adjustments are reflected in the Consolidated Balance Sheets in "Accumulated other comprehensive gains/(losses)." Currency transaction gains and losses are included in the Consolidated Statements of Income in "Other income (expense)." Additionally, translation gains and losses of subsidiaries operating in hyperinflationary economies are included in operating results currently.

### Comprehensive Income

Comprehensive income is the change in equity of a business enterprise during a period from transactions and other events and circumstances except those transactions resulting from investments by owners and distributions to owners. Comprehensive income

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

includes net income, foreign currency translation gains and losses, and unrealized holding gains and losses on investments.

### Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimated.

### Reclassifications

Certain amounts applicable to the prior periods have been reclassified to conform to the classifications currently followed. Such reclassifications do not affect earnings.

## 2. EARNINGS PER SHARE

A reconciliation of the numerators and the denominators of the basic and diluted per-share computations for net income follows:

	For the Year Ended December 31,		
	2000	1999	1998
	(in thousands, except per share data)		
Net income – basic (numerator):			
Net income	\$ 72,281	\$ 156,071	\$ 383,659
Effect of dilutive potential shares			
Convertible notes	4,249	5,988	9,419
Net income including conversions	\$ 76,530	\$ 162,059	\$ 393,078
Weighted average shares – basic (denominator):			
Weighted average shares	135,164	135,822	138,020
Effect of dilutive potential shares			
Convertible notes	9,876	9,876	9,876
Weighted average shares including conversions	145,040	145,698	147,896
Earnings per share:			
Basic	\$ 0.53	\$ 1.15	\$ 2.78
Diluted	\$ 0.53	\$ 1.11	\$ 2.66

On February 4, 1997, the Company issued \$400.0 million of 3.75% convertible subordinated notes (the “Notes”) due February 15, 2007. The Notes are convertible into approximately 9.8 million shares of the Company’s common stock at any time prior to February 15, 2007 at a conversion price of \$40.50 per share. The number of shares outstanding for the periods presented were increased to include the weighted average number of shares issuable assuming full conversion of the notes.

On June 6, 2000, the Company issued 20-year zero coupon convertible debentures (the “Debentures”). The Debentures were issued at a discount with a yield to maturity of 3.50% per year. The Debentures are convertible into approximately 6.9 million shares of the Company’s common stock at any time prior to June 6, 2020 at a fixed conversion rate of 8.6075 shares per Debenture. The computation of diluted earnings per share (“EPS”) does not assume conversion of the Debentures for the year ended December 31, 2000 since there would be an antidilutive effect on EPS.

At the 2000 Annual Meeting of Stockholders on May 16, 2000, the Diamond Offshore Drilling, Inc. 2000 Stock Option Plan (the “Stock Option Plan”) was approved. There were 109,000 non-qualified stock options outstanding at December 31, 2000. Non-qualified stock options granted in July 2000 to purchase 2,500 shares of common stock at an exercise price of \$35.72 per share were included in the computation of diluted EPS for the periods presented since the options’ exercise price was less than the average market price of the common stock. However, the incremental shares calculated were immaterial for presentation purposes.

The options to originally purchase up to 1.0 million shares of common stock assumed in the merger with Arethusa (the “Arethusa Options”) have not been included as dilutive potential shares. The effect on the computation of EPS, had the Arethusa Options been included, was not material. All unexercised Arethusa Options had expired as of August 31, 2000. At December 31, 1999 and 1998, there were Arethusa Options outstanding for the purchase of approximately 39,000 and 48,000 shares of common stock, respectively.

In August 2000, the Company sold put options covering 750,000 common shares at an exercise price of \$37.85 per share. The options were outstanding through December 31, 2000 but were not included in the computation of diluted EPS for 2000 because the options’ exercise price was less than the average market price of the common stock.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 3. MARKETABLE SECURITIES

Investments classified as available for sale are summarized as follows:

	December 31, 2000		
	Cost	Unrealized Gain (Loss)	Market Value
	(in thousands)		
Debt securities issued by the U.S. Treasury			
Due within one year	\$ 149,005	\$ 60	\$149,065
Due after one year through five years	265,981	1,045	267,026
Collateralized mortgage obligations	297,446	3,757	301,203
Equity securities	231	153	384
Total	<u>\$ 712,663</u>	<u>\$ 5,015</u>	<u>\$717,678</u>

	December 31, 1999		
	Cost	Unrealized Gain (Loss)	Market Value
	(in thousands)		
Debt securities issued by the U.S. Treasury			
Due within one year	\$ 259,090	\$ (1,123)	\$ 257,967
Due after one year through five years	124,935	(2,180)	122,755
Collateralized mortgage obligations	153,004	(6,130)	146,874
Equity securities	1,446	--	1,446
Total	<u>\$ 538,475</u>	<u>\$ (9,433)</u>	<u>\$ 529,042</u>

All of the Company's investments are included as current assets in the Consolidated Balance Sheets in "Marketable securities," representing the investment of cash available for current operations.

During the year ended December 31, 2000, certain debt securities due within one year were sold or matured for proceeds of \$757.6 million, resulting in an after-tax realized loss of \$0.8 million. Certain debt securities due after one year were sold for proceeds of \$222.3 million during the year ended December 31, 2000, with a resulting after-tax realized gain of \$0.5 million. Collateralized mortgage obligations were sold for proceeds of \$348.7 million during the year ended December 31, 2000, with a resulting after-tax realized gain of \$1.1 million. Collateralized mortgage obligation principals were reduced by \$14.5 million during the year. The after-tax realized losses were immaterial. Also during the year ended December 31, 2000, certain equity securities were sold for proceeds of \$2.1 million, with a resulting after-tax realized gain of \$0.6 million.

At December 31, 1999, the market value of the Company's investment in equity securities was \$1.4 million, which included an unrealized loss of \$10.7 million. Because this decline in

value was judged to be other than temporary, the cost of the securities was written down from \$12.1 million to \$1.4 million at December 31, 1999 and a corresponding after-tax impairment loss of \$6.9 million was charged against net income for the year ended December 31, 1999.

During the year ended December 31, 1999, certain debt securities due within one year were sold or matured for proceeds of \$640.9 million, resulting in after-tax realized gains that were immaterial. Certain debt securities due after one year were sold for proceeds of \$99.8 million during the year ended December 31, 1999, with a resulting after-tax realized loss of \$0.3 million.

### 4. DRILLING AND OTHER PROPERTY AND EQUIPMENT

Cost and accumulated depreciation of drilling and other property and equipment are summarized as follows:

	December 31,	
	2000	1999
	(in thousands)	
Drilling rigs and equipment	\$2,155,924	\$ 2,095,613
Construction work in progress	474,154	241,102
Land and buildings	14,224	13,992
Office equipment and other	18,480	17,552
Cost	<u>2,662,782</u>	<u>2,368,259</u>
Less accumulated depreciation	<u>(760,367)</u>	<u>(630,354)</u>
Drilling and other property and equipment, net	<u>\$1,902,415</u>	<u>\$ 1,737,905</u>

Construction work in progress in 2000 included approximately \$450.0 million for the conversion of the *Ocean Confidence*. In January 2001, this amount was reclassified from construction work in progress to drilling rigs and equipment due to the completion of the conversion of the rig from an accommodation vessel to a semisubmersible drilling unit. The customer accepted the rig on January 5, 2001 at which time it began a five-year drilling program in the Gulf of Mexico.

