DIAMOND OFFSHORE DRILLING INC
Form 10-Q
July 29, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2014

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________ to __________

Commission file number 1-13926

DIAMOND OFFSHORE DRILLING, INC.

(Exact name of registrant as specified in its charter)

Delaware	**76-0321760**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

15415 Katy Freeway

Houston, Texas

77094

(Address of principal executive offices)

(Zip Code)

(281) 492-5300

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

As of July 23, 2014	Common stock, $0.01 par value per share	137,145,889 shares

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QUARTER ENDED JUNE 30, 2014

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements.

DIAMOND OFFSHORE DRILLING, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands, except share and per share data)

	June 30, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$ 980,817	$ 347,011
Marketable securities	350,156	1,750,053
Accounts receivable, net of allowance for bad debts	545,024	469,355
Prepaid expenses and other current assets	200,867	143,997
Asset held for sale		7,694
Total current assets	2,076,864	2,718,110
Drilling and other property and equipment, net of accumulated depreciation	6,055,990	5,467,227
Other assets	229,468	206,097
Total assets	$ 8,362,322	$ 8,391,434
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 121,164	$ 94,151
Accrued liabilities	417,477	370,671
Taxes payable	11,583	30,806
Current portion of long-term debt	249,992	249,954
Total current liabilities	800,216	745,582
Long-term debt	2,244,336	2,244,189
Deferred tax liability	533,788	525,541
Other liabilities	237,034	238,864
Total liabilities	3,815,374	3,754,176
Commitments and contingencies (Note 10)		
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; 143,958,250 shares issued and 137,145,889 shares outstanding at June 30, 2014; 143,952,248 shares issued and 139,035,448 shares outstanding at December 31, 2013)	1,440	1,440
Additional paid-in capital	1,991,293	1,988,720
Retained earnings	2,752,837	2,761,161
Accumulated other comprehensive gain (loss)	3,547	350
Treasury stock, at cost (6,812,361 and 4,916,800 shares of common stock at June 30, 2014 and December 31, 2013, respectively)	(202,169)	(114,413)
Total stockholders equity	4,546,948	4,637,258
Total liabilities and stockholders equity	$ 8,362,322	$ 8,391,434

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

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DIAMOND OFFSHORE DRILLING, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Revenues:				
Contract drilling	$ 649,554	$ 744,898	$ 1,334,862	$ 1,444,871
Revenues related to reimbursable expenses	42,690	13,120	66,806	42,888
Total revenues	692,244	758,018	1,401,668	1,487,759
Operating expenses:				
Contract drilling, excluding depreciation	395,376	369,036	765,166	744,130
Reimbursable expenses	42,290	12,805	65,956	42,094
Depreciation	108,906	97,143	215,917	193,964
General and administrative	20,478	16,435	43,305	33,250
Gain on disposition of assets	(8,572)	(260)	(8,719)	(2,264)
Total operating expenses	558,478	495,159	1,081,625	1,011,174
Operating income	133,766	262,859	320,043	476,585
Other income (expense):				
Interest income	150	271	558	888
Interest expense	(18,523)	(7,951)	(36,678)	(16,020)
Foreign currency transaction gain (loss)	(2,971)	448	(4,149)	607
Other, net	181	674	508	420
Income before income tax expense	112,603	256,301	280,282	462,480
Income tax expense	(22,890)	(70,967)	(44,759)	(101,157)
Net income .	$ 89,713	$ 185,334	$ 235,523	$ 361,323
Earnings per share, Basic and Diluted	$ 0.65	$ 1.33	$ 1.71	$ 2.60
Weighted-average shares outstanding:				
Shares of common stock	137,145	139,035	137,803	139,034
Dilutive potential shares of common stock	4	37	5	43
Total weighted-average shares outstanding	137,149	139,072	137,808	139,077

Cash dividends declared per share of common stock	$ 0.875	$ 0.875	$ 1.75	$ 1.75

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

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DIAMOND OFFSHORE DRILLING, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(In thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	**2013**	**2014**	**2013**
Net income	$ 89,713	$ 185,334	$ 235,523	$ 361,323
Other comprehensive gains (losses), net of tax:				
Derivative financial instruments:				
Unrealized holding gain (loss)	2,882	(6,799)	5,721	(6,516)
Reclassification adjustment for gain included in net income	(2,360)	(253)	(2,537)	(1,704)
Investments in marketable securities:				
Unrealized holding gain	1	2	39	9
Reclassification adjustment for gain included in net income	(18)	(49)	(26)	(132)
Total other comprehensive gain (loss)	505	(7,099)	3,197	(8,343)
Comprehensive income	$ 90,218	$ 178,235	$ 238,720	$ 352,980

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

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DIAMOND OFFSHORE DRILLING, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Operating activities:		
Net income	$ 235,523	$ 361,323
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	215,917	193,964
Gain on disposition of assets	(8,719)	(2,264)
Gain on foreign currency forward exchange contracts	(5,007)	(2,772)
Deferred tax provision	6,523	24,996
Accretion of discounts on marketable securities	(225)	(514)
Stock-based compensation expense	2,421	1,777
Deferred income, net	55,432	(22,595)
Deferred expenses, net	(80,579)	7,030
Long-term employee remuneration programs	3,952	4,319
Other assets, noncurrent	(144)	(4,413)
Other liabilities, noncurrent	2,334	(4,185)
Proceeds from settlement of foreign currency forward exchange contracts designated as accounting hedges	5,007	2,772
Bank deposits denominated in nonconvertible currencies	5,442	
Other	1,119	939
Changes in operating assets and liabilities:		
Accounts receivable	(75,893)	13,895
Prepaid expenses and other current assets	(18,857)	(5,916)
Accounts payable and accrued liabilities	40,948	(32,859)
Taxes payable	(17,867)	(15,375)
Net cash provided by operating activities	367,327	520,122
Investing activities:		
Capital expenditures (including rig construction)	(817,375)	(542,923)
Proceeds from disposition of assets, net of disposal costs	16,477	2,478
Proceeds from sale and maturities of marketable securities	5,800,033	1,750,038
Purchases of marketable securities	(4,399,889)	(1,449,745)
Net cash provided by (used in) investing activities	599,246	(240,152)
Financing activities:		

Payment of dividends	(244,364)	(245,567)
Purchase of treasury stock	(87,756)	
Other	(647)	137
Net cash used in financing activities	(332,767)	(245,430)
Net change in cash and cash equivalents	633,806	34,540
Cash and cash equivalents, beginning of period	347,011	335,432
Cash and cash equivalents, end of period	$ 980,817	$ 369,972

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

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DIAMOND OFFSHORE DRILLING, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. General Information

The unaudited consolidated financial statements of Diamond Offshore Drilling, Inc. and subsidiaries, which we refer to as Diamond Offshore, we, us or our, should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2013 (File No. 1-13926).

As of July 23, 2014, Loews Corporation owned 51.1 % of the outstanding shares of our common stock.

Interim Financial Information

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the U.S., or GAAP, for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission. Accordingly, pursuant to such rules and regulations, they do not include all disclosures required by GAAP for complete financial statements. The consolidated financial information has not been audited but, in the opinion of management, includes all adjustments (consisting only of normal recurring accruals) necessary for a fair presentation of the consolidated balance sheets, statements of operations, statements of comprehensive income and statements of cash flows at the dates and for the periods indicated. Results of operations for interim periods are not necessarily indicative of results of operations for the respective full years.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with GAAP 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.

