UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 1997

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<br>(State or other jurisdiction of incorporation or organization) | 76-0321760<br>(I.R.S. Employer Identification No.) |

15415 KATY FREEWAY
HOUSTON, TEXAS 77094
(Address and zip code of principal executive offices)

(281) 492-5300
(Registrant's telephone number, including area code)

SECURITIES REGISTERED PURSUANT TO SECTION 12(B) OF THE ACT:

| TITLE OF EACH CLASS | NAME OF EACH EXCHANGE ON WHICH REGISTERED |
|---|---|
| Common Stock, $0.01 par value per share | New York Stock Exchange |

SECURITIES REGISTERED PURSUANT TO SECTION 12(G) OF THE ACT: None

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant.

As of January 30, 1998 $3,089,306,640

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

As of January 30, 1998 Common Stock, $0.01 par value per share 139,328,160 shares

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive proxy statement relating to the 1998 Annual Meeting of Stockholders of Diamond Offshore Drilling, Inc., which will be filed within 120 days of December 31, 1997, are incorporated by reference in Part III of this form.

DIAMOND OFFSHORE DRILLING, INC. AND SUBSIDIARIES
FORM 10-K FOR THE YEAR ENDED DECEMBER 31, 1997

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PART I

ITEM 1. BUSINESS.

GENERAL

Diamond Offshore Drilling, Inc., incorporated in Delaware in 1989, engages principally in the contract drilling of offshore oil and gas wells. Unless the context otherwise requires, references herein to the "Company" shall mean Diamond Offshore Drilling, Inc. and its consolidated subsidiaries. The Company is a leader in deep water drilling with a fleet of 46 offshore rigs. The fleet consists of 30 semisubmersibles (including an accommodation vessel), 15 jack-ups and one drillship and operates in the waters of six of the world's seven continents.

STOCK DIVIDEND

In July 1997, the Board of Directors declared a two-for-one stock split in the form of a stock dividend which was distributed on August 14, 1997 to stockholders of record on July 24, 1997. The dividend was charged to retained earnings in the amount of $0.7 million. Weighted average shares outstanding and all per share amounts included herein are based on the increased number of shares, giving retroactive effect to the stock dividend.

ISSUANCE OF CONVERTIBLE SUBORDINATED NOTES

In February 1997, the Company issued $400.0 million, including $50.0 million from an over-allotment option, of 3.75 percent convertible subordinated notes (the "Notes") due February 15, 2007. The Notes are convertible, in whole or in part, at the option of the holder at any time following the date of original issuance thereof and prior to the close of business on the business day immediately preceding the maturity date, unless previously redeemed, into shares of the Company's common stock, par value $0.01 per share ("Common Stock"), at a conversion price of $40.50 per share (equivalent to a conversion rate of 24.691 shares per $1,000 principal amount of Notes), subject to adjustment in certain circumstances. 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. See "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Liquidity" in Item 7 of this Report.

MERGER WITH ARETHUSA

On April 29, 1996, the Company acquired 100 percent of the common stock of Arethusa (Off-Shore) Limited ("Arethusa"), a Bermuda corporation, (the "Arethusa Merger") in exchange for shares of Common Stock. Arethusa owned a fleet of 11 mobile offshore drilling rigs, operated two additional mobile offshore drilling rigs pursuant to bareboat charters and provided drilling services worldwide to international and government-controlled oil and gas companies. The fleet was comprised of eight semisubmersible rigs and five jack-up rigs. The Company issued 35.8 million shares of Common Stock based on an exchange ratio of 1.76 shares for each share of Arethusa's issued and outstanding common stock. See Note 2 to the Company's Consolidated Financial Statements in Item 8 of this Report.

INDUSTRY CONDITIONS

The offshore contract drilling business is influenced by a number of factors, including the current and anticipated prices of oil and natural gas, the expenditures by oil and gas companies for exploration and development and the availability of drilling rigs. In addition, demand for drilling services remains dependent on a variety of political and economic factors beyond the Company's control, including worldwide demand for oil and natural gas, the ability of the Organization of Petroleum Exporting Countries ("OPEC") to set and maintain production levels and pricing, the level of production of non-OPEC countries and the policies of the various governments regarding exploration and development of their oil and natural gas reserves.

Historically, the offshore contract drilling industry has been highly competitive and cyclical, with periods of low demand, excess rig supply and low dayrates followed by periods of high demand, short rig supply and high dayrates. For a number of years, depressed oil and natural gas prices and an oversupply of rigs adversely affected the offshore drilling market. In particular, the prolonged weakness and uncertainty in the demand for and price of natural gas resulted in a significant decline in exploration and production activities in the Gulf of Mexico. Subsequently, the offshore drilling industry has benefited from increased demand and from a tight supply of major offshore drilling rigs worldwide. These conditions are due, in part, to technological advances that have broadened opportunities for offshore exploration and development.

All of the Company's markets have experienced high utilization levels and improved dayrates in 1997 and early 1998 and, in many cases, customers seek to contract rigs for term commitments (as opposed to contracts for the drilling of a single well or a group of wells) and often will pay for upgrades and modifications necessary for more challenging drilling locations in order to assure rig availability. Although not currently a material factor in the Company's markets, weak commodity prices, economic problems in countries outside the United States, or a number of other influencing factors could curtail spending by oil and gas companies and possibly depress the offshore drilling industry. Therefore, the Company cannot predict whether and, if so, to what extent current market conditions will continue. See "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Outlook" in Item 7 of this Report.

THE FLEET

The Company's large, diverse fleet, which includes some of the most technologically advanced rigs in the world, enables it to offer a broad range of services worldwide in various markets, including the deep water market, the harsh environment market (such as the North Sea), the conventional semisubmersible market and the jack-up market.

Semisubmersibles. The Company owns and operates 30 semisubmersibles (including an accommodation vessel). Semisubmersible rigs consist of an upper working and living deck resting on vertical columns connected to lower hull members. Such rigs operate in a "semi-submerged" position, remaining afloat, off bottom, in a position in which the lower hull is approximately 55 to 90 feet below the water line and the upper deck protrudes well above the surface. The rig is typically anchored in position and remains stable for drilling in the semi-submerged floating position due in part to its wave transparency characteristics at the water line.

The Company owns and operates three fourth-generation semisubmersibles and three fourth-generation deep water conversions. Fourth-generation semisubmersibles are larger than other semisubmersibles, are capable of working in deep water or harsh environments and have other advanced features. Currently the Ocean America, the Ocean Quest, the Ocean Star, and the Ocean Victory are located in deep water areas of the Gulf of Mexico; the Ocean Alliance is located in the harsh environment of the North Sea offshore Norway; and the Ocean Valiant is located offshore West Africa.

In addition, the Company owns and operates 24 other semisubmersibles, which operate in maximum water depths of up to 3,500 feet. The diverse capabilities of most of these semisubmersibles enable them to work in both shallow and deep water environments in the U.S. and in most markets outside the U.S. Currently, 12 of these semisubmersibles are contracted in the Gulf of Mexico; four are contracted offshore Brazil; three are contracted in the North Sea; three are contracted offshore Australia; and one is contracted offshore West Africa.

In May 1997, the Company purchased a semisubmersible accommodation vessel, the Polyconfidence, equipped with dynamic-positioning capabilities. The Polyconfidence (soon to be renamed Ocean Confidence) will be converted to a drilling unit with fourth-generation capabilities, including harsh environment and ultra-deep water capabilities. The rig is anticipated to be delivered in late 1999. See "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Capital Resources" in Item 7 of this Report.

Jack-ups. The Company owns 15 jack-ups. Jack-up rigs are mobile, self-elevating drilling platforms equipped with legs that are lowered to the ocean floor until a foundation is established to support the drilling platform. The rig hull includes the drilling rig, jacking system, crew quarters, loading and unloading facilities, storage areas for bulk and liquid materials, heliport and other related equipment. Jack-ups are used extensively for drilling in water depths from 20 feet to 350 feet. The water depth limit of a particular rig is principally determined by the length of the rig's legs. A jack-up rig is towed by tugboats to the drillsite with its hull riding in the sea, as a vessel, with its legs retracted. Once over a drillsite, the legs are lowered until they rest on the seabed and jacking continues until the hull is elevated above the surface of the water. After completion of drilling operations, the hull is lowered until it rests in the water and then the legs are retracted for relocation to another drillsite.

The principal market for the Company's jack-up rigs is currently the Gulf of Mexico, where 12 of the Company's jack-up rigs are located. Of the Company's jack-up rigs in the Gulf of Mexico, seven are independent-leg cantilevered rigs, two are mat-supported cantilevered rigs, two are independent-leg slot rigs, and one is a mat-supported slot rig. All three of the Company's internationally based jack-ups are independent-leg cantilevered rigs.

Drillship. Drillships, which are typically self-propelled, are positioned over a drillsite through the use of either an anchoring system or a computer controlled thruster system (dynamic-positioning) similar to those used on certain semisubmersible rigs. Deep water drillships compete in many of the same markets as do fourth-generation semisubmersible rigs. The Company's drillship, the Ocean Clipper I, was upgraded in 1997 with dynamic-positioning capabilities and other enhancements and is operating in the deep water market of the Gulf of Mexico.