In January 2000, the Company sold a jack-up drilling rig, the *Ocean Scotian*, for \$32.0 million in cash resulting in a gain of \$13.9 million (\$9.0 million after-tax). The rig had been cold stacked offshore The Netherlands prior to the sale.

### 5. GOODWILL

The merger with Arethusa generated an excess of the purchase price over the estimated fair value of the net assets acquired. Cost and accumulated amortization of such goodwill is summarized as follows:



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	December 31,	
	2000	1999
	(in thousands)	
Goodwill	\$ 82,628	\$ 96,112
Less accumulated amortization	(27,423)	(22,938)
Total	<u>\$ 55,205</u>	<u>\$ 73,174</u>

During the years ended December 31, 2000 and 1999, adjustments of \$13.5 million and \$31.3 million, respectively, were recorded to reduce goodwill before accumulated amortization. The adjustments represent tax benefits not previously recognized for the excess of tax deductible goodwill over the book goodwill amount.

### 6. ACCRUED LIABILITIES

Accrued liabilities consist of the following:

	December 31,	
	2000	1999
	(in thousands)	
Personal injury and other claims	\$ 21,565	\$ 18,219
Payroll and benefits	22,688	16,281
Interest payable	5,870	5,667
Other	3,800	3,884
Total	<u>\$ 53,923</u>	<u>\$ 44,051</u>

### 7. LONG-TERM DEBT

Long-term debt consists of the following:

	December 31,	
	2000	1999
	(in thousands)	
Convertible subordinated notes-3.75%	\$ 399,980	\$ 400,000
Zero coupon convertible debentures-3.50%	410,211	—
Lease-leaseback agreement	56,100	—
	<u>866,291</u>	<u>400,000</u>
Less: Current maturities	9,732	—
Total	<u>\$ 856,559</u>	<u>\$ 400,000</u>

#### Convertible Subordinated Notes

In February 1997, the Company issued \$400.0 million of convertible subordinated notes due February 15, 2007. The Notes are convertible into shares of the Company's common stock, at a conversion price of \$40.50 per share, subject to adjustment in certain circumstances. The

Notes have a stated interest rate of 3.75% and an effective interest rate of 3.93%. Interest is payable semi-annually on each February 15 and August 15. In August 2000, \$20,000 in Notes were converted into 493 shares of the Company's common stock.

The Notes are redeemable, in whole or, from time to time, in part, at the option of the Company, at any time on or after February 22, 2001, at specified redemption prices, plus accrued and unpaid interest to the date of redemption. The Notes are general unsecured obligations of the Company, subordinated in right of payment to the prior payment in full of the principal and premium, if any, and interest on all indebtedness of the Company for borrowed money, other than the Notes, with certain exceptions, and effectively subordinated in right of payment to the prior payment in full of all indebtedness of the Company's subsidiaries. The Notes do not restrict the Company's ability to incur other indebtedness or additional indebtedness of the Company's subsidiaries.

On March 7, 2001, the Company announced its decision to redeem, on April 6, 2001, all of its outstanding Notes at a redemption price of 102.08% of the principal amount thereof, together with interest accrued to (but not including) the redemption date. These Notes are convertible on or before the close of business on April 5, 2001 into shares of the Company's common stock at a conversion price of \$40.50 per share, subject to adjustment in certain circumstances. If none of the Notes outstanding are converted into common stock prior to April 6, 2001, the redemption of all of the outstanding Notes would result in a charge of \$7.9 million after-tax and reported as an extraordinary loss in the second quarter of 2001.

#### Zero Coupon Convertible Debentures

On June 6, 2000, the Company issued zero coupon convertible Debentures due June 6, 2020. The Debentures were issued at a price of \$499.60 per \$1,000 debenture, which represents a yield to maturity of 3.50% per year. The Company will not pay interest prior to maturity unless it elects to convert the Debentures to interest-bearing debentures upon the occurrence of certain tax events. The Debentures are convertible at the option of the holder at any time prior to maturity, unless previously redeemed, into the Company's common stock at a fixed conversion rate of 8.6075 shares of common stock per Debenture, subject to adjustments in certain events. The Debentures are senior unsecured obligations of the Company.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company has the right to redeem the Debentures, in whole or in part, after June 6, 2005 for a price equal to the issuance price plus accrued original issue discount through the date of redemption. Holders have the right to require the Company to repurchase the Debentures on the fifth, tenth and fifteenth anniversaries of issuance at the accreted value through the date of repurchase. The Company may pay such repurchase price with either cash or shares of the Company's common stock or a combination of cash and shares of common stock.

### Lease-Leaseback Agreement

In December 2000, the Company entered into a lease-leaseback agreement (the "Agreement") with a European bank. The Agreement provides for the Company to lease the *Ocean Alliance*, one of the Company's high specification semisubmersible drilling rigs, to the bank for a lump-sum payment of \$55.0 million plus an origination fee of \$1.1 million and for the bank to then sub-lease the rig back to the Company. Under the Agreement, which has a five-year term, the Company is to make five annual payments of \$13.7 million. This financing arrangement has an effective interest rate of 7.13% and is an unsecured subordinated obligation of the Company.

### Credit Agreement

In April 1999, the Company entered into a \$20.0 million short-term revolving credit agreement with a U.S. bank. The credit agreement provides for borrowings at various interest rates and varying commitment fees dependent upon public credit ratings. In April 2000, the credit agreement was amended to revise these interest rates and commitment fees. The Company intends to use the facility primarily for letters of credit that the Company must post, from time to time, for bid and performance guarantees required in certain parts of the world. The credit agreement contains certain financial and other covenants and provisions that must be maintained by the Company for compliance. As of December 31, 2000, there were no outstanding borrowings under this credit agreement and the Company was in compliance with each of the covenants and provisions.

## 8. COMPREHENSIVE INCOME

The income tax effects allocated to the components of other comprehensive income are as follows:

	Year Ended December 31, 2000		
	Before Tax	Tax Effect	Net-of-Tax
	(in thousands)		
Foreign currency translation gain (loss)	\$ 778	\$ (272)	\$ 506
Unrealized gain (loss) on investments:			
Gain (loss) arising during 2000	5,014	(1,755)	3,259
Reclassification adjustment	9,437	(3,303)	6,134
Net unrealized gain (loss)	14,451	(5,058)	9,393
Other comprehensive income (loss)	\$ 15,229	\$ (5,330)	\$ 9,899

	Year Ended December 31, 1999		
	Before Tax	Tax Effect	Net-of-Tax
	(in thousands)		
Foreign currency translation gain (loss)	\$ (1,512)	\$ 529	\$ (983)
Unrealized gain (loss) on investments:			
Gain (loss) arising during 1999	(9,081)	3,178	(5,903)
Reclassification adjustment	8,700	(3,045)	5,655
Net unrealized gain (loss)	(381)	133	(248)
Other comprehensive income (loss)	\$ (1,893)	\$ 662	\$ (1,231)