Cash and Cash Equivalents

We consider 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 to be cash equivalents. We had bank deposits denominated in Egyptian pounds totaling $7.9 million and $14.3 million at June 30, 2014 and December 31, 2013, respectively. However, the local currency is not readily convertible into U.S. dollars or other currencies at this time. While we believe that a portion of these amounts will be used to fund local obligations in Egyptian pounds in the short term, we have reported $7.3 million and $12.7 million as Other assets in our Consolidated Balance Sheets at June 30, 2014 and December 31, 2013, respectively.

The effect of exchange rate changes on cash balances held in foreign currencies was not material for each of the three-month and six-month periods ended June 30, 2014 and 2013.

Marketable Securities

We classify our investments in marketable securities as available for sale and they are stated at fair value in our Consolidated Balance Sheets. Accordingly, any unrealized gains and losses, net of taxes, are reported in our Consolidated Balance Sheets in Accumulated other comprehensive gain (loss), or AOCGL, 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 our Consolidated Statements of Operations in Interest income. The sale and purchase of securities are recorded on the date of the trade. The cost of debt securities sold is based on the specific identification method. Realized gains or losses, as well as any declines in value that are judged to be other than temporary, are reported in our Consolidated Statements of Operations in Other income (expense) Other, net. See Note 5.

Derivative Financial Instruments

Our derivative financial instruments consist primarily of foreign currency forward exchange, or FOREX, contracts which we may designate as cash flow hedges. In accordance with GAAP, each derivative contract is stated in the balance sheet at its fair value with gains and losses reflected in the income statement except that, to the extent the derivative qualifies for and is designated as an accounting hedge, the gains and losses are reflected in income in the same period as offsetting gains and losses on the qualifying hedged positions. Designated hedges are expected to be highly effective, and therefore, adjustments to record the carrying value of the effective portion of our derivative financial instruments to their fair value are recorded as a component of AOCGL in our Consolidated Balance Sheets. The effective portion of the cash flow hedge will remain in AOCGL until it is reclassified into earnings in the period or periods during which the hedged transaction affects earnings or it is determined that the hedged transaction will not occur. We report such realized gains and losses as a component of Contract drilling, excluding depreciation expense in our Consolidated Statements of Operations to offset the impact of foreign currency fluctuations in our expenditures in local foreign currencies in the countries in which we operate. See Note 11.

Adjustments to record the carrying value of the ineffective portion of our derivative financial instruments to fair value and realized gains or losses upon settlement of derivative contracts not designated as cash flow hedges are reported as Foreign currency transaction gain (loss) in our Consolidated Statements of Operations. See Notes 6 and 7.

Drilling and Other Property and Equipment

We carry our drilling and other property and equipment at cost. Maintenance and routine repairs are charged to income currently while replacements and betterments, which upgrade or increase the functionality of our existing equipment and that significantly extend the useful life of an existing asset, are capitalized. Significant judgments, assumptions and estimates may be required in determining whether or not such replacements and betterments meet the criteria for capitalization and in determining useful lives and salvage values of such assets. Changes in these judgments, assumptions and estimates could produce results that differ from those reported. Historically, the amount of capital additions requiring significant judgments, assumptions or estimates has not been significant. During the three months ended June 30, 2014 and the year ended December 31, 2013, we capitalized $215.8 million and $302.0 million, respectively, in replacements and betterments of our drilling fleet, resulting from numerous projects ranging from $25,000 to $70 million per project.

Costs incurred for major rig upgrades and/or the construction of rigs are accumulated in construction work-in-progress, with no depreciation recorded on the additions, until the month the upgrade or newbuild is completed and the rig is ready for its intended use. Upon retirement or sale of a rig, the cost and related accumulated depreciation are removed from the respective accounts and any gains or losses are included in our results of operations as Gain on disposition of assets. Depreciation is recognized up to applicable salvage values by applying the straight-line method over the remaining estimated useful lives from the year the asset is placed in service. Drilling rigs and equipment are depreciated over their estimated useful lives ranging from three to 30 years.

Asset Held For Sale and Impairment of Long-Lived Assets

We evaluate our property and equipment for impairment whenever changes in circumstances indicate that the carrying amount of an asset may not be recoverable, such as cold stacking a rig or excess spending over budget on a newbuild, construction project or major rig upgrade. At December 31, 2013, we had four cold-stacked rigs, consisting of three mid-water semisubmersible rigs and one jack-up rig, the *Ocean Spartan*, which was reported as an Asset held for sale in our Consolidated Balance Sheets at a carrying value of $7.7 million. We sold the *Ocean Spartan* in June 2014 for an aggregate selling price of $16.5 million and recognized a net gain of $8.5 million on the transaction.

The three mid-water semisubmersible rigs remain cold stacked at June 30, 2014. We did not record any impairment with respect to our cold-stacked rigs for the three-month and six-month periods ended June 30, 2014 and 2013.

Treasury Stock

We account for the purchase of treasury stock using the cost method, which reports the cost of the shares acquired in Treasury stock as a deduction from stockholders equity in our Consolidated Balance Sheets. Depending on market conditions, we may, from time to time, purchase shares of our common stock in the open market or otherwise. During the six months ended June 30, 2014, we repurchased 1,895,561 shares of common stock at a cost of $87.8 million.

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Capitalized Interest

We capitalize interest cost for qualifying construction and upgrade projects. See Note 8. A reconciliation of our total interest cost to Interest expense as reported in our Consolidated Statements of Operations is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(In thousands)			
Total interest cost, including amortization of debt issuance costs	$ 33,526	$ 25,089	$ 67,893	$ 48,994
Capitalized interest	(15,003)	(17,138)	(31,215)	(32,974)
Total interest expense as reported	$ 18,523	$ 7,951	$ 36,678	$ 16,020

Foreign Currency

Our functional currency is the U.S. dollar. Foreign currency transaction gains and losses are reported as Foreign currency transaction gain (loss) in our Consolidated Statements of Operations and include, when applicable, unrealized gains and losses to record the carrying value of our FOREX contracts not designated as accounting hedges, as well as realized gains and losses from the settlement of such contracts. For the three-month and six-month periods ended June 30, 2014, we recognized net foreign currency transaction (losses) of $(3.0) million and $(4.1) million, respectively. For the three-month and six-month periods ended June 30, 2013, we recognized net foreign currency transaction gains of $0.4 million and $0.6 million, respectively. See Note 6.

Revenue Recognition

We recognize revenue from dayrate drilling contracts as services are performed. In connection with such drilling contracts, we may receive fees (on either a lump-sum or dayrate basis) for the mobilization of equipment. We earn these fees as services are performed over the initial term of the related drilling contracts. We defer mobilization fees received, as well as direct and incremental mobilization costs incurred, and amortize each on a straight-line basis, over the term of the related drilling contracts (which is the period we estimate to be benefited from the mobilization activity). Straight-line amortization of mobilization revenues and related costs over the term of the related drilling contracts (which generally range from two to 60 months) is consistent with the timing of net cash flows generated from the actual drilling services performed. Absent a contract, mobilization costs are recognized currently.