Fleet Enhancements. The Company's strategy is to maximize dayrates and utilization by adapting to trends in its markets, including enhancing its fleet to meet customer demand for diverse drilling capabilities. The average age of the Company's fleet of offshore drilling rigs (calculated as of December 31, 1997 and measured from the year built) is 19.6 years. Many of the Company's rigs have been upgraded during the last five years with enhancements such as top-drive drilling systems, additional water depth capability, mud pump additions or increases in deck load capacity, and the Company believes that it will be feasible to continue to upgrade its rigs notwithstanding the average age of its fleet. However, there can be no assurance as to if, when or to what extent upgrades will continue to be made to rigs in the Company's fleet, particularly in view of current dayrates that would be forgone by removing a rig from service for upgrade. See "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Capital Resources" in Item 7 of this Report.

The design of the Company's Victory-class semisubmersible rigs, including their cruciform hull configurations, long fatigue-life and advantageous stress characteristics, makes this class of rig particularly well-suited for significant upgrade projects. Since 1995, the Company has upgraded five of its eight Victory-class rigs with enhancements such as increased efficiency in the handling of subsea completion equipment, stability enhancements that allow increased variable deck load, and increased water depth capabilities. Currently, the Company's Victory-class rigs are outfitted for service in maximum water depths of 1,200 to 5,000 feet.

The Ocean Quest, one of the Company's Victory-class rigs, was upgraded to conduct drilling operations in the Gulf of Mexico in water depths of up to 3,500 feet and was placed into service in September 1996. In March 1997, the Company completed the major upgrade of the Ocean Star, including stability and other enhancements such as water depth capabilities of up to 4,500 feet, increased variable deck load to approximately 6,000 tons, a top-drive drilling system, a 15,000 psi blow-out prevention system, increased deck area, and additional mud pit and tensioner capacity. The Company completed the upgrade of the Ocean Victory in November 1997, which enabled the rig to conduct drilling operations in water depths of up to 5,000 feet with enhancements similar to the Ocean Star. These rigs are now able to compete effectively in the fourth-generation deep water market.

The upgrade of the Company's drillship, the Ocean Clipper I, was completed in July 1997. The drillship is now equipped with dynamic-positioning capabilities, a 15,000 psi blow-out prevention system, three mud pumps, and other enhancements. Since completion of its upgrade, however, the Ocean Clipper I has experienced certain subsea system equipment difficulties primarily associated with new technology for operations in deep water. While the drillship is operating under its drilling contract in the Gulf of Mexico, the

Company continues to participate in developing design revisions that will benefit the affected systems long-term.

The Company is scheduled to upgrade the Polyconfidence from an accommodation vessel to a semisubmersible drilling unit capable of operating in harsh environments and ultra-deep waters. The conversion will include enhancements such as increased capability for operations in up to 7,500 foot water depths, approximately 6,000 tons variable deck load, a 15,000 psi blow-out prevention system, and four mud pumps. The upgrade is anticipated to be completed in late 1999, when the rig will commence a five-year commitment in the Gulf of Mexico.

More detailed information concerning the Company's fleet of mobile offshore drilling rigs, as of January 31, 1998, is set forth in the table below.

| TYPE AND NAME | WATER DEPTH CAPABILITY(FT.) | ATTRIBUTES | YEAR BUILT/LATEST ENHANCEMENT (A) | CURRENT LOCATION | CUSTOMER (B) |
|---|---|---|---|---|---|
| FOURTH-GENERATION EQUIPMENT | | | | | |
| ORIGINAL CONSTRUCTION (3): | | | | | |
| Ocean Alliance............. | 5,000 | TDS; DP; 15K; 3M | 1988/1995 | North Sea | Shell |
| Ocean America.............. | 5,000 | TDS; SP; 15K; 3M | 1988/1992 | Gulf of Mexico | BP |
| Ocean Valiant.............. | 5,000 | TDS; SP; 15K; 3M | 1988/1995 | Angola | Exxon |
| CONVERSIONS (3): | | | | | |
| Ocean Victory.............. | 5,000 | TDS; VC; 15K; 3M | 1972/1997 | Gulf of Mexico | Vastar |
| Ocean Star................. | 4,500 | TDS; VC; 15K; 3M | 1974/1997 | Gulf of Mexico | Texaco |
| Ocean Quest................ | 3,500 | TDS; VC; 15K; 3M | 1973/1996 | Gulf of Mexico | Chevron |
| DRILLSHIP (1): | | | | | |
| Ocean Clipper I............ | 7,500 | TDS; DP; 15K; 3M | 1976/1997 | Gulf of Mexico | BP |
| OTHER SEMISUBMERSIBLES (24): | | | | | |
| Polyconfidence (c)......... | 5,000 | DP | 1987 | Enroute | BP |
| Ocean Worker (d)........... | 3,500 | TDS; 3M | 1982/1992 | Gulf of Mexico | Shell |
| Ocean Voyager.............. | 3,200 | TDS; VC | 1973/1995 | Gulf of Mexico | EEX |
| Ocean Winner (d)........... | 3,000 | TDS; 3M | 1977/1996 | Gulf of Mexico | Chevron |
| Ocean Yatzy (d)............ | 3,000 | TDS; DP; 15K | 1989 | Brazil | Petrobras |
| Ocean Yorktown (d)......... | 2,850 | TDS | 1976/1996 | Brazil | Petrobras |
| Ocean Concord (d).......... | 2,200 | TDS; 3M | 1975/1995 | Gulf of Mexico | Shell |
| Ocean Lexington (d)........ | 2,200 | TDS; 3M | 1976/1995 | Gulf of Mexico | Marathon |
| Ocean Saratoga (d)......... | 2,200 | TDS; 3M | 1976/1995 | Gulf of Mexico | Shell |
| Ocean Endeavor............. | 2,000 | TDS; VC | 1975/1994 | Gulf of Mexico | British-Borneo |
| Ocean Rover................ | 2,000 | TDS; VC; 15K | 1973/1992 | Gulf of Mexico | Amerada Hess |
| Ocean Prospector........... | 1,700 | VC | 1971/1981 | Gulf of Mexico | Mariner (e) |
| Ocean Bounty............... | 1,500 | TDS; VC; 3M | 1977/1992 | Australia | BHPP |
| Ocean Guardian............. | 1,500 | TDS; SP; 3M | 1985 | North Sea | Enterprise |
| Ocean New Era.............. | 1,500 | TDS | 1974/1990 | Gulf of Mexico | Amerada Hess |
| Ocean Princess............. | 1,500 | TDS; 15K | 1977/1996 | North Sea | Mobil |
| Ocean Whittington (d)(f)... | 1,500 | TDS; 3M | 1974/1995 | Gulf of Mexico | Petrobras |
| Ocean Epoch................ | 1,200 | TDS | 1977/1990 | Australia | Woodside |
| Ocean General.............. | 1,200 | TDS | 1976/1990 | Australia | Shell |
| Ocean Nomad................ | 1,200 | TDS | 1975/1995 | North Sea | Shell |
| Ocean Baroness............. | 1,200 | TDS; VC | 1973/1995 | Brazil | Petrobras |
| Ocean Ambassador........... | 1,100 | TDS; 3M | 1975/1995 | Gulf of Mexico | Coastal |
| Ocean Century.............. | 800 | | 1973 | Gulf of Mexico | Murphy |
| Ocean Liberator............ | 600 | | 1974 | Congo | AGIP |
| JACK-UPS (15): | | | | | |
| Ocean Titan................ | 350 | TDS; IS; 15K; 3M | 1974/1989 | Gulf of Mexico | CNG |
| Ocean Tower (g)............ | 350 | TDS; IS; 3M | 1972/1998 | Gulf of Mexico | Seneca |
| Ocean King................. | 300 | TDS; IC | 1973/1989 | Gulf of Mexico | Chevron |
| Ocean Nugget............... | 300 | TDS; IC | 1976/1995 | Gulf of Mexico | ADTI |
| Ocean Summit............... | 300 | SDS; IC | 1972/1991 | Gulf of Mexico | Coastal |
| Ocean Warwick.............. | 300 | TDS; IC | 1971/1998 | Gulf of Mexico | Upgrade (h) |
| Ocean Champion............. | 250 | MS | 1975/1985 | Gulf of Mexico | Vastar |
| Ocean Columbia............. | 250 | TDS; IC | 1978/1990 | Gulf of Mexico | Coastal |
| Ocean Heritage (d)......... | 250 | TDS; IC | 1981/1995 | Indonesia | Maxus |
| Ocean Sovereign (d)........ | 250 | TDS; IC | 1981/1994 | Indonesia | Maxus |
| Ocean Spartan.............. | 250 | TDS; IC | 1980/1994 | Gulf of Mexico | Vastar |
| Ocean Spur................. | 250 | TDS; IC | 1981/1994 | Gulf of Mexico | ADTI |
| Ocean Crusader............. | 200 | TDS; MC | 1982/1992 | Gulf of Mexico | Chevron |
| Ocean Drake................ | 200 | TDS; MC | 1983/1986 | Gulf of Mexico | Chevron |
| Ocean Scotian (d).......... | 200 | TDS; IC; 15K | 1981/1988 | Netherlands | Elf |

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ATTRIBUTES

| | | |
|---|---|---|
| DP = Dynamically-Positioned/Self-Propelled | MS = Mat-Supported Slot Rig | TDS = Top-Drive Drilling System |
| IC = Independent-Leg Cantilevered Rig | SDS = Side-Drive Drilling System | 3M = Three Mud Pumps |
| IS = Independent-Leg Slot Rig | VC = Victory-Class | 15K = 15,000 psi Blow-Out Preventer |
| MC = Mat-Supported Cantilevered Rig | SP = Self-Propelled | |

(a) Such enhancements include the installation of top-drive drilling systems, water depth upgrades, mud pump additions and increases in deck load capacity.