	Year Ended December 31, 1998		
	Before Tax	Tax Effect	Net-of-Tax
	(in thousands)		
Foreign currency translation loss	\$ (1,430)	\$ 1,139	\$ (291)
Unrealized gain (loss) on investments:			
Gain (loss) arising during 1998	(8,918)	3,121	(5,797)
Reclassification adjustment	28	(10)	18
Net unrealized gain (loss)	(8,890)	3,111	(5,779)
Other comprehensive income (loss)	\$ (10,320)	\$ 4,250	\$ (6,070)

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### 9. COMMITMENTS AND CONTINGENCIES

The Company leases office facilities under operating leases, which expire through the year 2005. Total rent expense amounted to \$1.2 million, \$1.4 million, and \$1.8 million for the years ended December 31, 2000, 1999, and 1998, respectively. Minimum future rental payments under leases are approximately \$0.6 million, \$0.3 million, \$30,000, \$22,000 and \$14,000 for the years 2001 to 2005, respectively. There are no minimum future rental payments under leases after the year 2005.

The Company is contingently liable as of December 31, 2000 in the amount of \$32.0 million under certain performance, bid, customs and export bonds. On the Company's behalf, banks have issued letters of credit securing certain of these bonds.

*Raymond Verdin v. R&B Falcon Drilling USA, Inc., et al;* No. G-00-488 in the United States District Court for the Southern District of Texas, Galveston Division, filed October 10, 2000. The Company was named as a defendant in a proposed class action suit filed on behalf of offshore oil workers against all of the major offshore drilling companies. The proposed class includes persons hired in the United States by the companies to work in the Gulf of Mexico and around the world. The allegation is that the companies, through trade groups, shared wage information in order to fix and suppress the wages of the workers in violation of the Sherman Antitrust Act and various state laws. Plaintiff Thomas Bryant has replaced the named plaintiff as the proposed class representative. No class has been certified at this time, however, a hearing on class certification is scheduled for the second week of May 2001. The lawsuit is seeking damages as well as attorney's fees and costs. The Company believes that the case is without merit and is vigorously contesting liability.

In August 1999, a customer terminated a contract for use of one of the Company's drilling rigs located offshore Australia. The termination was made in accordance with the terms of the contract and was not the result of performance failures by the Company or its equipment. The Company believed that the contract required the customer to pay approximately \$16.5 million in remaining revenue through the end of the contract period, which was previously scheduled to end in early January 2000. However, the customer believed that there was no further obligation under the contract and refused to pay the \$16.5 million early termination fee. The Company filed suit in Australia in August 1999 requesting reconstruction of the contract and a declaratory judgment requiring the customer to pay such early termination fee. In January 2001, the Company and the

customer entered into an out-of-court settlement of the claim. The Company received \$7.3 million from the customer which will be included in the Company's Consolidated Statements of Income in the first quarter of 2001. Separately, the Company entered into contracts with the customer to work two of its rigs at favorable dayrates; both of which are scheduled to begin work during the first quarter of 2001.

Various other claims have been filed against the Company in the ordinary course of business, particularly claims alleging personal injuries. Management believes that the Company has established adequate reserves for any liabilities that may reasonably be expected to result from these claims. In the opinion of management, no pending or threatened claims, actions or proceedings against the Company are expected to have a material adverse effect on the Company's consolidated financial position, results of operations, or cash flows.

### 10. FINANCIAL INSTRUMENTS

#### **Concentrations of Credit and Market Risk**

Financial instruments which potentially subject the Company to significant concentrations of credit or market risk consist primarily of periodic temporary investments of excess cash and trade accounts receivable, and investments in debt and equity securities, including treasury inflation-indexed protective bonds ("TIP's") and collateralized mortgage obligations ("CMO's"). The Company places its temporary excess cash investments in high quality short-term money market instruments through several financial institutions. At times, such investments may be in excess of the insurable limit. The Company's periodic evaluations of the relative credit standing of these financial institutions are considered in the Company's investment strategy.

Concentrations of credit risk with respect to trade accounts receivable are limited primarily due to the entities comprising the Company's customer base. Since the market for the Company's services is the offshore oil and gas industry, this customer base consists primarily of major oil companies and independent oil and gas producers. The Company provides allowances for potential credit losses when necessary. No such allowances were deemed necessary for the years presented and, historically, the Company has not experienced significant losses on trade receivables. The Company's investments in debt securities, which are primarily U.S. government securities, do not impose a significant market risk on the Company as they are generally short-term with ready marketability. TIP's are not considered high-risk investments. While the amount of each semiannual interest

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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payment is based on the security's inflation-adjusted principal amount on an interest payment date, if at maturity the inflation-adjusted principal is less than the security's par amount, the U.S. government pays an additional amount so that the inflation-adjusted principal equals the par amount. Investments in CMO's are not considered high-risk as they consist of high quality mortgage-backed securities and are principal-only certificates, which eliminates the risk of potential loss related to prepayment.

### Fair Values

The amounts reported in the Consolidated Balance Sheets for cash and cash equivalents, marketable securities, accounts receivable, and accounts payable approximate fair value. At December 31, 2000 and 1999, the fair value of the Notes was approximately \$440.2 million and \$403.9 million, respectively, compared to a carrying amount of approximately \$400.0 million. At December 31, 2000, the fair value of the Debentures was approximately \$406.2 million compared to a carrying amount of approximately \$410.2 million.

The estimated fair value amounts have been determined by the Company using appropriate valuation methodologies and information available to management as of December 31, 2000 and 1999. Considerable judgment is required in developing these estimates, and accordingly, no assurance can be given that the estimated values are indicative of the amounts that would be realized in a free market exchange. The following methods and assumptions were used to estimate the fair value of each class of financial instrument for which it was practicable to estimate that value:

Cash and cash equivalents — The carrying amounts approximate fair value because of the short maturity of these instruments.

Marketable securities — The fair values of the debt and equity securities, including TIP's and CMO's, available for sale were based on quoted market prices as of December 31, 2000 and 1999.

Accounts receivable and accounts payable — The carrying amounts approximate fair value based on the nature of the instruments.

Long-term debt — The fair value was based on the quoted market price from brokers of the Notes and Debentures.

## 11. RELATED PARTY TRANSACTIONS

The Company and Loews have entered into a services agreement which was effective upon consummation of the Common Stock Offering (the "Services Agreement") pursuant to which Loews agreed to continue to perform certain administrative and technical services on behalf of the Company. Such services include personnel, telecommunications, purchasing, internal auditing, accounting, data processing and cash management services, in addition to advice and assistance with respect to preparation of tax returns and obtaining insurance. Under the Services Agreement, the Company is required to reimburse Loews for (i) allocated personnel costs (such as salaries, employee benefits and payroll taxes) of the Loews personnel actually providing such services and (ii) all out-of-pocket expenses related to the provision of such services. The Services Agreement may be terminated at the Company's option upon 30 days' notice to Loews and at the option of Loews upon six months' notice to the Company. In addition, the Company has agreed to indemnify Loews for all claims and damages arising from the provision of services by Loews under the Services Agreement, unless due to the gross negligence or willful misconduct of Loews. The Company was charged \$0.4 million, \$0.3 million, and \$0.4 million by Loews for these support functions during the years ended December 31, 2000, 1999, and 1998, respectively.