Some of our drilling contracts require downtime before the start of the contract to prepare the rig to meet customer requirements. At times, we may be compensated by the customer for such work (on either a lump-sum or dayrate basis). These fees are generally earned as services are performed over the initial term of the related drilling contracts. We defer contract preparation fees received as well as direct and incremental costs associated with the contract preparation activities and amortize each, on a straight-line basis, over the term of the related drilling contracts (which we estimate to be benefited from the contract preparation activity).

From time to time, we may receive fees from our customers for capital improvements to our rigs (either lump-sum or dayrate). We defer such fees received in Accrued liabilities and Other liabilities in our Consolidated Balance Sheets and recognize these fees into income on a straight-line basis over the period of the related drilling contract. We capitalize the costs of such capital improvements and depreciate them over the estimated useful life of the improvement.

We record reimbursements received for the purchase of supplies, equipment, personnel services and other services provided at the request of our customers in accordance with a contract or agreement, for the gross amount billed to the customer, as Revenues related to reimbursable expenses in our Consolidated Statements of Operations.

Recent Accounting Pronouncements

In June 2014, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update, or ASU, No. 2014-12, Compensation Stock Compensation (Topic 718), or ASU 2014-12. The new standard amends existing standards to provide specific guidance on how to account for share-based payment awards that provide for the achievement of a performance target after an employee completes the requisite service period (*e.g.*, the employee is eligible to vest in the award regardless of whether the employee is rendering service on the date the performance target is achieved). ASU 2014-12 is effective for annual and interim periods within those annual periods beginning after December 15, 2015. Earlier adoption is permitted. We are currently evaluating the provisions of ASU 2014-12 and have not yet determined its impact on our financial position, results of operations or cash flows.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), or ASU 2014-09. The new standard supersedes the industry-specific standards that currently exist under GAAP and provides a framework to address revenue recognition issues comprehensively for all contracts with customers regardless of industry-specific or transaction-specific fact patterns. Under the new guidance, companies recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. ASU 2014-09 also provides for additional disclosure requirements. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period and may be adopted using a retrospective or modified retrospective approach. Early adoption is not permitted. We are currently evaluating the provisions of ASU 2014-09 and have not yet determined its impact on our financial position, results of operations or cash flows.

2. Supplemental Financial Information

Consolidated Balance Sheets Information

Accounts receivable, net of allowance for bad debts, consists of the following:

	June 30, 2014	December 31, 2013
	(In thousands)	
Trade receivables	$ 539,732	$ 473,013
Value added tax receivables	15,462	19,407
Amounts held in escrow	17,052	3,066
Related party receivables	459	587
Other	153	622
	572,858	496,695
Allowance for bad debts	(27,834)	(27,340)
Total	$ 545,024	$ 469,355

Prepaid expenses and other current assets consist of the following:

	June 30, 2014	December 31, 2013
	(In thousands)	
Rig spare parts and supplies	$ 56,197	$ 52,439
Deferred mobilization costs	51,826	20,274

Prepaid insurance	26,864	12,503
Deferred tax assets	10,222	10,221
Prepaid taxes	44,117	42,058
FOREX contracts	5,600	1,562
Other	6,041	4,940
Total	$ 200,867	$ 143,997

Accrued liabilities consist of the following:

	June 30, 2014	December 31, 2013
	(In thousands)	
Rig operating expenses	$ 117,993	$ 87,307
Payroll and benefits	104,386	121,387
Deferred revenue	72,382	26,975
Accrued capital project/upgrade costs	73,643	86,274
Interest payable	28,750	28,324
Personal injury and other claims	8,042	9,687
FOREX contracts	176	1,143
Other	12,105	9,574
Total	$ 417,477	$ 370,671

Consolidated Statements of Cash Flows Information

Noncash investing activities excluded from the Consolidated Statements of Cash Flows and other supplemental cash flow information is as follows:

	Six Months Ended June 30, 2014	2013
	(In thousands)	
Accrued but unpaid capital expenditures at period end	$ 73,643	$ 82,109
Cash interest payments[(1)]	63,560	41,469
Cash income taxes paid, net of refunds:		
U.S. federal		47,000
Foreign	44,589	42,211
State	149	160

(1) Interest payments, net of amounts capitalized, were $33.3 million and $9.5 million for the six months ended June 30, 2014 and 2013, respectively.

3. Stock-Based Compensation

In March 2014, our Board of Directors adopted our Equity Incentive Compensation Plan, or Equity Plan, which amended and restated our Second Amended and Restated 2000 Stock Option Plan, or Stock Plan. The Equity Plan was approved by our stockholders in May 2014.

The Equity Plan amended the Stock Plan by, among other things:

- increasing the number of shares of our common stock available for issuance under the Equity Plan from 1,500,000 shares to 7,500,000 shares;

- increasing the annual limit on the number of shares of our common stock with respect to which awards may be granted to any single individual from 200,000 shares to 500,000 shares;

- providing performance goals upon which the awards under the Equity Plan may be conditioned; and

- providing for the grant of other stock-based awards (in addition to options and stock appreciation rights) that may be granted under the Equity Plan, including awards of restricted stock, restricted stock units, or RSUs, performance shares and units and other stock-based awards.

In March 2014, we awarded 52,581 in targeted performance RSUs, with a volume weighted average price of our common stock preceding the grant date of $47.52 per share, to our Chief Executive Officer, or CEO, in connection with his commencement of service with us on March 3, 2014, subject to stockholder approval of the Equity Plan. RSUs are contractual rights to receive shares of our common stock in the future if the applicable vesting conditions are met. Targeted RSUs will become earned RSUs upon achievement of certain performance goals as set forth in the award certificate. Earned RSUs granted to our CEO will vest in one-third increments annually, over three years, commencing on the first anniversary of his hire date, with the first year being prorated for the portion of 2014 during which he was employed.

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Because the stock-based compensation awarded to our CEO is a fixed monetary amount at the date of grant (the target value of $3.0 million on a prorated basis) with variances based on actual achievement of a performance goal, the award is being recorded as a share-based liability. Compensation cost will be recognized over the requisite service period as specified in the award. In connection with the targeted RSUs granted in March 2014, we recognized $0.2 million and $0.3 million in compensation expense for the three-month and six-month periods ended June 30, 2014, respectively. As of June 30, 2014, the targeted performance goal, as set forth in the award certificate, had not been met, but its achievement was deemed probable.

4. Earnings Per Share

A reconciliation of the numerators and the denominators of our basic and diluted per-share computations follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(In thousands, except per share data)			
Net income basic and diluted numerator	$ 89,713	$ 185,334	$ 235,523	$ 361,323
Weighted average shares basic (denominator):	137,145	139,035	137,803	139,034
Effect of dilutive potential shares				
Stock options and stock appreciation rights	4	37	5	43
Weighted average shares including conversions diluted (denominator)	137,149	139,072	137,808	139,077
Earnings per share:				
Basic	$ 0.65	$ 1.33	$ 1.71	$ 2.60
Diluted	$ 0.65	$ 1.33	$ 1.71	$ 2.60

The following table sets forth the share effects of stock options and the number of stock appreciation rights excluded from our computations of diluted earnings per share, or EPS, as the inclusion of such potentially dilutive shares would have been antidilutive for the periods presented:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(In thousands)			
Employee and director:				
Stock options	31	18	32	10
Stock appreciation rights	1,475	863	1,444	854

5. Marketable Securities

We report our investments as current assets in our Consolidated Balance Sheets in Marketable securities, representing the investment of cash available for current operations. See Note 7.