(b) For ease of presentation in this table, customer names have been shortened or abbreviated.

(c) Committed under a five-year term contract with BP in the Gulf of Mexico upon completion of relocation from the North Sea and conversion to a drilling unit.

(d) Formerly an Arethusa rig.

(e) Managed daywork project operated by Diamond Offshore Team Solutions, Inc.

(f) Committed under a three-year term contract with Petrobras offshore Brazil upon completion of repairs and relocation from the Gulf of Mexico.

(g) Committed under a nine-month term contract with Seneca in the Gulf of Mexico after completion of a leg reinforcement upgrade.

(h) Subsequent to January 31, 1998, committed under a three-well contract with Apache in the Gulf of Mexico upon completion of cantilever conversion.

MARKETS

The Company's principal markets for its offshore contract drilling services are the Gulf of Mexico, Europe, including principally the U.K. sector of the North Sea, South America, Africa, and Australia/Southeast Asia. The Company actively markets its rigs worldwide. In the past, rigs in the Company's fleet have also operated in various other markets throughout the world. See Note 14 to the Company's Consolidated Financial Statements in Item 8 of this Report.

The Company believes that its presence in multiple markets is valuable in many respects. For example, the Company believes that its experience with safety and other regulatory matters in the U. K. has been beneficial in Australia and in the Gulf of Mexico and that production experience gained through Brazilian and North Sea operations has potential application worldwide. Additionally, the Company believes that its performance for a customer in one market segment or area enables it to better understand that customer's needs and serve that customer in different market segments or other geographic locations.

OFFSHORE CONTRACT DRILLING SERVICES

The Company's contracts to provide offshore drilling services vary in their terms and provisions. The Company often obtains its contracts through competitive bidding, although it is not unusual for the Company to be awarded drilling contracts without competitive bidding. Drilling contracts generally provide for a basic drilling rate on a fixed dayrate basis regardless of whether such drilling results in a productive well. Drilling contracts may also provide for lower rates during periods when the rig is being moved or when drilling operations are interrupted or restricted by equipment breakdowns, adverse weather or water conditions or other conditions beyond the control of the Company. Under dayrate contracts, the Company generally pays the operating expenses of the rig, including wages and the cost of incidental supplies. Dayrate contracts have historically accounted for a substantial portion of the Company's revenues. In addition, the Company has worked some of its rigs under dayrate contracts pursuant to which the customer also agrees to pay the Company an incentive bonus based upon performance.

A dayrate drilling contract generally extends over a period of time covering either the drilling of a single well, a group of wells (a "well-to-well contract") or a stated term (a "term contract") and may be terminated by the customer in the event the drilling unit is destroyed or lost or if drilling operations are suspended for a specified period of time as a result of a breakdown of major equipment or, in some cases, due to other events beyond the control of either party. In addition, certain of the Company's contracts permit the customer to terminate the contract early by giving notice and in some circumstances may require the payment of an early termination fee by the customer. The contract term in many instances may be extended by the customer exercising options for the drilling of additional wells at fixed or mutually agreed terms, including dayrates.

The duration of offshore drilling contracts is generally determined by market demand and the respective management strategy of the offshore drilling contractor and its customers. In periods of rising demand for offshore rigs, contractors typically prefer well-to-well contracts that allow contractors to profit from increasing dayrates. In contrast, during these periods customers with reasonably definite drilling programs typically prefer longer term contracts to maintain dayrate prices at the lowest level possible. Conversely, in periods of decreasing demand for offshore rigs, contractors generally prefer longer term contracts to preserve dayrates at existing levels and ensure utilization, while the customers prefer well-to-well contracts that allow them to obtain the benefit of lower dayrates. Under current conditions, the Company seeks to have a foundation of long-term contracts with a reasonable balance of single well, well-to-well and short-term contracts to minimize the downside impact of a decline in the market while still participating in the benefit of increasing dayrates in a rising market.

The Company, through its wholly owned subsidiary, Diamond Offshore Team Solutions, Inc. ("DOTS"), offers a portfolio of drilling services to complement the Company's offshore contract drilling business. These services include overall project management, extended well tests, and drilling and completion operations. During 1997 and 1996, DOTS primarily provided project management services on a dayrate basis and contributed operating income of $1.9 million and $2.5 million, respectively, to the Company's consolidated results of operations. See "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Results of Operations" in Item 7 of this Report.

DISPOSITION OF ASSETS

During 1997, the Company's bareboat charter of a jack-up drilling rig acquired in the Arethusa Merger terminated and the Company no longer operates this rig. In addition, in 1997, the Company sold a semisubmersible drilling rig located offshore Brazil for approximately $5.4 million, resulting in an after-tax gain for the year ended December 31, 1997 of $0.6 million. In December 1996, the Company exited the land drilling business with the sale of its land rigs and associated equipment for approximately $26.0 million, resulting in an after-tax gain for the year ended December 31, 1996 of $15.6 million. See "Management's Discussion and Analysis of Financial Condition -- Results of Operations" in Item 7 and Note 5 to the Company's Consolidated Financial Statements in Item 8 of this Report.

Certain other assets, including drilling rigs, have been sold in previous years. These assets have generally been inactive or did not fit the overall strategic direction of the Company. Although the Company does not, as of the date hereof, have any commitment with respect to a material disposition, it could enter into such agreement in the future.

CUSTOMERS

The Company provides offshore drilling services to a customer base that includes major and independent oil and gas companies and government-owned oil companies. Occasionally, several customers have accounted for 10.0 percent or more of the Company's annual consolidated revenues, although the specific customers may vary from year to year. During 1997, the Company performed services for approximately 50 different customers with Shell companies (including domestic and foreign affiliates) ("Shell") accounting for 14.3 percent of the Company's annual total consolidated revenues. During 1996, the Company performed services for approximately 80 different customers with Shell and British Petroleum companies (including domestic and foreign affiliates) ("BP") accounting for 13.8 percent and 13.5 percent of the Company's annual total consolidated revenues, respectively. During 1995, the Company performed services for approximately 90 different customers with BP accounting for 16.5 percent of the Company's annual total consolidated revenues. Management believes that at current levels of activity the Company has alternative customers for its services such that the loss of a single customer would not have a material adverse effect on the Company.

The Company's services are marketed principally through its Houston office, with support from its regional offices in New Orleans, Louisiana; Aberdeen, Scotland; and Perth, Western Australia. Technical and administrative support functions for the Company's operations are provided by its Houston office.

COMPETITION

The contract drilling industry is highly competitive. Customers often award contracts on a competitive bid basis, and although a customer selecting a rig may consider, among other things, a contractor's safety record, crew quality and quality of service and equipment, the historical oversupply of rigs has created an intensely competitive market in which price is the primary factor in determining the selection of a drilling contractor. However, due to the escalation of drilling activity, rig availability has, in some cases, also become a consideration, particularly with respect to fourth-generation and other technologically advanced units. The Company believes that competition for drilling contracts will continue to be intense in the foreseeable future. Contractors are also able to adjust localized supply and demand imbalances by moving rigs from areas of low utilization and dayrates to areas of greater activity and relatively higher dayrates. Such movements or reactivations or a decrease in drilling activity in any major market could depress dayrates and could adversely affect utilization of the Company's rigs. See "-- Offshore Contract Drilling Services."

In addition, the recent improvement in the current results of operations and prospects for the offshore contract drilling industry as a whole has led to increased rig construction and enhancement programs by the Company's competitors. A significant increase in the supply of technologically advanced rigs capable of drilling in deep water may have an adverse effect on the average operating dayrates for the Company's rigs, particularly its more advanced semisubmersible units, and on the overall utilization level of the Company's fleet. In such case, the Company's results of operations would be adversely affected.

GOVERNMENTAL REGULATION

The Company's operations are subject to numerous federal, state and local laws and regulations that relate directly or indirectly to its operations, including certain regulations controlling the discharge of materials into the environment, requiring removal and clean-up under certain circumstances, or otherwise relating to the protection of the environment. For example, the Company may be liable for damages and costs incurred in connection with oil spills for which it is held responsible. Laws and regulations protecting the environment have become increasingly stringent in recent years and may in certain circumstances impose "strict liability" rendering a company liable for environmental damage without regard to negligence or fault on the part of such company. Liability under such laws and regulations may result from either governmental or citizen prosecution. Such laws and regulations may expose the Company to liability for the conduct of or conditions caused by others, or for acts of the Company that were in compliance with all applicable laws at the time such acts were performed. The application of these requirements or the adoption of new requirements could have a material adverse effect on the Company.

The United States Oil Pollution Act of 1990 ("OPA '90") and similar legislation enacted in Texas, Louisiana and other coastal states address oil spill prevention and control and significantly expand liability exposure across all segments of the oil and gas industry. OPA '90, such similar legislation and related regulations impose a variety of obligations on the Company related to the prevention of oil spills and liability for damages resulting from such spills. OPA '90 imposes strict and, with limited exceptions, joint and several liability upon each responsible party for oil removal costs and a variety of public and private damages.