## 12. STOCK OPTION PLAN

On March 28, 2000, the Company adopted the Stock Option Plan, which was approved by its stockholders on May 16, 2000. Under the terms of the plan, certain of the Company's employees, consultants and non-employee directors may be granted options to purchase stock at no less than 100% of the fair market value of the stock on the date the option is granted. Such plan reserved for issuance up to 750,000 shares of the Company's common stock, none of which had been issued as of December 31, 2000. Unless otherwise specified by the Board of Directors at the time of the grant, stock options have a maximum term of ten years, subject to earlier termination under certain conditions and vest over four years.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table summarizes the stock option activity related to the Stock Option Plan:

	2000	
	Options	Weighted-Average Exercise Price
Outstanding, January 1	\$ —	\$ —
Granted	113,000	42.84
Forfeited	(4,000)	43.03
Outstanding, December 31	\$ 109,000	\$ 42.83

The following table summarizes information for options outstanding and exercisable at December 31, 2000:

Range of Exercise Prices	\$35.72 – \$43.03
Options Outstanding	
Number	109,000
Weighted-Average Remaining Contractual Life	9.4 years
Weighted-Average Exercise Price	\$ 42.83
Options Exercisable	
Number	5,000
Weighted-Average Exercise Price	\$ 38.75

The Company accounts for the Stock Option Plan in accordance with Accounting Principle Board Opinion No. 25, "Accounting for Stock Issued to Employees." Accordingly, no compensation expense has been recognized for the options granted under the plan. Had compensation expense for the Company's stock options been recognized based on the fair value of the options at the grant dates, using the methodology prescribed by SFAS No. 123, "Accounting for Stock-Based Compensation," the Company's net income and earnings per share would have been reduced to the pro forma amounts indicated below:

	2000	
	(In thousands except per share amounts)	
Net Income:		
As reported	\$ 72,281	
Pro forma	\$ 71,918	
Earnings Per Share of Common Stock:		
As reported	\$ 0.53	
Pro forma	\$ 0.53	
Earnings Per Share of Common Stock – assuming dilution:		
As reported	\$ 0.53	
Pro forma	\$ 0.53	

The per share weighted-average fair value of stock options granted during 2000 was \$26.71. The fair value

of each stock option granted was estimated on the date of grant using the Binomial Option Pricing Model. Assumptions used in the model included a weighted average risk-free interest rate of 6.71%, an expected life of options of six years, expected volatility of the Company's stock price of 69% and an expected dividend yield on the Company's stock of 1.25%.

### 13. INCOME TAXES

An analysis of the Company's income tax expense is as follows:

	Year Ended December 31,		
	2000	1999	1998
	(in thousands)		
U.S. – current	\$ 7,981	\$ 15,830	\$ 110,379
U.S. – deferred	26,155	38,529	61,403
Non-U.S. – current	4,450	29,933	34,790
Total	\$ 38,586	\$ 84,292	\$ 206,572

Significant components of the Company's deferred income tax assets and liabilities are as follows:

	December 31,	
	2000	1999
	(in thousands)	
Deferred tax assets:		
Net operating loss carryforwards	\$ 8,990	\$ 12,061
Worker's compensation accruals <sup>(1)</sup>	4,635	2,978
Foreign tax credits	30,214	24,121
Other <sup>(2)</sup>	4,227	14,849
Total deferred tax assets	48,066	54,009
Deferred tax liabilities:		
Depreciation and amortization	(300,969)	(284,264)
Undistributed earnings of non-U.S. subsidiaries	(37,193)	(32,546)
Non-U.S. deferred taxes	(14,684)	(15,402)
Other	(7,076)	(10,032)
Total deferred tax liabilities	(359,922)	(342,244)
Net deferred tax liability	\$ (311,856)	\$ (288,235)

<sup>(1)</sup> Reflected in "Prepaid expenses and other" in the Company's Consolidated Balance Sheets.

<sup>(2)</sup> In 2000, approximately \$136,000 reflected in "Prepaid expenses and other" in the Company's Consolidated Balance Sheets.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Except for selective dividends, the Company's practice prior to 1997 was to reinvest the unremitted earnings of its non-U.S. subsidiaries and postpone their remittance indefinitely. Thus, no additional U.S. taxes were provided on such earnings. Undistributed earnings of non-U.S. subsidiaries generated prior to 1997 for which no U.S. deferred income tax provision has been made for possible future remittances totaled approximately \$46.6 million at December 31, 2000. In addition, the Company has negative undistributed earnings of non-U.S. subsidiaries generated prior to 1997 of \$66.8 million at December 31, 2000 for which no deferred tax benefit has been recognized. It is not practicable to estimate the amount of unrecognized U.S. deferred taxes, if any, that might be payable on the actual or deemed remittance of such earnings. On actual remittance, certain countries impose withholding taxes that, subject to certain limitations, are then available for use as tax credits against a U.S. tax liability, if any.

The Company believes it is probable that its deferred tax assets of \$48.1 million will be realized on future tax returns, primarily from the generation of future taxable income through both profitable operations and future reversals of existing taxable temporary differences. However, if the Company is unable to generate sufficient taxable income in the future through operating results, a valuation allowance will be required as a charge to expense.

Deferred income taxes are not recorded on differences between financial reporting and tax bases of investments in stock of the Company's subsidiaries, unless realization of the effect is probable in the foreseeable future. The Company also has certain income tax loss carryforwards in non-U.S. tax jurisdictions to which it has assigned no value because of the uncertainty of utilization of these carryforwards.

In connection with the merger with Arethusa, the Company acquired net operating loss ("NOL") carryforwards available to offset future taxable income. The utilization of these NOL carryforwards is limited pursuant to Section 382 of the Internal Revenue Code of 1986, as amended (the "Code"). For the year ended December 31, 2000, the Company utilized \$8.8 million of such carryforwards and has previously recorded a deferred tax asset for the benefit of the remaining NOL carryforwards available for future years. Such carryforwards expire as follows:

Year	Tax Benefit of Net Operating Losses (in thousands)
2007	\$ 547
2008	3,676
2009	3,901
2010	866
Total	<u>\$ 8,990</u>

The difference between actual income tax expense and the tax provision computed by applying the statutory federal income tax rate to income before taxes is attributable to the following:

	Year Ended December 31,		
	2000	1999	1998
	(in thousands)		
Income before income tax expense:			
U.S.	\$ 97,118	\$ 212,331	\$ 532,378
Non-U.S.	13,749	28,032	57,853
Worldwide	<u>\$ 110,867</u>	<u>\$ 240,363</u>	<u>\$ 590,231</u>
Expected income tax expense at federal statutory rate	\$ 38,803	\$ 84,127	\$ 206,581
Adjustment to prior year return	(69)	(4)	—
Other	(148)	169	(9)
Income tax expense	<u>\$ 38,586</u>	<u>\$ 84,292</u>	<u>\$ 206,572</u>

#### 14. EMPLOYEE BENEFIT PLANS

##### Defined Contribution Plans

The Company maintains defined contribution retirement plans for its U.S., U.K. and third country national ("TCN") employees. The plan for U.S. employees (the "401k Plan") is designed to qualify under Section 401k of the Code. Under the 401k Plan, each participant may elect to defer taxation on a portion of his or her eligible earnings, as defined by the 401k Plan, by directing the Company to withhold a percentage of such earnings. A participating employee may also elect to make after-tax contributions to the 401k Plan. The Company contributes 3.75% of a participant's defined compensation and matches 25% of the first 6% of each employee's compensation contributed. Participants are fully vested immediately upon enrollment in the plan. For the years ended December 31, 2000, 1999, and 1998, the Company's provision for contributions was \$6.2 million, \$6.4 million and \$5.7 million, respectively.