Our investments in marketable securities are classified as available for sale and are summarized as follows:

	June 30, 2014		
	Amortized Cost	Unrealized Gain (Loss)	Market Value
	(In thousands)		
U.S. Treasury Bills and Notes (due within one year)	$ 349,993	$ 1	$ 349,994
Mortgage-backed securities	155	7	162
Total	$ 350,148	$ 8	$ 350,156

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	December 31, 2013		
	Amortized Cost	Unrealized Gain (Loss)	Market Value
		(In thousands)	
U.S. Treasury Bills and Notes (due within one year)	$ 1,749,879	$ (22)	$ 1,749,857
Mortgage-backed securities	188	8	196
Total	$ 1,750,067	$ (14)	$ 1,750,053

Proceeds from maturities and sales of marketable securities and gross realized gains and losses are summarized as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(In thousands)			
Proceeds from maturities	$ 3,625,000	$ 1,025,000	$ 5,800,000	$ 1,750,000
Proceeds from sales	12	23	33	37
Gross realized gains				
Gross realized losses				

6. Derivative Financial Instruments

Foreign Currency Forward Exchange Contracts

Our international operations expose us to foreign exchange risk associated with our costs payable in foreign currencies for employee compensation, foreign income tax payments and purchases from foreign suppliers. We may utilize FOREX contracts to manage our foreign exchange risk. Our FOREX contracts generally require us to net settle the spread between the contracted foreign currency exchange rate and the spot rate on the contract settlement date, which, for most of our contracts, is the average spot rate for the contract period.

We enter into FOREX contracts when we believe market conditions are favorable to purchase contracts for future settlement with the expectation that such contracts, when settled, will reduce our exposure to foreign currency gains and losses on future foreign currency expenditures. The amount and duration of such contracts are based on our monthly forecast of expenditures in the significant currencies in which we do business and for which there is a financial market (*i.e.*, Australian dollars, Brazilian reais, British pounds sterling, Mexican pesos and Norwegian kroner). These forward contracts are derivatives as defined by GAAP.

During the six months ended June 30, 2014 and 2013, we settled FOREX contracts with aggregate notional values of approximately $153.5 million and $157.0 million, respectively, of which the entire aggregate amounts were designated as a cash flow accounting hedge. During the six-month periods ended June 30, 2014 and 2013, we did not enter into or settle any FOREX contracts that were not designated as accounting hedges.

The following table presents the aggregate amount of gain recognized in our Consolidated Statements of Operations related to our FOREX contracts designated as accounting hedges for the three-month and six-month periods ended June 30, 2014 and 2013.

Location of Gain Recognized in Income	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
	(In thousands)			
Contract drilling expense	$ 4,496	$ 337	$ 5,007	$ 2,772

As of June 30, 2014, we had FOREX contracts outstanding in the aggregate notional amount of $167.2 million, consisting of $20.2 million in Australian dollars, $73.7 million in Brazilian reais, $47.1 million in British pounds sterling, $19.1 million in Mexican pesos and $7.1 million in Norwegian kroner. These contracts generally settle monthly through March 2015. As of June 30, 2014, all outstanding derivative contracts had been designated as cash flow hedges. See Note 7.

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We have International Swap Dealers Association, or ISDA, contracts, which are standardized master legal arrangements that establish key terms and conditions, which govern certain derivative transactions. At June 30, 2014, all of our FOREX contracts were with two counterparties and were governed under such ISDA contracts. There are no requirements to post collateral under these contracts; however, they do contain credit-risk related contingent provisions including credit support provisions and the net settlement of amounts owed in the event of early terminations. Additionally, should our credit rating fall below a specified rating immediately following the merger of Diamond Offshore with another entity, the counterparty may require all outstanding derivatives under the ISDA contract to be settled immediately at current market value. Our ISDA arrangements also include master netting agreements to further manage counterparty credit risk associated with our FOREX contracts. We have elected not to offset the fair value amounts recorded for our FOREX contracts under these agreements in our Consolidated Balance Sheets as of June 30, 2014 and December 31, 2013; however, there would have been no significant difference in our Consolidated Balance Sheets if the estimated fair values were presented on a net basis for these periods.

The following table presents the fair values of our derivative FOREX contracts designated as hedging instruments at June 30, 2014 and December 31, 2013.

Balance Sheet Location	**Fair Value June 30, 2014**	**Fair Value December 31, 2013**	**Balance Sheet Location**	**Fair Value June 30, 2014**	**Fair Value December 31, 2013**
	(In thousands)			**(In thousands)**	
Prepaid expenses and other current assets	$ 5,600	$ 1,562	Accrued liabilities	$ (176)	$ (1,143)

The following table presents the amounts recognized in our Consolidated Balance Sheets and Consolidated Statements of Operations related to our derivative financial instruments designated as cash flow hedges for the three-month and six-month periods ended June 30, 2014 and 2013, respectively.

	Three Months Ended June 30, 2014	**Three Months Ended June 30, 2013**	**Six Months Ended June 30, 2014**	**Six Months Ended June 30, 2013**
	(In thousands)			
FOREX contracts:				
Amount of gain (loss) recognized in AOCGL on derivative (effective portion)	$ 4,434	$ (10,460)	$ 8,802	$ (10,025)
Location of gain (loss) reclassified from AOCGL into income (effective portion)	Contract drilling expense	Contract drilling expense	Contract drilling expense	Contract drilling expense
Amount of gain (loss) reclassified from AOCGL into income (effective portion)	$ 3,630	$ 389	$ 3,899	$ 2,621
Location of gain (loss) recognized in income on derivative (ineffective portion and amount excluded from	Foreign currency transaction gain (loss)	Foreign currency transaction gain (loss)	Foreign currency transaction gain (loss)	Foreign currency transaction gain (loss)

effectiveness testing)								
Amount of gain (loss) recognized in income on derivative (ineffective portion and amount excluded from effectiveness testing)	$		$	(116)	$	(1)	$	(118)
Treasury lock agreements:								
Amount of gain recognized in AOCGL on derivative (effective portion)								
Location of gain reclassified from AOCGL into income (effective portion)	Interest Expense				Interest Expense			
Amount of gain reclassified from AOCGL into income (effective portion)	$	2	$		$	4	$	

As of June 30, 2014, the estimated amount of net unrealized gains associated with our FOREX contracts and treasury lock agreements that will be reclassified to earnings during the next twelve months was $5.4 million and $8,052, respectively. The net unrealized gains associated with these derivative financial instruments will be reclassified to contract drilling expense and interest expense, respectively. During the three-month and six-month periods ended June 30, 2014 and 2013, we did not reclassify any amounts from AOCGL due to the probability of an underlying forecasted transaction not occurring.

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7. Financial Instruments and Fair Value Disclosures

Financial instruments which potentially subject us to significant concentrations of credit or market risk consist primarily of periodic temporary investments of excess cash, trade accounts receivable and investments in debt securities, including residential mortgage-backed securities. We generally place our excess cash investments in U.S. government-backed short-term money market instruments through several financial institutions. At times, such investments may be in excess of the insurable limit. We periodically evaluate the relative credit standing of these financial institutions as part of our investment strategy.

Most of our investments in debt securities are U.S. government securities with minimal credit risk. However, we are exposed to market risk due to price volatility associated with interest rate fluctuations.