INDEMNIFICATION AND INSURANCE

The Company's operations are subject to hazards inherent in the drilling of oil and gas wells such as blowouts, reservoir damage, loss of production, loss of well control, cratering or fires, the occurrence of which could result in the suspension of drilling operations, injury to or death of rig and other personnel and damage to or destruction of the Company's, the Company's customer's or a third party's property or equipment. Damage to the environment could also result from the Company's operations, particularly through oil spillage or uncontrolled fires. In addition, offshore drilling operations are subject to perils peculiar to marine operations, including capsizing, grounding, collision and loss or damage from severe weather. The Company has insurance coverage and contractual indemnification for certain risks, but there can be no assurance that such coverage or indemnification will adequately cover the Company's loss or liability in many circumstances or that the Company will continue to carry such insurance or receive such indemnification.

OPERATIONS OUTSIDE THE UNITED STATES

Operations outside the United States accounted for approximately 36.3 percent, 37.1 percent and 36.4 percent of the Company's total consolidated revenues for the years ended December 31, 1997, 1996 and 1995, respectively. The Company's non-U.S. operations are subject to certain political, economic and other uncertainties not encountered in U.S. operations, including risks of war and civil disturbances (or other risks that may limit or disrupt markets), expropriation and the general hazards associated with the assertion of national sovereignty over certain areas in which operations are conducted. The Company's operations outside the United States may face the additional risk of fluctuating currency values, hard currency shortages, controls of currency exchange and repatriation of income or capital. See "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Other -- Currency Risk" in Item 7 and Note 14 to the Company's Consolidated Financial Statements in Item 8 of this Report. No prediction can be made as to what governmental regulations may be enacted in the future that could adversely affect the international drilling industry.

EMPLOYEES

As of December 31, 1997, the Company had approximately 4,020 employees (including international crews furnished through labor contractors), approximately 80 of whom were union members. The Company has experienced satisfactory labor relations and provides comprehensive benefit plans for its employees. The improved opportunities for the offshore contract drilling industry worldwide have resulted in increased demand for and a shortage of experienced personnel necessary on offshore drilling rigs. As a result, employment and retention of qualified personnel is likely to become more difficult without significant increases in compensation.

ITEM 2. PROPERTIES.

The Company owns an eight-story office building containing approximately 182,000 net rentable square feet on approximately 6.2 acres of land located in Houston, Texas, where the Company has its corporate headquarters, an 18,000 square foot building and 20 acres of land in New Iberia, Louisiana for its offshore drilling warehouse and storage facility, and a 13,000 square foot building and five acres of land in Aberdeen, Scotland for its North Sea operations. Additionally, the Company currently leases various office, warehouse and storage facilities in Louisiana, Africa, Australia, Brazil, India, Indonesia, Scotland, Singapore, and The Netherlands to support its offshore drilling operations.

ITEM 3. LEGAL PROCEEDINGS.

Brown Services, Inc. and KOS Industries, Inc. v. Michael D. Brown, BSI International, Inc., Robert Brown, Robert Furlough, Power House International, Inc., Zapata Off-Shore Company and Zapata Corporation; No. 92-05691 in the 334th Judicial District Court of Harris County, Texas, filed February 7, 1992. Plaintiffs sued Zapata Off-Shore Company and Zapata Corporation (the "Zapata Defendants") for tortious interference with contract and conspiracy to tortiously interfere with contract seeking $14.0 million in actual damages and unspecified punitive damages, plus costs of court, interest and attorneys' fees. A former subsidiary of Arethusa, which is now a subsidiary of the Company, defended and indemnified the Zapata Defendants pursuant to a contractual defense and indemnification agreement. In November 1997, the jury awarded a take nothing judgment in favor of the Zapata Defendants. It is not yet known whether the plaintiffs will appeal the judgment.

The Company and its subsidiaries are named defendants in certain other lawsuits and are involved from time to time as parties to governmental proceedings, all arising in the ordinary course of business. Although the outcome of lawsuits or other proceedings involving the Company and its subsidiaries cannot be predicted with certainty and the amount of any liability that could arise with respect to such lawsuits or other proceedings cannot be predicted accurately, management does not expect these matters to have a material adverse effect on the financial position, results of operations, or cash flows of the Company.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

There were no matters submitted to a vote of security holders of the Company during the fourth quarter of 1997.

EXECUTIVE OFFICERS OF THE REGISTRANT

In reliance on General Instruction G(3) to Form 10-K, information on executive officers of the Registrant is included in this Part I. The executive officers of the Company are elected annually by the Board of Directors to serve until the next annual meeting of the Board of Directors, or until their successors are duly elected and qualified, or until their earlier death, resignation, disqualification or removal from office. Information with respect to the executive officers of the Company is set forth below.

| NAME | AGE AS OF JANUARY 31, 1998 | POSITION |
| --- | --- | --- |
| James S. Tisch | 45 | Chairman of the Board and Chief Executive Officer(1)(2) |
| Lawrence R. Dickerson | 45 | President and Chief Operating Officer and Director(1)(2) |
| Robert E. Rose | 59 | President and Chief Executive Officer and Director(2) |
| David W. Williams | 40 | Executive Vice President(1) |
| Rodney W. Eads | 46 | Senior Vice President -- Worldwide Operations |
| Denis J. Graham | 48 | Senior Vice President -- Technical Services |
| Gary T. Krenek | 39 | Vice President and Chief Financial Officer(1) |
| Richard L. Lionberger | 47 | Vice President, General Counsel and Secretary |
| Leslie C. Knowlton | 30 | Controller(1) |

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(1) Effective March 31, 1998.

(2) Robert E. Rose resigned as President and Chief Executive Officer and a Director of the Company effective March 31, 1998.

James S. Tisch was elected to become Chief Executive Officer of the Company effective March 31, 1998. Mr. Tisch has served as Chairman of the Board since 1995 and as a director of the Company since June 1989. Mr. Tisch has served as President and Chief Operating Officer of Loews Corporation ("Loews"), a diversified holding company and the Company's controlling stockholder, since 1994 and prior thereto served as Executive Vice President of Loews for more than five years. Mr. Tisch, a director of Loews since 1986, also serves as a director of CNA Financial Corporation, an 84 percent owned subsidiary of Loews, and serves as a director of Vail Resort, Inc.

Lawrence R. Dickerson was elected President and Chief Operating Officer and a Director of the Company effective March 31, 1998. Prior to such date, Mr. Dickerson serves as Senior Vice President and Chief Financial Officer of the Company. Mr. Dickerson has served as Chief Financial Officer of the Company since June 1989. Mr. Dickerson has also served as Senior Vice President of the Company since April 1993 and as Vice President of the Company from June 1989 through April 1993.

Robert E. Rose has served as President and Chief Executive Officer of the Company and as a director since June 1989. Mr. Rose resigned as President and Chief Executive Officer and a director of the Company effective March 31, 1998.

David W. Williams was elected Executive Vice President of the Company effective March 31, 1998. Prior to such date, Mr. Williams serves as Senior Vice President of the Company, which position he has held since December 1994. He was a Marketing Vice President between February 1992 and May 1994. Mr. Williams was employed by Noble Drilling Corporation, a contract drilling company, from May 1994 through December 1994 as Vice President of Marketing.

Rodney W. Eads has served as Senior Vice President of the Company since May 1997. Mr. Eads was employed by Exxon Company, International from August 1994 through May 1997 as Field Drilling Manager. From February 1991 through August 1994, Mr. Eads served as Drilling Manager for Esso Exploration & Production UK.

Denis J. Graham has served as Senior Vice President of the Company since July 1997 and from September 1993 through June 1997 as Vice President of the Company. Previously, Mr. Graham served as Manager of Design Services for the Company.

Gary T. Krenek was elected Vice President and Chief Financial Officer of the Company effective March 31, 1998. Prior to such date, Mr. Krenek serves as Controller of the Company, which position he has held since February 1992.

Richard L. Lionberger has served as Vice President, General Counsel and Secretary of the Company since February 1992.

Leslie C. Knowlton was elected Controller of the Company effective March 31, 1998. Prior to such date, Ms. Knowlton serves as Assistant Controller of the Company, which position she has held since August 1995. From February 1992 through July 1995, Ms. Knowlton served as Accounting Manager of the Company.

# PART II

## ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

### 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. Periods prior to the July 1997 two-for-one stock split in the form of a stock dividend have been restated, giving retroactive effect to the stock dividend. See Note 3 to the Company's Consolidated Financial Statements in Item 8 of this Report.

| | COMMON STOCK | |
|---|---|---|
| | HIGH | LOW |
| 1997 | | |
| First Quarter | $36 1/2 | $27 11/16 |
| Second Quarter | 38 15/16 | 31 1/8 |
| Third Quarter | 59 1/8 | 39 1/4 |
| Fourth Quarter | 66 3/4 | 42 5/8 |
| 1996 | | |
| First Quarter | $21 11/16 | $16 11/16 |
| Second Quarter | 28 1/2 | 21 3/4 |
| Third Quarter | 29 1/16 | 23 1/2 |
| Fourth Quarter | 32 3/16 | 27 1/8 |

On January 30, 1998, the closing price of the Common Stock, as reported by the NYSE, was $44 5/8 per share. As of January 30, 1998, there were approximately 234 holders of record of Common Stock. This number does not include the stockholders for whom shares are held in a "nominee" or "street" name.