The plan for U.K. employees provides that the Company contributes amounts equivalent to the employee's contributions generally up to a maximum of 5.25% of the employee's defined compensation per year. The Company's provision for contributions was \$0.4 million for the year ended December 31, 2000 and \$0.5 million for each of the years ended December 31, 1999 and 1998.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The plan for the Company's TCN employees was effective April 1, 1998 and is similar to the 401k Plan. The Company contributes 3.75% of a participant's defined compensation and matches 25% of the first 6% of each employee's compensation contributed. For the years ended December 31, 2000, 1999, and 1998, the Company's provision for contributions was \$0.5 million, \$0.6 million and \$0.3 million, respectively.

### Deferred Compensation and Supplemental Executive Retirement Plan

The Company established its Deferred Compensation and Supplemental Executive Retirement Plan in December 1996. The Company contributes any portion of the 3.75% of the base salary contribution and the matching contribution to the 401k Plan that cannot be contributed because of the limitations within the Code and because of elective deferrals that the participant makes under the plan. Additionally, the plan provides that participants may defer up to 10% of base compensation and/or up to 100% of any performance bonus. Participants in this plan are a select group of management or highly compensated employees of the Company and are fully vested in all amounts paid into the plan. The Company's provision for contributions for the years ended December 31, 2000, 1999, and 1998 was not material.

### Pension Plan

The defined benefit pension plan established by Arethusa effective October 1, 1992 was frozen on April 30, 1996. At that date, all participants were deemed fully vested in the plan, which covered substantially all U.S. citizens and U.S. permanent residents who were employed by Arethusa. Benefits are calculated and paid based on an employee's years of credited service and average compensation at the date the plan was frozen using an excess benefit formula integrated with social security covered compensation.

Pension costs are determined actuarially and funded as required by the Code. The plan's assets are invested in cash and cash equivalents, equity securities, government and corporate debt securities. As a result of freezing the plan, no service cost has been accrued for the years presented.

The data and significant actuarial assumptions as of the plan's year end set forth in the following tables are presented in accordance with SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits," which the Company has retroactively adopted for all periods presented.

	September 30,		
	2000	1999	1998
	(in thousands)		
Change in benefit obligation:			
Benefit obligation at beginning of year	\$ 12,023	\$ 10,597	\$ 9,365
Interest cost	894	705	668
Actuarial gain	42	1,068	877
Benefits paid	(378)	(347)	(313)
Benefit obligation at end of year	<u>12,581</u>	<u>12,023</u>	<u>10,597</u>
Change in plan assets:			
Fair value of plan assets at beginning of year	14,427	12,571	12,971
Actual return on plan assets	641	2,203	(87)
Benefits paid	(378)	(347)	(313)
Fair value of plan assets at end of year	<u>14,690</u>	<u>14,427</u>	<u>12,571</u>
Funded status	2,109	2,404	1,974
Unrecognized loss/(gain)	905	215	(394)
Prepaid benefit cost	<u>\$ 3,014</u>	<u>\$ 2,619</u>	<u>\$ 1,580</u>

	September 30,		
	2000	1999	1998
Weighted-average assumptions:			
Discount rate	7.50%	7.50%	6.75%
Expected long-term rate	9.00%	9.00%	9.00%

	September 30,		
	2000	1999	1998
	(in thousands)		
Components of net periodic benefit cost:			
Interest cost	\$ (894)	\$ (705)	(668)
Expected return on plan assets	1,289	1,118	1,154
Amortization of gain	—	—	63
Net periodic pension benefit income	<u>\$ 395</u>	<u>\$ 413</u>	<u>\$ 549</u>

## 15. SEGMENTS AND GEOGRAPHIC AREA ANALYSIS

The Company manages its business on the basis of one reportable segment, contract drilling of offshore oil and gas wells. Although the Company provides contract drilling services from different types of offshore drilling rigs and provides such services in many geographic locations, these operations have been aggregated into one reportable segment based on the similarity of economic characteristics among all divisions and locations, including the nature of services provided and the type of customers of such services. The data below is presented in accordance with SFAS No. 131, "Disclosures about

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Segments of an Enterprise and Related Information," which the Company has retroactively adopted for all periods presented.

### Similar Services

Revenues from external customers for contract drilling and similar services by equipment-type are listed below (eliminations offset dayrate revenues earned when the Company's rigs are utilized in its integrated services):

	Year Ended December 31,		
	2000	1999	1998
	(in thousands)		
High specification floaters	\$ 212,000	\$ 262,571	\$ 286,875
Other semisubmersibles	313,287	463,168	707,227
Jack-ups	118,885	74,484	209,134
Integrated services	23,298	32,769	26,876
Other	140	—	—
Eliminations	(8,174)	(11,968)	(21,311)
Total revenues	<u>\$ 659,436</u>	<u>\$ 821,024</u>	<u>\$ 1,208,801</u>

### Geographic Areas

At December 31, 2000, the Company had drilling rigs located offshore six countries outside of the United States. As a result, the Company is exposed to the risk of changes in social, political and economic conditions inherent in foreign operations and the Company's results of operations and the value of its foreign assets are affected by fluctuations in foreign currency exchange rates. Revenues by geographic area are presented by attributing revenues to the individual country where the services were performed.

	Year Ended December 31,		
	2000	1999	1998
	(in thousands)		
Revenues from unaffiliated customers:			
United States	\$ 355,470	\$ 420,123	\$ 692,648
Foreign:			
Europe/Africa	69,495	178,254	292,579
South America	177,891	133,528	84,518
Australia/Southeast Asia	56,580	89,119	139,056
	<u>303,966</u>	<u>400,901</u>	<u>516,153</u>
Interarea revenues from affiliates:			
United States	98,367	114,393	169,322
Other	—	—	7,284
	<u>98,367</u>	<u>114,393</u>	<u>176,606</u>
Eliminations	(98,367)	(114,393)	(176,606)
Total	<u>\$ 659,436</u>	<u>\$ 821,024</u>	<u>\$ 1,208,801</u>

An individual foreign country may, from time to time, contribute a material percentage of the Company's total revenues from unaffiliated customers. For the years ended December 31, 2000, 1999, and 1998, individual countries that contributed 5 % or more of the Company's total revenues from unaffiliated customers are listed below.