Concentrations of credit risk with respect to our trade accounts receivable are limited primarily due to the entities comprising our customer base. Since the market for our services is the offshore oil and gas industry, this customer base consists primarily of major and independent oil and gas companies and government-owned oil companies. At June 30, 2014 and December 31, 2013, our largest customer in Brazil, Petróleo Brasileiro S.A. (a Brazilian multinational energy company that is majority-owned by the Brazilian government), accounted for $122.1 million and $154.5 million, or 24% and 35%, respectively, of our total consolidated net trade accounts receivable balance.

In general, before working for a customer with whom we have not had a prior business relationship and/or whose financial stability may be uncertain to us, we perform a credit review on that company. Based on that analysis, we may require that the customer present a letter of credit, prepay or provide other credit enhancements. We record a provision for bad debts on a case-by-case basis when facts and circumstances indicate that a customer receivable may not be collectible and, historically, losses on our trade receivables have been infrequent occurrences.

In June 2014, we received $14.7 million from Niko Resources Ltd. pursuant to a settlement agreement entered into at the end of 2013 with respect to certain unpaid obligations under dayrate contracts. We recognized the entire $14.7 million as revenue in the second quarter of 2014, as revenue had not been previously recognized. At June 30, 2014, $40.3 million remained outstanding under the settlement agreement, payable at various times through March 2017.

Fair Values

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The fair value hierarchy prescribed by GAAP requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. There are three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices for identical instruments in active markets. Level 1 assets include short-term investments such as money market funds, U.S. Treasury Bills and Treasury notes. Our Level 1 assets at June 30, 2014 consisted of cash held in money market funds of $945.1 million, time deposits of $20.1 million and investments in U.S. Treasury securities of $350.0 million. Our Level 1 assets at December 31, 2013 consisted of cash held in money market funds of $281.3 million, time deposits of $30.0 million and investments in U.S. Treasury securities of $1,749.9 million.

Level 2 Quoted market prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets. Level 2 assets and liabilities include residential mortgage-backed securities and over-the-counter FOREX contracts. Our residential mortgage-backed securities were valued using a model-derived valuation technique based on the quoted closing market prices received from a financial institution. Our FOREX contracts are valued based on quoted market prices, which are derived from observable inputs including current spot and forward rates, less the contract rate multiplied by the notional amount. The inputs used in our valuation are obtained from a Bloomberg curve analysis which uses par coupon swap rates to calculate implied forward rates so that projected floating rate cash flows can be calculated. The valuation techniques underlying the models are widely accepted in the financial services industry and do not involve significant judgment.

Level 3 Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable. Level 3 assets and liabilities generally include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation or for which there is a lack of transparency as to the inputs used.

Market conditions could cause an instrument to be reclassified among Levels 1, 2 and 3. Our policy regarding fair value measurements of financial instruments transferred into and out of levels is to reflect the transfers as having occurred at the beginning of the reporting period. There were no transfers between fair value levels during the six-month periods ended June 30, 2014 and 2013.

Certain of our assets and liabilities are required to be measured at fair value on a recurring basis in accordance with GAAP. In addition, certain assets and liabilities may be recorded at fair value on a nonrecurring basis. Generally, we record assets at fair value on a nonrecurring basis as a result of impairment charges. We did not record any impairment charges related to assets measured at fair value on a nonrecurring basis during the three-month and six-month periods ended June 30, 2014 and 2013.

Assets and liabilities measured at fair value are summarized below:

	June 30, 2014 Fair Value Measurements Using			
	Level 1	Level 2	Level 3	Assets at Fair Value
	(In thousands)			
Recurring fair value measurements:				
Assets:				
Short-term investments	$ 1,315,258	$	$	$ 1,315,258
FOREX contracts		5,600		5,600
Mortgage-backed securities		162		162
Total assets	$ 1,315,258	$ 5,762	$	$ 1,321,020
Liabilities:				
FOREX contracts	$	$ (176)	$	$ (176)

	December 31, 2013 Fair Value Measurements Using			
	Level 1	Level 2	Level 3	Assets at Fair Value
	(In thousands)			
Recurring fair value measurements:				
Assets:				
Short-term investments	$ 2,061,154	$	$	$ 2,061,154
FOREX contracts		1,562		1,562
Mortgage-backed securities		197		197

Total assets	$ 2,061,154	$ 1,759	$	$ 2,062,913
Liabilities:				
FOREX contracts	$	$ (1,143)	$	$ (1,143)

We believe that the carrying amounts of our other financial assets and liabilities (excluding long-term debt), which are not measured at fair value in our Consolidated Balance Sheets, approximate fair value based on the following assumptions:

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

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

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We consider our senior notes, including current maturities, to be Level 2 liabilities under the GAAP fair value hierarchy and, accordingly, the fair value of our senior notes was derived using a third-party pricing service at June 30, 2014 and December 31, 2013. We perform control procedures over information we obtain from pricing services and brokers to test whether prices received represent a reasonable estimate of fair value. These procedures include the review of pricing service or broker pricing methodologies and comparing fair value estimates to actual trade activity executed in the market for these instruments occurring generally within a 10-day period of the report date. Fair values and related carrying values of our senior notes are shown below.

	June 30, 2014		December 31, 2013	
	Fair Value	Carrying Value	Fair Value	Carrying Value
	(In millions)			
5.15% Senior Notes due 2014	$ 252.0	$ 250.0	$ 257.4	$ 250.0
4.875% Senior Notes due 2015	261.1	249.9	265.7	249.9
5.875% Senior Notes due 2019	582.3	499.6	578.1	499.6
3.45% Senior Notes due 2023	250.7	249.0	241.4	249.0
5.70% Senior Notes due 2039	567.1	496.9	543.1	496.9
4.875% Senior Notes due 2043	757.0	748.8	736.1	748.8

We have estimated the fair value amounts by using appropriate valuation methodologies and information available to management. 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.

8. Drilling and Other Property and Equipment

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

	June 30, 2014	December 31, 2013
	(In thousands)	
Drilling rigs and equipment	$ 8,649,093	$ 7,412,066
Construction work-in-progress	1,232,313	1,668,211
Land and buildings	66,039	65,627
Office equipment and other	68,232	65,799
Cost	10,015,677	9,211,703
Less: accumulated depreciation	(3,959,687)	(3,744,476)
Drilling and other property and equipment, net	$ 6,055,990	$ 5,467,227

Construction work-in-progress, including capitalized interest, at June 30, 2014 and December 31, 2013 is summarized as follows:

	June 30,	December 31,

	2014	2013
	(In thousands)	
Ultra-deepwater drillships	$ 690,483	$ 868,908
Ultra-deepwater semisubmersible:		
Ocean GreatWhite	203,282	195,578
Deepwater semisubmersibles:		
Ocean Onyx		339,129
Ocean Apex	338,548	264,596
Total construction work-in-progress	$ 1,232,313	$ 1,668,211

In January and February of 2014, the deepwater semisubmersible *Ocean Onyx* and the ultra-deepwater drillship *Ocean BlackHawk*, respectively, were placed in service and are no longer reported as construction work-in-progress at June 30, 2014.