### DIVIDEND POLICY

The Company paid cash dividends of $0.07 per share on August 7, 1997 and December 1, 1997 and has declared a dividend of $0.125 per share payable March 2, 1998 to stockholders of record on February 6, 1998. In connection with the Company's initial public offering in October 1995, the Company paid a special dividend of $2.1 million to Loews Corporation ("Loews"), the Company's controlling stockholder, with a portion of the proceeds. 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.

# ITEM 6. 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" in Item 7 and the Company's Consolidated Financial Statements (including the Notes thereto) in Item 8 of this Report.

| | 1997 | 1996(1) | 1995 | 1994 | 1993 |
|---|---|---|---|---|---|
| | (IN THOUSANDS, EXCEPT PER SHARE DATA) | | | | |
| INCOME STATEMENT DATA: | | | | | |
| Total revenues | $ 956,093 | $ 611,430 | $ 336,584 | $ 307,918 | $ 288,069 |
| Operating income (loss) | 419,873 | 213,491 | 11,651 | (14,624) | 4,455 |
| Net income (loss) | 278,605 | 146,388 | (7,026) | (34,804) | (16,629) |
| Net income per share(2): | | | | | |
| Basic | 2.01 | 1.18 | -- | -- | -- |
| Diluted | 1.93 | 1.18 | -- | -- | -- |
| Pro forma net income per share(2)(3) | -- | -- | 0.10 | -- | -- |
| BALANCE SHEET DATA: | | | | | |
| Drilling and other property and equipment, net | 1,451,741 | 1,198,160 | 502,278 | 488,664 | 498,740 |
| Total assets | 2,298,561 | 1,574,500 | 618,052 | 588,158 | 592,162 |
| Long-term debt | 400,000 | 63,000 | -- | 394,777 | 353,483 |
| OTHER FINANCIAL DATA: | | | | | |
| Capital expenditures | 281,572 | 267,000 | 66,646 | 21,146 | 14,345 |
| Cash dividends declared per share(4) | 0.14 | -- | -- | -- | -- |
| Ratio of earnings to fixed charges(5) | 28.94x | 31.56x | -- | -- | -- |

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(1) The Company acquired all of the common stock of Arethusa in consideration of 35.8 million shares of Common Stock effective April 29, 1996. See Note 2 to the Company's Consolidated Financial Statements in Item 8 of this Report.

(2) 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. See Note 3 to the Company's Consolidated Financial Statements in Item 8 of this Report.

(3) Pro forma net income per share gives effect to the Company's initial public offering and the after-tax effects of a reduction in interest expense. Assuming the offering had occurred at January 1, 1995, the Company would have recognized net income of $10.0 million, or $0.10 per share of Common Stock, after adjusting for the after-tax effects of a reduction in interest expense. See Note 1 to the Company's Consolidated Financial Statements in Item 8 of this Report.

(4) The Company paid dividends of $0.07 per share on August 7, 1997 and on December 1, 1997 and has declared a dividend of $0.125 per share payable March 2, 1998 to stockholders of record on February 6, 1998. In connection with the Company's initial public offering in 1995, the Company paid a special dividend of $2.1 million to Loews with a portion of the proceeds. No other dividends were declared or paid during the periods presented.

(5) The deficiency in the Company's earnings available for fixed charges for the years ended December 31, 1995, 1994, and 1993 was approximately $13.8 million, $46.4 million, and $21.7 million, respectively. Fixed charges for the years ended December 31, 1993 through December 31, 1995 consisted primarily of interest expense on notes payable to Loews. For all periods presented, the ratio of earnings to fixed charges has been computed on a total enterprise basis. Earnings represent income (loss) 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.

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the Company's Consolidated Financial Statements (including the Notes thereto) in Item 8 of this Report.

## RECENT EVENTS

On March 5, 1998, the Company announced several changes in its executive management structure which will be effective March 31, 1998. Robert E. Rose resigned as President and Chief Executive Officer and a Director of the Company to pursue another opportunity. James S. Tisch, Chairman of the Board of Directors, will assume the additional title of Chief Executive Officer. Lawrence R. Dickerson, formerly Senior Vice President and Chief Financial Officer, was elected President and Chief Operating Officer and Director. Mr. Dickerson will serve on the Board's Executive Committee. David W. Williams, formerly Senior Vice President -- Contracts and Marketing, was elected Executive Vice President. Gary T. Krenek, formerly Controller, was elected Vice President and Chief Financial Officer. Leslie C. Knowlton, formerly Assistant Controller, was elected Controller for the Company.

## 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, however, 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 which was 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.

Operating Income. Operating income is primarily affected by revenue factors, but is also a function of varying levels of operating expenses. Operating expenses are not affected by changes in dayrates, nor are they necessarily significantly affected by fluctuations in utilization. For instance, if a rig is to be idle for a short period of time, the Company realizes few decreases in operating expenses since the rig is typically maintained in a prepared state with a full crew. 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 associated with loss of revenues. The Company recognizes as an operating expense activities such as painting, inspections and routine overhauls 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. From time to time, the Company sells assets in the ordinary course of its business and gains or losses associated with such sales are included in operating income.

Merger with Arethusa. Effective April 29, 1996, the Arethusa Merger was completed. Arethusa owned a fleet of 11 mobile offshore drilling rigs, operated two additional mobile offshore drilling rigs pursuant to bareboat charters, and provided drilling services worldwide to international and government-controlled oil and gas companies. Because the Arethusa Merger was accounted for as a purchase for financial reporting purposes, results of operations include those of Arethusa from the effective date of the Arethusa Merger. See Note 2 to the Company's Consolidated Financial Statements in Item 8 of this Report.

YEARS ENDED DECEMBER 31, 1997 AND 1996

Comparative data relating to the Company's revenues and operating expenses by equipment type are listed below (eliminations offset dayrate revenues earned when the Company's rigs are utilized in its integrated services and 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.

During November 1997, July 1997, March 1997, and September 1996, the Company completed its major upgrades of the Ocean Victory, the Ocean Clipper I, the Ocean Star, and the Ocean Quest, respectively, expanding these rigs to have fourth-generation capabilities. Upon completion, these rigs are included in Fourth-Generation Semisubmersibles for discussion purposes (prior period information will continue to include these rigs in Other Semisubmersibles).

| | YEAR ENDED DECEMBER 31, 1997 | 1996 | INCREASE/ (DECREASE) |
|---|---|---|---|
| | (IN THOUSANDS) | | |
| REVENUES | | | |
| Fourth-Generation Semisubmersibles | $206,708 | $112,022 | $ 94,686 |
| Other Semisubmersibles | 545,701 | 341,163 | 204,538 |
| Jack-ups | 192,169 | 122,503 | 69,666 |
| Integrated Services | 36,342 | 32,798 | 3,544 |
| Land | -- | 22,675 | (22,675) |
| Other | 3,257 | -- | 3,257 |
| Eliminations | (28,084) | (19,731) | (8,353) |
| Total Revenues | $956,093 | $611,430 | $344,663 |
| CONTRACT DRILLING EXPENSE | | | |
| Fourth-Generation Semisubmersibles | $ 64,314 | $ 37,512 | $ 26,802 |
| Other Semisubmersibles | 234,578 | 191,937 | 42,641 |
| Jack-ups | 96,246 | 85,149 | 11,097 |
| Integrated Services | 34,464 | 30,344 | 4,120 |
| Land | -- | 19,631 | (19,631) |
| Other | 6,119 | (865) | 6,984 |
| Eliminations | (29,378) | (22,054) | (7,324) |
| Total Contract Drilling Expense | $406,343 | $341,654 | $ 64,689 |
| OPERATING INCOME | | | |
| Fourth-Generation Semisubmersibles | $142,394 | $ 74,510 | $ 67,884 |
| Other Semisubmersibles | 311,123 | 149,226 | 161,897 |
| Jack-ups | 95,923 | 37,354 | 58,569 |
| Integrated Services | 1,878 | 2,454 | (576) |
| Land | -- | 3,044 | (3,044) |
| Other | (2,862) | 865 | (3,727) |
| Eliminations | 1,294 | 2,323 | (1,029) |
| Depreciation and Amortization Expense | (108,335) | (75,767) | (32,568) |
| General and Administrative Expense | (22,556) | (15,640) | (6,916) |
| Gain on Sale of Assets | 1,014 | 35,122 | (34,108) |
| Total Operating Income | $419,873 | $213,491 | $206,382 |