	Year Ended December 31,		
	2000	1999	1998
Brazil	25.5 %	15.5 %	7.0 %
United Kingdom	5.9 %	10.0 %	11.0 %
Australia	5.8 %	5.7 %	5.3 %
Angola	2.1 %	7.5 %	2.8 %

Long-lived tangible assets located in the United States and all foreign countries in which the Company holds assets as of December 31, 2000, 1999, and 1998 are listed below. A substantial portion of the Company's assets are mobile, therefore asset locations at the end of the period are not necessarily indicative of the geographic distribution of the earnings generated by such assets during the periods.

	December 31,		
	2000	1999	1998
	(in thousands)		
Drilling and other property and equipment, net:			
United States	\$ 1,312,031	\$ 1,113,908	\$ 1,073,862
Foreign:			
South America	388,358	399,471	186,432
Europe/Africa	81,401	154,378	233,753
Australia/Southeast Asia	120,625	70,148	57,773
	<u>590,384</u>	<u>623,997</u>	<u>477,958</u>
Total	<u>\$ 1,902,415</u>	<u>\$ 1,737,905</u>	<u>\$ 1,551,820</u>

Brazil is currently the only individual country outside the United States with a material concentration of the Company's assets. Approximately 20.4%, 20.2%, and 12.0% of the Company's total drilling and other property and equipment were located in or offshore Brazil as of December 31, 2000, 1999, and 1998, respectively.

### Major Customers

The Company's customer base includes major and independent oil and gas companies and government-owned oil companies. During the year ended December 31, 2000, two customers contributed 25.4% and 20.0% of total revenues, respectively. During the year ended December 31, 1999, two customers contributed 15.5% and 14.5% of total revenues, respectively. During the year ended December 31, 1998, one customer contributed 17.4% of total revenues.



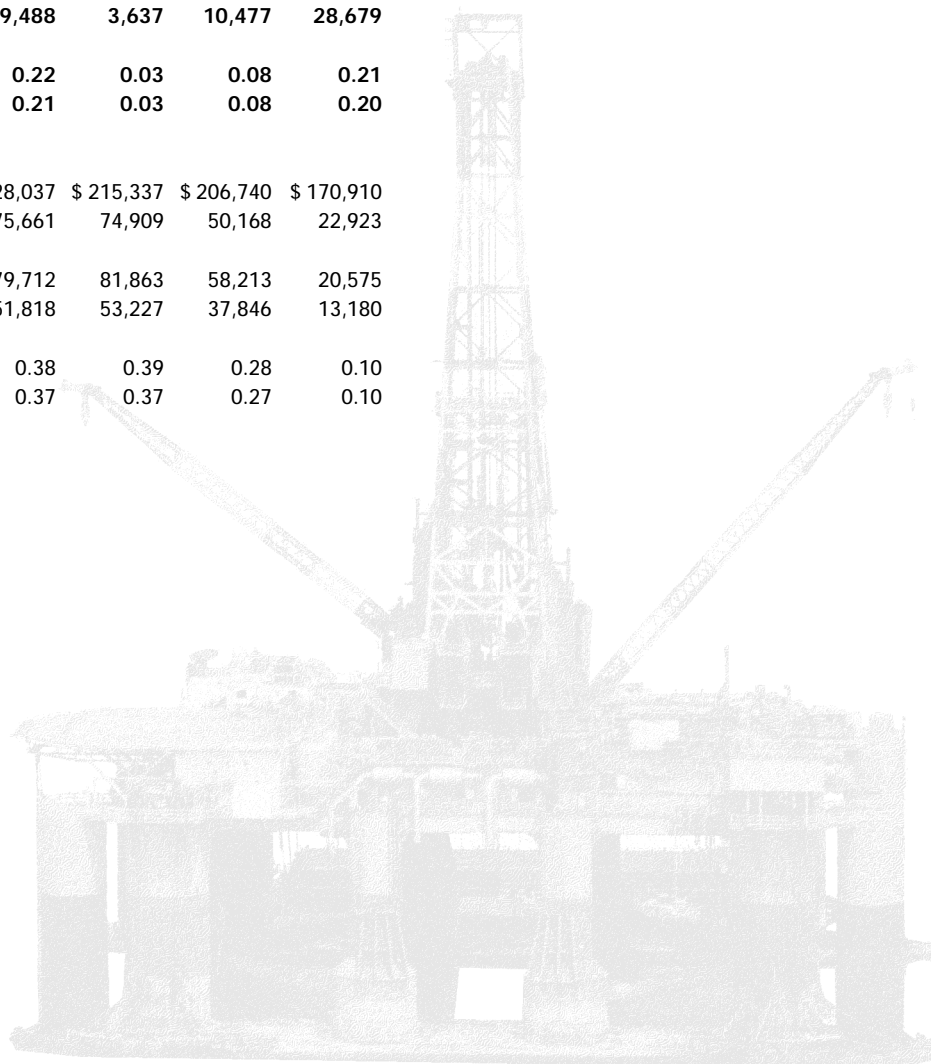
## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### 16. UNAUDITED QUARTERLY FINANCIAL DATA

Unaudited summarized financial data by quarter for the years ended December 31, 2000 and 1999 is shown below.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
(in thousands, except per share data)				
<b>2000</b>				
Revenues	\$167,828	\$143,317	\$157,348	\$190,943
Operating income	24,110	(2,098)	3,128	31,806
Income before income tax expense	45,426	5,675	16,068	43,698
Net income	29,488	3,637	10,477	28,679
Net income per share:				
Basic	0.22	0.03	0.08	0.21
Diluted	0.21	0.03	0.08	0.20
<b>1999</b>				
Revenues	\$ 228,037	\$ 215,337	\$ 206,740	\$ 170,910
Operating income	75,661	74,909	50,168	22,923
Income before income tax expense	79,712	81,863	58,213	20,575
Net income	51,818	53,227	37,846	13,180
Net income per share:				
Basic	0.38	0.39	0.28	0.10
Diluted	0.37	0.37	0.27	0.10



## INDEPENDENT AUDITORS' REPORT

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Board of Directors and Stockholders  
Diamond Offshore Drilling, Inc. and subsidiaries  
Houston, Texas

We have audited the accompanying consolidated balance sheets of Diamond Offshore Drilling, Inc. and subsidiaries (the "Company") as of December 31, 2000 and 1999, and the related consolidated statements of income, stockholders' equity, comprehensive income and cash flows for each of the three years in the period ended December 31, 2000. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