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9. Credit Agreement

We have a syndicated 5-Year Revolving Credit Agreement, or Credit Agreement, with Wells Fargo Bank, National Association, as administrative agent and swingline lender. Effective March 17, 2014, we entered into a commitment increase agreement and second amendment to the Credit Agreement, which, among other things, provided for a $250.0 million increase in the aggregate commitment under the revolving credit facility and an approximately six-month extension of the maturity date with all of the existing lenders. The Credit Agreement provides for a $1.0 billion senior unsecured revolving credit facility for general corporate purposes, maturing on March 17, 2019. The entire amount of the facility is available, subject to its terms, for revolving loans. Up to $250 million of the facility may be used for the issuance of performance or other standby letters of credit and up to $100 million may be used for swingline loans.

At June 30, 2014, we had no amounts outstanding under the Credit Agreement.

10. Commitments and Contingencies

Various claims have been filed against us in the ordinary course of business, including claims by offshore workers alleging personal injuries. With respect to each claim or exposure, we have made an assessment, in accordance with GAAP, of the probability that the resolution of the matter would ultimately result in a loss. When we determine that an unfavorable resolution of a matter is probable and such amount of loss can be determined, we record a liability for the amount of the estimated loss at the time that both of these criteria are met. Our management believes that we have recorded adequate accruals for any liabilities that may reasonably be expected to result from these claims.

Asbestos Litigation. We are one of several unrelated defendants in lawsuits filed in state courts alleging that defendants manufactured, distributed or utilized drilling mud containing asbestos and, in our case, allowed such drilling mud to have been utilized aboard our offshore drilling rigs. The plaintiffs seek, among other things, an award of unspecified compensatory and punitive damages. The manufacture and use of asbestos-containing drilling mud had already ceased before we acquired any of the drilling rigs addressed in these lawsuits. We believe that we are not liable for the damages asserted and we expect to receive complete defense and indemnity with respect to many of the lawsuits from Murphy Exploration & Production Company pursuant to the terms of our 1992 asset purchase agreement with them. We also believe that we are not liable for the damages asserted in the remaining lawsuits pursuant to the terms of our 1989 asset purchase agreement with Diamond M Corporation, and we filed a declaratory judgment action in Texas state court against NuStar Energy LP, or NuStar, the successor to Diamond M Corporation, seeking a judicial determination that we did not assume liability for these claims. We obtained summary judgment on our claims in the declaratory judgment action, but NuStar appealed the trial court s decision, and the appellate court has remanded the case to trial. We are unable to estimate our potential exposure, if any, to these lawsuits at this time but do not believe that ultimate liability, if any, resulting from this litigation will have a material effect on our consolidated financial condition, results of operations and cash flows.

Various other claims have been filed against us in the ordinary course of business. In the opinion of our management, no pending or known threatened claims, actions or proceedings against us are expected to have a material adverse effect on our consolidated financial position, results of operations and cash flows.

We intend to defend these matters vigorously; however, we cannot predict with certainty the outcome or effect of any litigation matters specifically described above or any other pending litigation or claims. There can be no assurance as to the ultimate outcome of these lawsuits.

Brazilian Withholding Contingency. Petróleo Brasileiro S.A., or Petrobras has notified us, along with other industry participants, that it is currently challenging assessments by Brazilian tax authorities of withholding taxes associated with the provision of drilling rigs for its operations in Brazil during the years 2008 and 2009. Petrobras has also notified us that if Petrobras is ultimately assessed and must pay such withholding taxes, it will seek reimbursement from us for the portion allocable to our drilling rigs. We dispute any basis for Petrobras to obtain such reimbursement, and we have notified Petrobras of our position. We will, if necessary, vigorously defend our rights. We are unable to estimate the amount of loss or range of loss, if any, at this time, should Petrobras ultimately be assessed such taxes and it be determined that Petrobras is entitled to obtain reimbursement from us. If we were required to pay such reimbursement, however, the amount of such reimbursement could be substantial and could have a material adverse effect on our financial condition, results of operations and cash flows.

NPI Arrangement. We received customer payments measured by a percentage net profits interest (primarily of 27%) under an overriding royalty interest in certain developmental oil-and-gas producing properties, or NPI, which we believe is a real property interest. Our drilling program related to the NPI was completed in 2011, and the balance of the amounts due to us under the NPI was received in 2013. However, the customer who conveyed the NPI to us filed a voluntary petition for reorganization under Chapter 11 of the Bankruptcy Code in August 2012. Certain parties (including the debtor) in the bankruptcy proceedings have questioned whether our NPI, and certain amounts we received under it since the filing of the bankruptcy, should be included in the debtor s estate under the bankruptcy proceeding. We filed a declaratory judgment action in the bankruptcy court seeking a declaration that our NPI, and payments that we received from it since the filing of the bankruptcy, are not part of the bankruptcy estate. We expect that once discovery is concluded in the bankruptcy court, the federal district court will hold a trial to determine the nature of our NPI. We will vigorously defend our rights and pursue our interests in this matter.

Personal Injury Claims. Under our current insurance policies that expire on May 1, 2015, our deductibles for marine liability insurance coverage, including personal injury claims, which primarily result from Jones Act liability in the Gulf of Mexico, are $25.0 million for the first occurrence, with no aggregate deductible, and vary in amounts ranging between $5.0 million and, if aggregate claims exceed certain thresholds, up to $100.0 million for each subsequent occurrence, depending on the nature, severity and frequency of claims that might arise during the policy year.

The Jones Act is a federal law that permits seamen to seek compensation for certain injuries during the course of their employment on a vessel and governs the liability of vessel operators and marine employers for the work-related injury or death of an employee. We engage outside consultants to assist us in estimating our aggregate liability for personal injury claims based on our historical losses and utilizing various actuarial models. We allocate a portion of the aggregate liability to Accrued liabilities based on an estimate of claims expected to be paid within the next twelve months with the residual recorded as Other liabilities. At June 30, 2014, our estimated liability for personal injury claims was $36.4 million, of which $7.8 million and $28.6 million were recorded in Accrued liabilities and Other liabilities, respectively, in our Consolidated Balance Sheets. At December 31, 2013, our estimated liability for personal injury claims was $35.5 million, of which $9.5 million and $26.0 million were recorded in Accrued liabilities and Other liabilities, respectively, in our Consolidated Balance Sheets. The eventual settlement or adjudication of these claims could differ materially from our estimated amounts due to uncertainties such as:

- the severity of personal injuries claimed;
- significant changes in the volume of personal injury claims;
- the unpredictability of legal jurisdictions where the claims will ultimately be litigated;
- inconsistent court decisions; and
- the risks and lack of predictability inherent in personal injury litigation.

Purchase Obligations

Ultra-Deepwater Floater Construction. The *Ocean GreatWhite*, a 10,000 foot dynamically positioned, harsh environment semisubmersible drilling rig, is under construction in South Korea at an estimated cost of $755 million, including shipyard costs, capital spares, commissioning and shipyard supervision. The contracted price to Hyundai Heavy Industries Co., Ltd., or Hyundai, totaling $628.5 million is payable in two installments, of which the first installment of $188.6 million has been paid. The final installment of $439.9 million is due upon delivery of the rig, which is expected to occur in the first quarter of 2016.