Revenues. The $94.7 million increase in revenues from fourth-generation semisubmersibles resulted, in part, from a $61.4 million increase in revenues generated by the Ocean Victory, the Ocean Clipper I, the Ocean Star, and the Ocean Quest upon completion of their upgrade projects in November 1997, July 1997, March 1997, and September 1996, respectively. However, utilization of the Ocean Clipper I was less than expected due to subsea system equipment difficulties. Also, improvements in dayrates in the Gulf of Mexico and the North Sea contributed $30.0 million of additional revenue and increased utilization in the North Sea contributed $3.3 million of additional revenue during the year ended December 31, 1997. The $204.5 million increase in revenues from other semisubmersibles resulted primarily from $123.0 million of additional revenue for improvements in dayrates in 1997. The average operating dayrate for other semisubmersibles was $67,400 per day in 1997, as compared to $50,100 per day in 1996. Also, $69.4 million of additional revenue was generated primarily by the inclusion of operating results for the eight semisubmersibles acquired in the Arethusa Merger for twelve months in 1997 as compared to the inclusion of only eight months in 1996. In addition, an increase of $12.1 million in revenue resulted primarily from improved utilization in 1997 for several rigs that were either relocating or undergoing repairs necessary for new contracts or locations in early 1996. The $69.7 million increase in revenues from jack-ups resulted primarily from improvements in dayrates, which contributed $59.6 million of additional revenue. The average operating dayrate for jack-ups was $37,000 per day in 1997 as compared to $24,700 per day in 1996. In addition, the inclusion of operating results for the jack-up rigs acquired in the Arethusa Merger for twelve months in 1997 as compared to the inclusion of only eight months in 1996 resulted in $14.0 million of additional revenue. Partially offsetting these increases was a decrease of $3.9 million due to downtime incurred in late 1997 for a regulatory inspection and leg reinforcement upgrade on the Ocean Tower and leg reinforcements and other modifications on the Ocean Titan. The $3.5 million increase in revenues from integrated services resulted from an increase in project management service revenue during 1997 as compared to the prior year. The $22.7 million decrease in land revenues resulted from the sale of the Company's land drilling assets in December 1996. Other revenues of $3.3 million were generated by the Polyconfidence, a semisubmersible accommodation vessel purchased in May 1997. See "-- Capital Resources."

Contract Drilling Expense. The $26.8 million increase in contract drilling expense for fourth-generation semisubmersibles resulted primarily from additional operating expense of $23.3 million from the Ocean Victory, the Ocean Clipper I, the Ocean Star, and the Ocean Quest, which was generated upon completion of their major upgrades. Also, the Ocean Valiant recognized increased expenses in late 1997 in preparation for its relocation from the Gulf of Mexico to West Africa. The $42.6 million increase for other semisubmersibles resulted primarily from $42.7 million of additional costs generated by the semisubmersibles acquired in the Arethusa Merger. These additional costs were primarily due to the inclusion of operating results for these rigs for twelve months in 1997 as compared to the inclusion of only eight months in 1996. Also, higher operating costs incurred in connection with the reactivation of the Ocean Century to work in the Gulf of Mexico and regulatory inspections and associated repairs on the Ocean Saratoga in early 1997 and the Ocean General in late 1997 resulted in increased contract drilling expense as compared to the prior year. Partially offsetting these increases was a decrease of approximately $4.5 million due to the reclassification of operations for the Ocean Clipper I to fourth-generation semisubmersibles upon completion of its upgrade in July 1997. The sale of the Ocean Zephyr, a semisubmersible located offshore Brazil, in 1997 also reduced expenses by $3.1 million as compared to 1996. The $11.1 million increase in jack-up expense resulted primarily from the rigs acquired in the Arethusa Merger, regulatory inspections and associated repairs on the Ocean Scotian, the Ocean Crusader, and the Ocean King, and leg reinforcement and other modifications on the Ocean Titan. Partially offsetting these increases was a decrease of $2.0 million resulting from the termination of the bareboat charter agreement in 1996 for the Bonito II, a jack-up rig previously operated by the Company. The $4.1 million increase in expenses for integrated services resulted primarily from increased intercompany rates charged for rigs utilized in project management services (offset in eliminations) during 1997 as compared to 1996. The $19.6 million decrease in land expense resulted from the sale of the Company's land drilling assets in December 1996. Other contract drilling expense increased $7.0 million primarily due to expenses associated with crew training programs for new employees and certain non-recurring charges in 1997 and non-recurring credits recognized in the prior year.

Depreciation and Amortization Expense. Depreciation and amortization expense of $108.3 million for the year ended December 31, 1997 increased primarily due to additional expense for (i) the eight semisubmersibles and three jack-up drilling rigs acquired in the Arethusa Merger, (ii) goodwill amortization expense associated with the Arethusa Merger, (iii) rig upgrades completed in 1997 and 1996, (iv) capital expenditures associated with the Company's continuing rig enhancement program, and (v) the Polyconfidence, which was acquired in May 1997. See "-- Capital Resources."

General and Administrative Expense. General and administrative expense of $22.6 million for the year ended December 31, 1997 increased from $15.6 million for the year ended December 31, 1996 primarily due to (i) additional overhead resulting from the Arethusa Merger, (ii) increased accruals for the Company's employee bonus and retention plan, and (iii) increased legal fees associated with various legal matters. See Note 9 to the Company's Consolidated Financial Statements in Item 8 of this Report. The increased accruals for the employee bonus and retention plan resulted from a higher bonus pool for the 1997 performance year and from additional participants in the plan.

Gain on Sale of Assets. Gain on sale of assets for the year ended December 31, 1997 consisted primarily of the gain associated with the sale of the Ocean Zephyr, a semisubmersible drilling rig located offshore Brazil. Gain on sale of assets for the year ended December 31, 1996 resulted primarily from the sale of all of the operational assets of Diamond M Onshore, Inc., the Company's wholly owned land drilling subsidiary, resulting in a gain of $24.0 million. Also during 1996, the Company sold two shallow water jack-up drilling rigs, the Ocean Magallanes and the Ocean Conquest, and one semisubmersible, the Ocean Zephyr II, resulting in gains totaling $10.8 million.

Interest Income. Interest income of $19.4 million for the year ended December 31, 1997 consisted primarily of the accretion of discounts and interest earned on investments of excess cash primarily generated by the issuance of the Notes. See " -- Liquidity."

Interest Expense. Interest expense of $10.3 million for the year ended December 31, 1997 consisted primarily of $14.7 million interest on the Notes, partially offset by $4.4 million interest capitalized to major upgrades. Interest expense for the year ended December 31, 1996 included $2.2 million of origination costs, including costs previously capitalized, which were expensed in connection with the restructuring of a revolving credit facility during December 1996. See Note 8 to the Company's Consolidated Financial Statements in Item 8 of this Report.

Income Tax Expense. Income tax expense for the year ended December 31, 1997 was $151.5 million as compared to $66.3 million for the prior year. This change resulted primarily from the increase of $217.4 million in the Company's income before income tax expense and a reduction in income tax expense during the prior year. In 1996, benefits for utilization of previously unrecorded net operating losses in a foreign jurisdiction were recognized, which contributed to the reduction in income tax expense. See Note 12 to the Company's Consolidated Financial Statements in Item 8 of this Report.

YEARS ENDED DECEMBER 31, 1996 AND 1995

Comparative data relating to the Company's revenues and operating expenses by equipment type are listed below (eliminations offset dayrate revenues earned when the Company's rigs are utilized in its integrated services and 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.

During September 1996, the Company completed its major upgrade of the Ocean Quest, expanding the rig to have fourth-generation capabilities. Upon completion, the Ocean Quest is included in Fourth-Generation Semisubmersibles for discussion purposes (prior period information will continue to include the rig in Other Semisubmersibles). The Company's drillship, Ocean Clipper I, is included in Other Semisubmersibles for discussion purposes.

| | YEAR ENDED DECEMBER 31, 1996 | YEAR ENDED DECEMBER 31, 1995 | INCREASE/ (DECREASE) |
|---|---|---|---|
| | (IN THOUSANDS) | | |
| REVENUES | | | |
| Fourth-Generation Semisubmersibles | $112,022 | $ 67,393 | $ 44,629 |
| Other Semisubmersibles | 341,163 | 168,582 | 172,581 |
| Jack-ups | 122,503 | 68,829 | 53,674 |
| Integrated Services | 32,798 | 27,121 | 5,677 |
| Land | 22,675 | 19,926 | 2,749 |
| Other | -- | 4 | (4) |
| Eliminations | (19,731) | (15,271) | (4,460) |
| Total Revenues | $611,430 | $336,584 | $274,846 |
| CONTRACT DRILLING EXPENSE | | | |
| Fourth-Generation Semisubmersibles | $ 37,512 | $ 34,717 | $ 2,795 |
| Other Semisubmersibles | 191,937 | 129,795 | 62,142 |
| Jack-ups | 85,149 | 60,798 | 24,351 |
| Integrated Services | 30,344 | 30,297 | 47 |
| Land | 19,631 | 17,899 | 1,732 |
| Other | (865) | 3,011 | (3,876) |
| Eliminations | (22,054) | (16,957) | (5,097) |
| Total Contract Drilling Expense | $341,654 | $259,560 | $ 82,094 |
| OPERATING INCOME | | | |
| Fourth-Generation Semisubmersibles | $ 74,510 | $ 32,676 | $ 41,834 |
| Other Semisubmersibles | 149,226 | 38,787 | 110,439 |
| Jack-ups | 37,354 | 8,031 | 29,323 |
| Integrated Services | 2,454 | (3,176) | 5,630 |
| Land | 3,044 | 2,027 | 1,017 |
| Other | 865 | (3,007) | 3,872 |
| Eliminations | 2,323 | 1,686 | 637 |
| Depreciation and Amortization Expense | (75,767) | (52,865) | (22,902) |
| General and Administrative Expense | (15,640) | (13,857) | (1,783) |
| Gain on Sale of Assets | 35,122 | 1,349 | 33,773 |
| Total Operating Income | $213,491 | $ 11,651 | $201,840 |

Revenues. The $44.6 million increase in revenues from fourth-generation semisubmersibles resulted from improvements in dayrates ($26.5 million) and increases in utilization ($18.1 million). The improvement in utilization for 1996 was partially attributable to the relocation of two fourth-generation rigs during the prior year, reducing the days worked for these rigs during that period. The $172.6 million increase in revenues from other semisubmersibles was primarily attributable to $90.9 million of revenues from the eight semisubmersibles acquired in the Arethusa Merger and increases in dayrates in both the North Sea and the Gulf of

Mexico. The $53.7 million increase in revenues from jack-ups resulted primarily from revenues associated with rigs acquired in the Arethusa Merger and improvements in dayrates in the Gulf of Mexico. The $5.7 million increase in revenues from integrated services resulted from an increase in project management service revenue during 1996 as compared to the prior year.