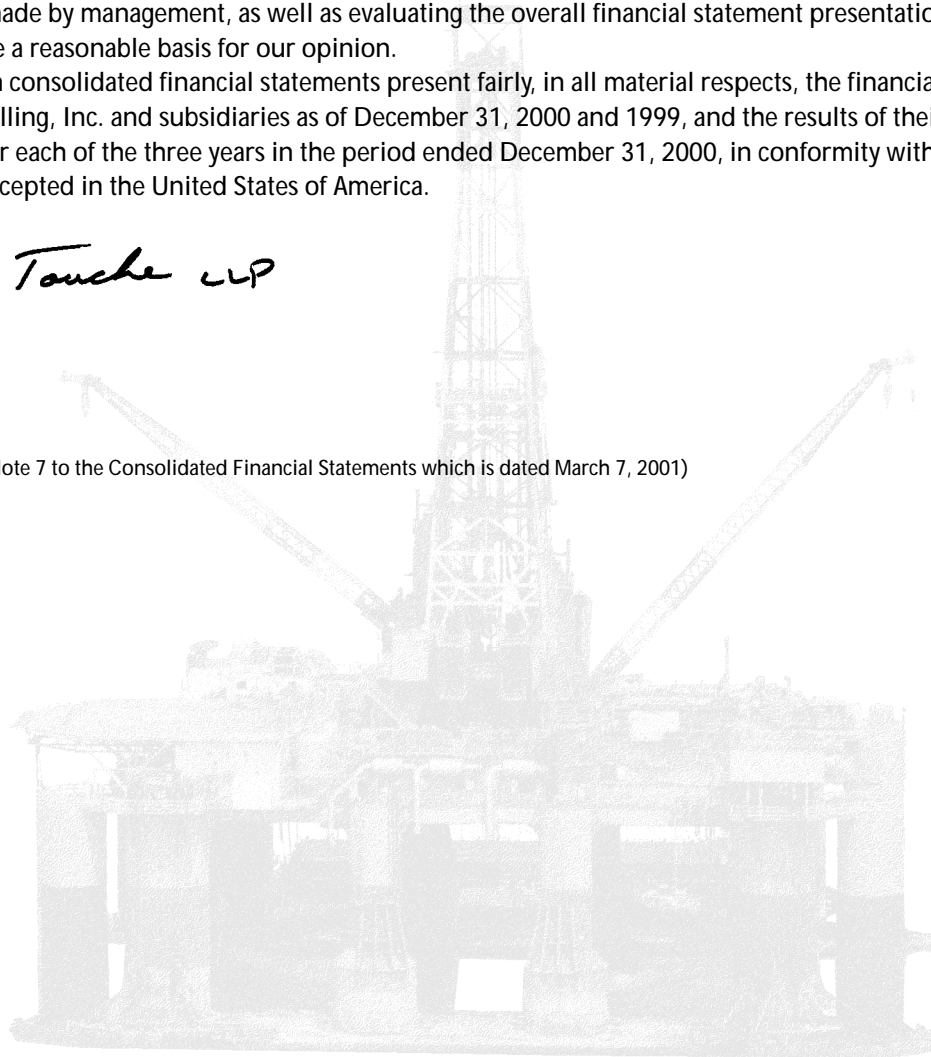
In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Diamond Offshore Drilling, Inc. and subsidiaries as of December 31, 2000 and 1999, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States of America.

*Deloitte & Touche LLP*

Deloitte & Touche LLP  
Houston, Texas

January 23, 2001

(except for paragraph 3 of Note 7 to the Consolidated Financial Statements which is dated March 7, 2001)



## STOCKHOLDER INFORMATION

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### Price Range of Common Stock

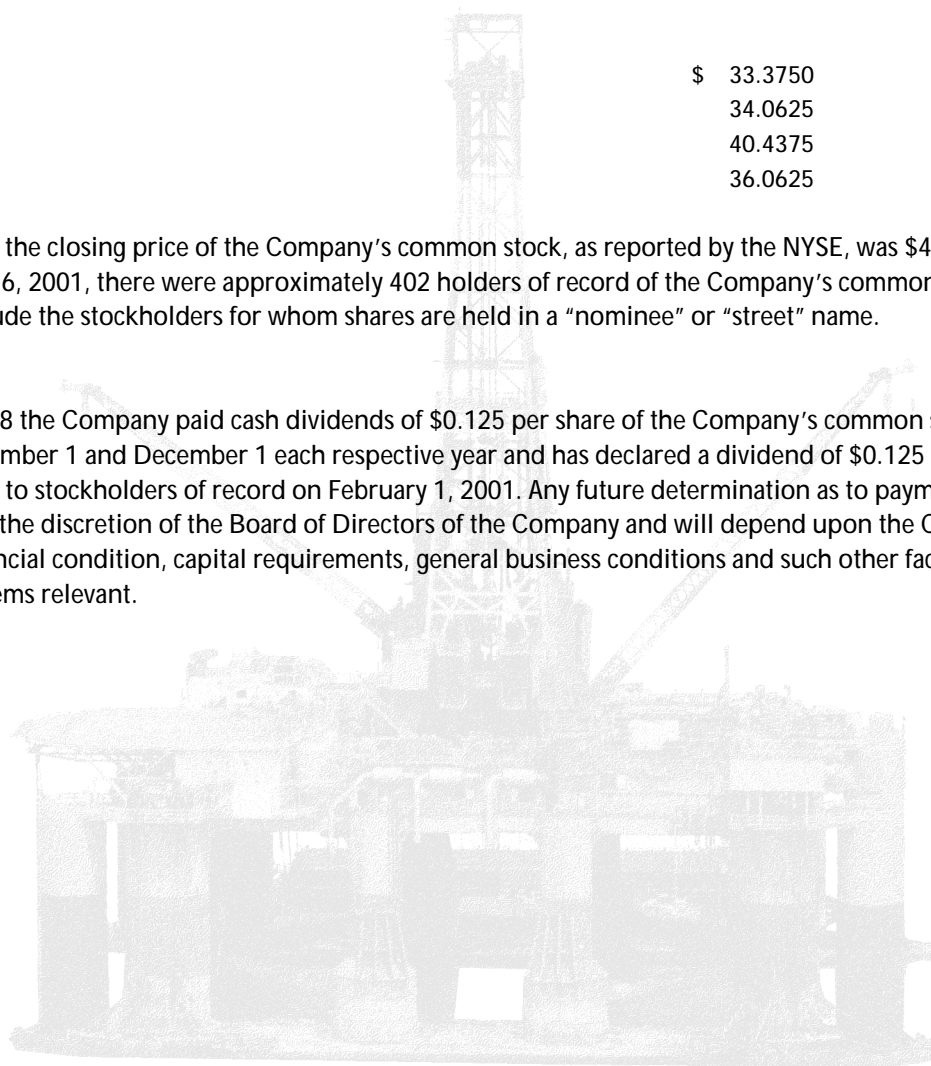
The Company's common stock is listed on the New York Stock Exchange ("NYSE") under the symbol "DO." The following table sets forth, for the calendar quarters indicated, the high and low closing prices of common stock as reported by the NYSE.