Drillship Construction. At June 30, 2014, we had three remaining ultra-deepwater drillships under construction at Hyundai for an estimated aggregate cost of $1.9 billion, including shipyard costs, commissioning, capital spares and project management costs. The contracted price of each drillship is payable to Hyundai in two installments, with final payment due on delivery of each drillship. We have paid the first installment for each of our drillships currently under construction, aggregating $493.2 million. The *Ocean BlackHornet, Ocean BlackRhino* and *Ocean BlackLion* are expected to be delivered in the third and fourth quarters of 2014 and the first quarter of 2015, respectively, at which times approximately $390 million will be payable to Hyundai for each rig.

Ocean Apex Construction. We are obligated under a vessel modification agreement with Jurong Shipyard Pte Ltd., or Jurong, for the construction of the *Ocean Apex*, a moored semisubmersible deepwater rig, which is expected to be delivered in the fourth quarter of 2014 at an aggregate cost of approximately $370.0 million, including shipyard costs, commissioning, capital spares and project management costs. The contracted price due to Jurong is payable in 12 installments based on the occurrence of certain events as detailed in the vessel modification agreement. We have paid the first eight installments, in the aggregate amount of $87.8 million. The remaining $47.3 million in aggregate milestone payments are payable to Jurong during 2014 as construction milestones are met.

At June 30, 2014 and December 31, 2013, we had no other purchase obligations for major rig upgrades or any other significant obligations, except for those related to our direct rig operations, which arise during the normal course of business.

Letters of Credit and Other. We were contingently liable as of June 30, 2014 in the amount of $99.6 million under certain performance, supersedeas and customs bonds and letters of credit. Agreements relating to approximately $90.0 million of performance, supersedeas and customs bonds can require collateral at any time. As of June 30, 2014, we had not been required to make any collateral deposits with respect to these agreements. The remaining agreements cannot require collateral except in events of default. On our behalf, banks have issued letters of credit securing certain of these bonds.

11. Accumulated Other Comprehensive Gain (Loss)

The components of our AOCGL and related changes thereto are as follows:

	Unrealized Gain (Loss) on Derivative Financial Instruments	Marketable Securities	Total AOCGL
		(In thousands)	
Balance at January 1, 2014	$ 357	$ (7)	$ 350
Change in other comprehensive gain (loss) before reclassifications, after tax of $(3,081) and $(16)	5,721	39	5,760
Reclassification adjustments for items included in Net Income, after tax of $1,366 and $7	(2,537)	(26)	(2,563)
Balance at June 30, 2014	$ 3,541	$ 6	$ 3,547

The following table presents the line items in our Consolidated Statements of Operations affected by reclassification adjustments out of AOCGL.

Major Category of AOCGL	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013	Consolidated Statements of Operations Line Items
	(In thousands)				
Derivative Financial Instruments:					
Unrealized (gain) loss on FOREX contracts	$ (3,630)	$ (389)	$ (3,899)	$ (2,621)	Contract drilling, excluding depreciation
Unrealized (gain) loss on Treasury Lock Agreements	(2)		(4)		Interest expense
	1,272	136	1,366	917	Income tax expense
	$ (2,360)	$ (253)	$ (2,537)	$ (1,704)	Net of tax
Marketable Securities:					
	$ (24)	$ (53)	$ (33)	$ (150)	Other, net

Unrealized (gain) loss on marketable securities									
		6		4		7		18	Income tax expense
	$	(18)	$	(49)	$	(26)	$	(132)	Net of tax

12. Segments and Geographic Area Analysis

Although we provide contract drilling services with different types of offshore drilling rigs and also provide such services in many geographic locations, we have aggregated these operations into one reportable segment based on the similarity of economic characteristics due to the nature of the revenue earning process as it relates to the offshore drilling industry over the operating lives of our drilling rigs.

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Revenues from contract drilling services by equipment type are listed below:

	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
	(In thousands)			
Floaters:				
Ultra-Deepwater	$ 182,656	$ 231,101	$ 388,450	$ 422,458
Deepwater	120,539	184,105	267,098	348,525
Mid-Water	300,902	288,860	586,881	594,081
Total Floaters	604,097	704,066	1,242,429	1,365,064
Jack-ups	45,457	40,832	92,433	79,807
Total contract drilling revenues	649,554	744,898	1,334,862	1,444,871
Revenues related to reimbursable expenses	42,690	13,120	66,806	42,888
Total revenues	$ 692,244	$ 758,018	$ 1,401,668	$ 1,487,759

Geographic Areas

Our drilling rigs are highly mobile and may be moved to other markets throughout the world in response to market conditions or customer needs. At June 30, 2014, our actively-marketed drilling rigs were en route to or located offshore 11 countries in addition to the United States. Revenues by geographic area are presented by attributing revenues to the individual country or areas where the services were performed.

	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
	(In thousands)			
United States	$ 128,639	$ 78,267	$ 243,508	$ 184,027
International:				
South America	262,072	300,756	549,996	584,321
Europe/Africa/Mediterranean	104,725	201,249	260,316	245,674
Australia/Asia	134,555	129,285	230,319	373,955
Mexico	62,253	48,461	117,529	99,782
Total revenues	$ 692,244	$ 758,018	$ 1,401,668	$ 1,487,759

13. Income Taxes

Our income tax expense is a function of the mix between our domestic and international pre-tax earnings or losses, as well as the mix of international tax jurisdictions in which we operate. Certain of our international rigs are owned and operated, directly or indirectly, by one of our wholly owned foreign subsidiaries. It is our intention to indefinitely reinvest future earnings of this subsidiary to finance foreign activities. Accordingly, we have not made a provision for U.S. income taxes on such earnings except to the extent that such earnings were immediately subject to U.S. income taxes.

Egypt Tax Jurisdiction. During 2013, we were under audit by the Egyptian tax authorities for the tax years 2006 through 2010. In December 2013, after receiving notification that the Egyptian government had concluded the income tax audit for the period 2006 to 2008 and proposed a $1.2 billion increase to taxable income, we accrued an additional $56.9 million of expense for uncertain tax positions in Egypt for all open years. During the first quarter of 2014, we settled certain disputes for the years 2006 through 2008 with the Egyptian tax authorities, which resulted in an aggregate $17.2 million reduction in tax expense, comprised of a $23.2 million reversal of uncertain tax positions, partially offset by $6.0 million in current income tax expense. One issue for the 2006 through 2008 period remains open, which we appealed. During the second quarter of 2014, the Appeals Committee in Egypt issued a decision regarding this open item, with which we disagree. In July 2014, we filed an objection with the Egyptian courts to continue disputing the matter. We are also seeking assistance from an agency of the U.S. Treasury Department, pursuant to international tax treaties, and continue to believe that our position will, more likely than not, be sustained. However, if our position is not sustained, tax expense and related penalties would increase by approximately $50 million related to this issue for the 2006 through 2008 tax years as of June 30, 2014.

United Kingdom Tax Jurisdiction. The U.K. Finance Act of 2014, or the Finance Act, was enacted in July 2014 with an effective date retroactive to April 1, 2014. Certain provisions of the Finance Act will limit the amount of tax deductions available with respect to our rigs working in the U.K. under bareboat charter arrangements, which could significantly increase our income tax expense in the U.K. We are actively reviewing various alternative arrangements under which our U.K. rigs could operate in order to minimize the impact of this legislative change.