Contract Drilling Expense. Contract drilling expense for fourth-generation semisubmersibles increased $2.8 million primarily due to the completion of the major upgrade of the Ocean Quest which, beginning in September 1996, was included as a fourth-generation semisubmersible as compared to the prior year. The $62.1 million increase for other semisubmersibles resulted from the additional rigs acquired in the Arethusa Merger, increased expenses for shipyard repairs on three rigs, and increased expenses attributable to improved utilization during 1996. These increases were partially offset by a reduction in local payroll expenses resulting from the relocation of a rig and decreased expenses for a rig undergoing a major upgrade during 1996. The $24.4 million increase in jack-up expense resulted primarily from the rigs acquired in the Arethusa Merger, partially offset by decreased operating expenses for two rigs which were cold stacked during 1996 (one of which was sold in July 1996). Integrated services expense was relatively unchanged from the prior year. Other contract drilling expense decreased $3.9 million primarily due to collections from a settlement in connection with a lawsuit and collections on accounts receivable written off in the prior year.

Depreciation and Amortization Expense. Depreciation and amortization expense of $75.8 million for the year ended December 31, 1996 increased primarily due to additional expense for (i) the eight semisubmersibles and three jack-up drilling rigs acquired in the Arethusa Merger, (ii) goodwill amortization expense associated with the Arethusa Merger, (iii) three rig upgrades completed in 1995, and (iv) capital expenditures associated with the Company's continuing rig enhancement program. Partially offsetting these increases was a change in accounting estimate to increase the estimated useful lives for certain classes of rigs. This change reduced depreciation expense by approximately $8.5 million, as compared to the year ended December 31, 1995.

General and Administrative Expense. General and administrative expense of $15.6 million for the year ended December 31, 1996 increased due to the Arethusa Merger; however, these increases were partially offset by cost savings in rent due to the February 1996 purchase of the building in which the Company has its corporate headquarters. In addition, approximately $0.8 million of general and administrative expense associated with the major upgrades of the Ocean Quest, the Ocean Star, the Ocean Victory and the Ocean Clipper I was capitalized to these projects during 1996.

Gain on Sale of Assets. Gain on sale of assets for the year ended December 31, 1996 consisted primarily of the sale of all of the operational assets of Diamond M Onshore, Inc., the Company's wholly owned land drilling subsidiary, resulting in a gain of $24.0 million. In addition, the Company sold two shallow water jack-up drilling rigs, the Ocean Magallanes and the Ocean Conquest, and one semisubmersible, the Ocean Zephyr II, resulting in gains totaling $10.8 million.

Interest Expense. Interest expense of $2.3 million for the year ended December 31, 1996 primarily consisted of $2.2 million to expense origination costs, including costs previously capitalized, in connection with the restructuring of a revolving credit facility during December 1996. The decrease from $27.1 million for the prior year was attributable to a reduction in outstanding indebtedness resulting from the repayment of the Company's loan from Loews in connection with the Company's initial public offering. In addition, interest costs associated with the Company's financing arrangements were capitalized with respect to qualified construction projects during 1996.

Income Tax (Expense) Benefit. Income tax (expense) benefit for the year ended December 31, 1996 was $(66.3) million as compared to $6.8 million for the prior year. This change resulted primarily from the increase of $226.5 million in the Company's income before income tax expense, partially offset by the recognition of benefits for utilization of previously unrecorded net operating losses in a foreign jurisdiction in 1996. In addition, during the year ended December 31, 1995, the Company's tax benefit reflected the effects of profits in foreign jurisdictions where the Company's tax liability was minimal. See Note 12 to the Company's Consolidated Financial Statements in Item 8 of this Report.

## OUTLOOK

The Company continues to benefit from increased demand and from the recent tight supply of major offshore drilling rigs worldwide. These conditions are due, in part, to the increasing impact of technological advances, including 3-D seismic, horizontal drilling, and subsea completion procedures, on oil and gas exploration and development economics. To address the current tight supply situation, customers seek to contract rigs for term commitments (as opposed to contracts for the drilling of a single well or a group of wells) in many cases, and often will pay for upgrades and modifications necessary for more challenging drilling locations in order to assure rig availability. The Company seeks to have a foundation of long-term contracts with a reasonable balance of short-term or well-to-well contracts to minimize risk while participating in the benefit of increasing dayrates in a rising market.

The Company continues to enhance its fleet to meet customer demand for diverse drilling capabilities, including those required for deep water and harsh environment operations. In March 1997, the Company completed the major upgrade of the Ocean Star to fourth-generation capabilities and the rig began a three-year commitment in the deep water market of the Gulf of Mexico. In July 1997, the Ocean Clipper I began a four-year contract in the deep water market of the Gulf of Mexico following its upgrade project. The Ocean Victory, previously stacked in the North Sea, completed modifications in connection with its three-year deep water drilling program in the Gulf of Mexico which began in November 1997. In addition, the Company began the conversion of the Polyconfidence, a semisubmersible accommodation vessel, in connection with a five-year commitment in the Gulf of Mexico anticipated to begin in late 1999.

In February 1998, a fire was detected in the engine room of the Ocean Victory, which was operating in the Gulf of Mexico. Although the fire was contained and extinguished, damage was done to the power and electrical systems aboard the rig. In March 1998, the rig was dockside in Mobile, Alabama for further damage evaluation. Until that process is completed, the Company is unable to determine how long the rig will be under repair. It is possible that the repair period could remove the rig from service for a significant portion of 1998. The Company expects that its insurance will cover the repairs, but the loss of revenue during the repair period is not covered by insurance. As a result, the loss of such revenues will reduce the Company's results of operations for 1998.

The ability to minimize costs and downtime is critical to the Company's results of operations. The improved opportunities for the offshore contract drilling industry worldwide have resulted in increased demand for and a shortage of experienced personnel and equipment, including drill pipe and riser, necessary on offshore drilling rigs. The Company does not consider the shortage of such personnel and equipment currently to be a material factor in its business. However, because of the increased demand for oil field services, a significant increase in costs, including compensation and training, is likely to occur if present trends continue for an extended period. In addition, because of periodic inspections required by certain regulatory agencies, 15 of the Company's rigs will be in the shipyard for a portion of 1998. The Company intends to focus on returning these rigs to operations as soon as reasonably possible, in order to minimize the downtime and associated loss of revenues.

In addition, the recent improvement in the current results of operations and prospects for the offshore contract drilling industry as a whole has led to increased rig construction and enhancement programs by the Company's competitors. A significant increase in the supply of technologically advanced rigs capable of drilling in deep water may have an adverse effect on the average operating dayrates for the Company's rigs, particularly its more advanced semisubmersible units, and on the overall utilization level of the Company's fleet. In such case, the Company's results of operations would be adversely affected.

The offshore contract drilling industry historically has been highly competitive and cyclical and, although not currently a material factor in the Company's markets, weak commodity prices, economic problems in countries outside the United States, or a number of other influencing factors could curtail spending by oil and gas companies and possibly depress the offshore drilling industry. Therefore, the Company cannot predict whether and, if so, to what extent current market conditions will continue.

## LIQUIDITY

At December 31, 1997, cash and short-term investments totaled $466.1 million, up from $28.2 million at December 31, 1996. Cash provided by operating activities for the year ended December 31, 1997 increased by $186.2 million to $396.4 million, as compared to $210.2 million for the prior year. This increase was primarily attributable to a $132.2 million increase in net income and a $32.6 million increase in depreciation and amortization expense primarily resulting from the Arethusa Merger and completion of upgrade projects.

Investing activities used $706.0 million in cash during the year ended December 31, 1997, as compared to $200.3 million during the prior year. In May 1997, the Company purchased the Polyconfidence, a semisubmersible accommodation vessel, for approximately $81.0 million in cash. See "-- Capital Resources." In addition, the Company purchased U.S. Treasury securities, equity securities, and also invested excess cash under repurchase agreements with third parties, primarily major brokerage firms, for a set rate of return. Capital expenditures also increased substantially during 1997 as the Company continued to invest in major upgrades of its existing fleet.

Cash provided by financing activities for 1997 increased $376.4 million to $384.4 million, as compared to $8.0 million of cash provided by financing activities for 1996. Sources of financing during the year ended December 31, 1997 consisted primarily of the Company's issuance of the Notes, which resulted in net proceeds of approximately $393.9 million. Also, in April 1997, the Company completed a public offering of 2.5 million shares of common stock generating net proceeds of approximately $82.3 million. The proceeds of the offering were used to finance the acquisition of the Polyconfidence. See "-- Capital Resources." Financing applications of cash during 1997 included repayment of amounts outstanding under the Company's short and long-term credit arrangements and the payment of cash dividends to stockholders.