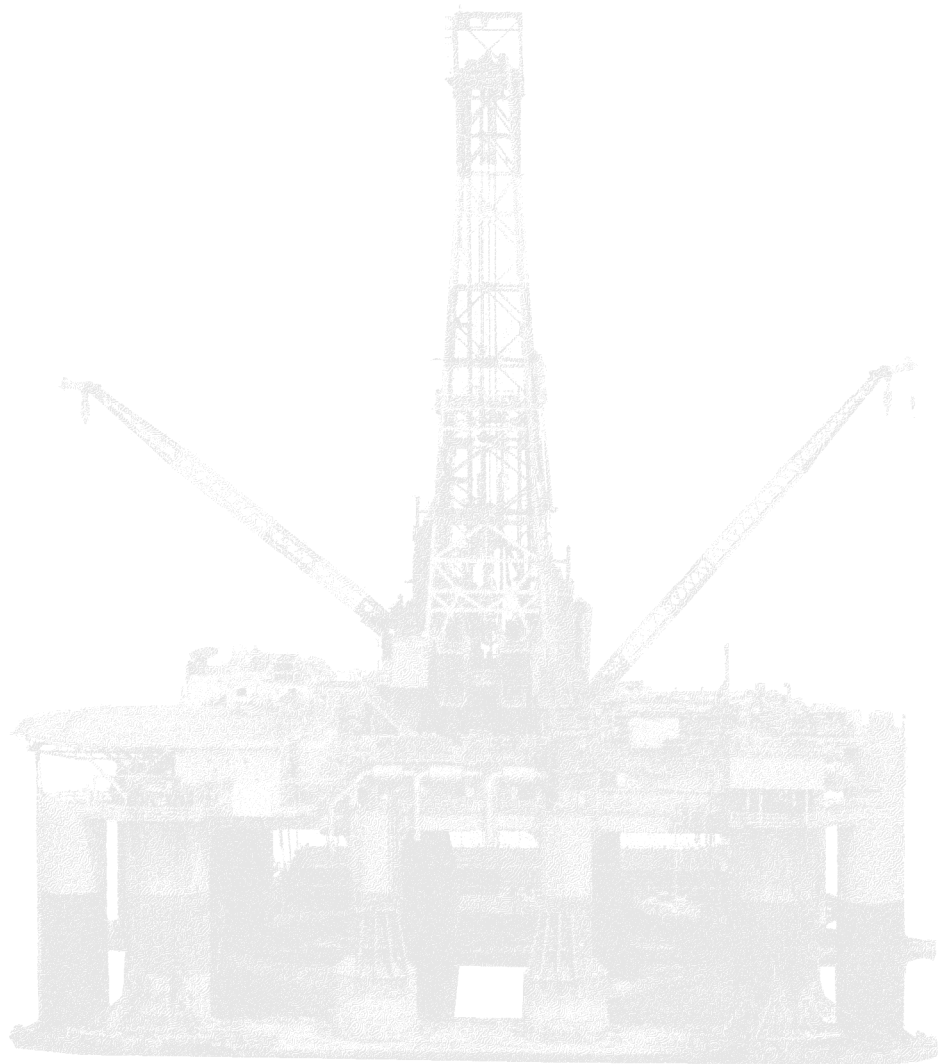
	Common Stock	
	High	Low
<b>2000</b>		
First Quarter	\$ 40.4375	\$ 26.5000
Second Quarter	44.7500	35.1250
Third Quarter	47.3125	32.8125
Fourth Quarter	41.9375	30.1875
<b>1999</b>		
First Quarter	\$ 33.3750	\$ 20.5000
Second Quarter	34.0625	25.9375
Third Quarter	40.4375	27.7500
Fourth Quarter	36.0625	27.4375

On February 26, 2001, the closing price of the Company's common stock, as reported by the NYSE, was \$41.17 per share. As of February 26, 2001, there were approximately 402 holders of record of the Company's common stock. This number does not include the stockholders for whom shares are held in a "nominee" or "street" name.

### Dividend Policy

In 2000, 1999 and 1998 the Company paid cash dividends of \$0.125 per share of the Company's common stock on March 1, June 1, September 1 and December 1 each respective year and has declared a dividend of \$0.125 per share payable March 1, 2001 to stockholders of record on February 1, 2001. Any future determination as to payment of dividends will be made at the discretion of the Board of Directors of the Company and will depend upon the Company's operating results, financial condition, capital requirements, general business conditions and such other factors that the Board of Directors deems relevant.





# CORPORATE INFORMATION

## Board of Directors

James S. Tisch  
*Chairman of the Board and  
Chief Executive Officer  
Diamond Offshore Drilling, Inc.  
Chief Executive Officer  
Loews Corporation*

Lawrence R. Dickerson  
*President and  
Chief Operating Officer  
Diamond Offshore Drilling, Inc.*

Herbert C. Hofmann  
*Senior Vice President  
Loews Corporation*

Arthur L. Rebell  
*Senior Vice President  
Loews Corporation*

Alan Batkin  
*Kissinger Associates, Inc.*

Michael H. Steinhardt  
*Steinhardt Management Company*

Raymond S. Troubh  
*Financial Consultant*

Bill Richardson  
*Former U.S. Secretary of Energy*

## Executive Officers

James S. Tisch  
*Chairman of the Board and  
Chief Executive Officer*

Lawrence R. Dickerson  
*President and  
Chief Operating Officer*

David W. Williams  
*Executive Vice President*

Rodney W. Eads  
*Senior Vice President – Worldwide  
Operations*

John L. Gabriel  
*Senior Vice President –  
Contracts and Marketing*

Gary T. Krenek  
*Vice President and Chief Financial  
Officer*

Beth G. Gordon  
*Controller*

William C. Long  
*Vice President, General Counsel  
and Secretary*

## Senior Management

Mark F. Baudoin  
*Vice President –  
Administration and Operations  
Support*

Robert G. Blair  
*Vice President –  
Contracts and Marketing,  
North and South America*

R. Lynn Charles  
*Vice President –  
Human Resources*

Stephen G. Elwood  
*Vice President – Tax*

Vance T. Greene  
*Vice President –  
Contracts and Marketing*

Glen E. Merrifield  
*Vice President –  
Operations  
(Management Systems)*

Steven A. Nelson  
*Vice President –  
International Operations*

Morrison R. Plaisance  
*Vice President –  
Team Solutions*

John M. Vecchio  
*Vice President –  
Technical Services*

C. Duncan Weir  
*Vice President –  
Contracts & Marketing,  
International*

James M. Welch  
*Vice President –  
Operations  
(North America)*

Lester L. Thomas  
*Treasurer*

## Corporate Headquarters

15415 Katy Freeway  
Houston, TX 77094  
(281) 492-5300  
www.diamondoffshore.com

## Investor Relations

Caren W. Steffes  
15415 Katy Freeway  
Houston, TX 77094  
(281) 492-5393

## Notice of Annual Meeting

The Annual Meeting of Stockholders will be held at The Regency Hotel, 540 Park Avenue, New York, NY 10021 on Wednesday, May 23, 2001 at 11:30 a.m. local time.

## Transfer Agent and Registrar

Mellon Investor Services LLC  
Overpeck Centre  
85 Challenger Road  
Ridgefield Park, NJ  
07660-2104  
(800) 635-9270  
www.mellon-investor.com

## Stock Exchange Listing

New York Stock Exchange

## Trading Symbol

"DO"

## Independent Auditors

Deloitte & Touche LLP



D I A M O N D  
O F F S H O R E

15415 Katy Freeway  
Houston, Texas 77094  
(281) 492-5300  
[www.diamondoffshore.com](http://www.diamondoffshore.com)