ITEM 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion should be read in conjunction with our unaudited consolidated financial statements (including the notes thereto) included elsewhere in this report and our audited consolidated financial statements and the notes thereto, Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations and Item 1A, Risk Factors included in our Annual Report on Form 10-K for the year ended December 31, 2013. References to Diamond Offshore, we, us or our mean Diamond Offshore Drilling, Inc., a Delaware corporation, an its subsidiaries.

We are a leader in offshore drilling, providing contract drilling services to the energy industry around the globe with a fleet of 44 offshore drilling rigs, including five rigs under construction. Our fleet consists of 33 semisubmersibles, two of which are under construction, six jack-ups and five dynamically positioned drillships, three of which are under construction. As of the date of this report, three of our mid-water semisubmersible drilling rigs are cold stacked.

The recently completed deepwater floater *Ocean Onyx* has been working under a one-year contract in the U.S. Gulf of Mexico, or GOM, since mid-January, and the ultra-deepwater drillship *Ocean BlackHawk* recently began drilling operations under a five-year contract in the GOM.

During the latter half of 2014, we expect to take delivery of two additional ultra-deepwater drillships, the *Ocean BlackHornet* and *Ocean BlackRhino*, as well as the deepwater floater *Ocean Apex*. The remaining ultra-deepwater drillship, the *Ocean BlackLion*, and the harsh environment, ultra-deepwater semisubmersible *Ocean GreatWhite* are expected to be delivered in 2015 and 2016, respectively. Of these rigs, the *Ocean BlackLion* is not yet contracted.

The North Sea enhancement project for the *Ocean Patriot* was completed late in the second quarter of 2014 and the rig is en route to Hartlepool, England, where the rig will make final preparations for its three-year contract in the North Sea, which is expected to commence in the fourth quarter of 2014. The *Ocean Confidence* is currently undergoing a service-life-extension project in the Canary Islands, which is expected to keep the rig out of drilling service until early in the second quarter of 2015. We transferred nine months of contracted backlog from the *Ocean Confidence* to our third newbuild drillship, the *Ocean BlackRhino*, which we expect to commence in early 2015 in the GOM.

Market Overview

Floater Markets

Floater markets, in general, continue to weaken, and industry analysts predict that a depressed market will continue at least through 2015.

Ultra-Deepwater Floaters. Newbuild rig deliveries and established rigs coming off contract continue to fuel an oversupply of floaters in both the ultra-deepwater and deepwater markets. The oversupply of rigs, exacerbated by cutbacks and/or delays in customer drilling programs, has led to fierce competition for a limited number of jobs, resulting in lower contracted dayrates, the execution of shorter-term contracts and, in some cases, the idling of rigs.

There have been few bidding opportunities during the first half of 2014, and the outlook for the remainder of the year and into 2015 is generally pessimistic. Dayrates may decline further, as some industry analysts predict that lower rates may be exchanged for utilization of newbuilds and higher specification rigs.

Deepwater Floaters. The market for deepwater floaters has continued to trend downward in tandem with the ultra-deepwater market. Demand in this market is intermittent, with limited bidding opportunities. As a result, multiple existing units face pockets of idle time in 2014 and 2015, and newbuild rigs may also have challenges securing work. Dayrates have also declined, compared to prior peak markets, and are projected by industry analysts to continue to soften in 2014.

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Mid-Water Floaters. Conditions in the mid-water market varies by region. Market analysts predict further decline in contracted dayrates in most geographic markets. Frontier markets across Southeast Asia and South America, including Colombia, Myanmar, Nicaragua, Peru and Trinidad and Tobago, remain areas of future, possible market demand. Certain of our rigs are either currently working or contracted for future work in Colombia and Trinidad and Tobago; however, future opportunities in these areas are not expected to emerge quickly.

Impact of Newbuild Rigs and Other Challenges Facing the Offshore Drilling Industry

Since the beginning of 2014, nine newbuild floaters were ordered, based on industry data, adding to the supply of rigs competing in the offshore drilling market. As of the date of this report, based on industry data, there are approximately 65 competitive, or non-owner-operated, newbuild floaters on order, and, in addition, an estimated 29 rigs potentially to be built on behalf of Petróleo Brasileiro S.A., which is currently our largest single customer based on annual consolidated revenues. Of the competitive rigs, 26 of the 47 newbuilds scheduled for delivery in the second half of 2014 through 2015, including one of our drillships that we expect to be delivered in 2015, as well as over half of the 11 newbuilds scheduled for delivery in 2016, are not yet contracted for future work. Six of the seven newbuilds on order with an estimated delivery in 2017 have not yet been contracted. The influx of newbuilds into the market, combined with established rigs coming off contract in 2014 and 2015, is expected to contribute to the further weakening of the ultra-deepwater and deepwater floater markets.

In addition, the offshore drilling industry is challenged by growing regulatory demands and more complex customer specifications, which could disadvantage the marketability of some lower specification rigs. Customer focus on completing existing projects, possible reduction or deferral of new investment, reallocation of budgets away from offshore projects and particular customer requirements in certain markets could also displace, or reduce, demand and result in the migration of some ultra-deepwater rigs to work in deepwater and, likewise, some deepwater rigs to compete against mid-water units.

See Contract Drilling Backlog for future commitments of our rigs during 2014 through 2020.

Contract Drilling Backlog

The following table reflects our contract drilling backlog as of July 23, 2014, February 5, 2014 (the date reported in our Annual Report on Form 10-K for the year ended December 31, 2013), and July 24, 2013 (the date reported in our Quarterly Report on Form 10-Q for the quarter ended June 30, 2013). Contract drilling backlog as presented below includes only firm commitments (typically represented by signed contracts) and is calculated by multiplying the contracted operating dayrate by the firm contract period and adding one-half of any potential rig performance bonuses. Our calculation also assumes full utilization of our drilling equipment for the contract period (excluding scheduled shipyard and survey days); however, the amount of actual revenue earned and the actual periods during which revenues are earned will be different than the amounts and periods shown in the tables below due to various factors. Utilization rates, which generally approach 92-98% during contracted periods, can be adversely impacted by downtime due to various operating factors including, but not limited to, weather conditions and unscheduled repairs and maintenance. Contract drilling backlog excludes revenues for mobilization, demobilization, contract preparation and customer reimbursables. No revenue is generally earned during periods of downtime for regulatory surveys. Changes in our contract drilling backlog between periods are generally a function of the performance of work on term contracts, as well as the extension or modification of existing term contracts and the execution of additional contracts.

In the second quarter of 2014, Statoil ASA, or Statoil, terminated its contract for the mid-water semisubmersible *Ocean Vanguard*. The contract, which provided for a dayrate of approximately $454,000, was estimated to conclude in accordance with its terms in late February 2015. We dispute Statoil s basis for terminating the contract and intend to vigorously defend our rights under the contract. Contract drilling backlog for our mid-water floaters no longer includes an aggregate of approximately $107.0 million in previously reported backlog for the third quarter of 2014 through 2015, associated with Statoil s contract for the *Ocean Vanguard*.

	July 23, 2014	February 5, 2014	July 24, 2013
		(In thousands)	
Contract Drilling Backlog			
Floaters:			
Ultra-Deepwater (1)	$ 3,751,000	$ 4,111,000	$ 4,967,000
Deepwater (2)	901,000	794,000	987,000
Mid-Water (3)	1,375,000	1,744,000	2,178,000
Total Floaters	6,027,000	6,649,000	8,132,000
Jack-ups	216,000	180,000	229,000