The Notes, issued in February 1997, have a stated and effective interest rate of 3.75 percent and 3.93 percent, respectively, and are due February 15, 2007. The Notes are convertible, in whole or in part, at the option of the holder at any time prior to the close of business on the business day immediately preceding the maturity date into shares of Common Stock, at a conversion price of $40.50 per share (equivalent to a conversion rate of 24.691 shares per $1,000 principal amount of Notes), subject to adjustment in certain circumstances. Interest on the Notes is payable in cash semi-annually on each February 15 and August 15. 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.

In August 1997, the Company terminated its revolving credit facility which had provided a maximum credit commitment of $200.0 million until December 2001. However, 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 that it has the financial resources needed to meet its business requirements in the foreseeable future, including capital expenditures for major upgrades and continuing rig enhancements, and working capital requirements.

## CAPITAL RESOURCES

Cash requirements for capital commitments result from rig upgrades to meet specific customer requirements and from the Company's continuing rig enhancement program, including top-drive drilling system installations and water depth and drilling capability upgrades. It is management's opinion that operating cash flow resulting from current conditions of improved dayrates and high utilization, in conjunction with proceeds from the Notes, will be sufficient to meet these capital commitments. 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 and other factors beyond its control.

During the year ended December 31, 1997, the Company expended $203.7 million, including capitalized interest expense, for significant rig upgrades in connection with contract requirements. Such upgrades included completion of modifications to the Ocean Star, the Ocean Clipper I, and the Ocean Victory. In addition, a cantilever conversion project on the Ocean Warwick, a jack-up drilling rig located in the Gulf of Mexico, began in early 1997. Also, leg strengthening and other modifications began in late 1997 on the Ocean Tower, a jack-up drilling rig operating in the Gulf of Mexico. Both upgrades are anticipated to be completed in the first half of 1998.

The Company has budgeted $108.5 million for rig upgrade capital expenditures during 1998. Included in this amount is approximately $93.5 million for 1998 expenditures associated with the conversion of the Polyconfidence (soon to be renamed Ocean Confidence) from an accommodation vessel to a semisubmersible drilling unit capable of operating in harsh environments and ultra-deep waters. The conversion includes enhancements which will provide capabilities greater than existing fourth-generation equipment: capability for operation in 7,500 foot water depths, approximately 6,000 tons variable deck load, a 15,000 psi blow-out prevention system and four mud pumps to complement the existing Class III dynamic-positioning system. Upon completion of the conversion, the rig will begin a five-year drilling program in the Gulf of Mexico, which is anticipated to commence in late 1999.

The Company generally seeks to mitigate financial risk associated with its upgrade projects by deferring commencement of an upgrade until a term drilling contract is secured with major integrated or large independent oil companies with projected contract revenues substantially covering the upgrade costs. The Company expects to evaluate other projects as opportunities arise.

During the year ended December 31, 1997, the Company expended $77.9 million associated with its continuing rig enhancement program and other corporate requirements, including $21.5 million to reactivate the Ocean Century to work in the Gulf of Mexico. In addition to rig upgrade capital expenditures, the Company has budgeted $126.7 million for 1998 capital expenditures associated with its continuing rig enhancement program, spare equipment and other corporate requirements. The increase in budgeted expenditures for 1998 is primarily attributable to anticipated purchases of anchor chain, drill pipe, riser, and other drilling equipment.

The Company is continually considering potential transactions including, but not limited to, enhancement of existing rigs, the purchase of existing rigs, construction of new rigs and the acquisition of other companies engaged in contract drilling. Certain of the potential transactions reviewed by the Company would, if completed, result in its entering new lines of business, although, in general, these opportunities have been related in some manner to the Company's existing operations. For example, the Company has explored the possibility of acquiring certain floating production systems, crew accommodation units similar to the Polyconfidence, oil service companies providing subsea products, technology and services, oil and gas exploration companies, and shipping assets such as oil tankers, through the acquisition of existing businesses or assets or new construction. Although the Company does not, as of the date hereof, have any commitment with respect to a material acquisition, it could enter into such agreement in the future and such acquisition could result in a material expansion of its existing operations or result in its 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.

RECENT ACCOUNTING PRONOUNCEMENTS

In June 1997, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 131, "Disclosure About Segments of an Enterprise and Related Information." The statement provides standards for reporting information about operating segments in annual financial statements and requires selected information about operating segments to be reported in interim financial statements. SFAS No. 131 is effective for fiscal years beginning after December 15, 1997, with restatements of prior years' comparative information required.

Also in June 1997, the FASB issued SFAS No. 130, "Reporting Comprehensive Income." This statement establishes standards for reporting comprehensive income and its components and requires that an enterprise (i) classify items of other comprehensive income by their nature in a financial statement and (ii) display the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of a statement of financial position. The statement is effective for fiscal years beginning after December 15, 1997, with reclassification of prior years' comparative information required.

The Company does not expect the adoption of these statements to have a material effect on its financial position or results of operations.

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. 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, operating difficulties arising from shortages of equipment or qualified personnel or as a result of other causes, 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, the ability to attract and retain qualified personnel, customer preferences and various other matters, many of which are beyond the Company's control. The risks included here are not exhaustive. Other sections of this Report and the Company's other filings with the Securities and Exchange Commission 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.

OTHER

Year 2000 Issues. The Company has addressed the impact of the upcoming change in the century on the Company's business, operations, and financial condition. However, the impact is dependent upon many factors, including the Company's software and hardware, as well as that of the Company's suppliers, customers, creditors, and financial service organizations. While the cost of addressing Year 2000 issues is not anticipated to be material, the Company is continuing to monitor, on an ongoing basis, the problems and uncertainties associated with these issues and their consequences.

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, Indonesia and Africa. 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. However, at present, contracts covering three of the Company's four rigs operating in the U.K. sector of the North Sea are payable in U.S. dollars. The Company has not hedged its exposure to changes in the exchange rate between U.S. dollars and pounds sterling for operating costs payable in pounds sterling, 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. Additionally, translation gains and losses for the Company's operations in areas which have experienced cumulative inflation of approximately 100 percent or more over a three-year period are recognized currently. The effect on results of operations from these translation gains and losses has not been material and is not expected to have a significant effect in the future.

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information included in this Item 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" in Item 7 of this Report.

### INTEREST RATE AND EQUITY PRICE SENSITIVITY

The Company's financial instruments that are potentially sensitive to changes in interest rates include the Notes and investments through repurchase agreements. In addition, the Company's investment in equity securities is sensitive to equity price risk. The Notes, which are due February 15, 2007, have a stated interest rate of 3.75 percent and an effective interest rate of 3.93 percent. At December 31, 1997, the fair value of the Notes, based on quoted market prices, was approximately $527.0 million, as compared to a carrying amount of $400.0 million. The Company's investments through repurchase agreements bear interest at rates ranging from 5.00 to 6.00 percent. However, these instruments are callable by the Company at any time or have original maturities generally less than three months. At December 31, 1997, the contracted amounts of such investments totaled $350.0 million, which approximates fair value because of the nature and short maturity of these instruments. At December 31, 1997, the fair value of the Company's investment in equity securities was approximately $13.1 million, which includes an unrealized holding loss of $0.2 million. Based on consideration of past market movements and reasonably possible, near-term market movements, the Company does not believe that potential, near-term losses in future earnings, fair values, or cash flows are likely to be material.

### EXCHANGE RATE SENSITIVITY

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.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

## INDEPENDENT AUDITORS' REPORT

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 as of December 31, 1997 and 1996, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1997. 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 generally accepted auditing standards. 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, 1997 and 1996, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1997, in conformity with generally accepted accounting principles.

DELOITTE & TOUCHE LLP

Houston, Texas
January 22, 1998

DIAMOND OFFSHORE DRILLING, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

ASSETS

| | DECEMBER 31, 1997 | DECEMBER 31, 1996 |
|---|---|---|
| Current assets: | | |
| Cash and cash equivalents | $ 102,958 | $ 28,180 |
| Short-term investments | 363,137 | -- |
| Accounts receivable | 205,589 | 172,214 |
| Rig inventory and supplies | 33,714 | 30,407 |
| Prepaid expenses and other | 13,377 | 12,166 |
| Total current assets | 718,775 | 242,967 |
| Drilling and other property and equipment, net of accumulated depreciation | 1,451,741 | 1,198,160 |
| Goodwill, net of accumulated amortization | 118,623 | 129,825 |
| Other assets | 9,422 | 3,548 |
| Total assets | $2,298,561 | $1,574,500 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | $ 57,557 | $ 63,172 |
| Accrued liabilities | 48,935 | 28,451 |
| Taxes payable | 24,653 | 26,377 |
| Short-term borrowings | -- | 10,000 |
| Total current liabilities | 131,145 | 128,000 |
| Long-term debt | 400,000 | 63,000 |
| Deferred tax liability | 209,513 | 176,296 |
| Other liabilities | 22,376 | 12,472 |
| Total liabilities | 763,034 | 379,768 |
| 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, 200,000,000 shares authorized, 139,309,948 and 68,353,409 shares issued and outstanding at December 31, 1997 and 1996, respectively) | 1,393 | 684 |
| Additional paid-in capital | 1,302,712 | 1,220,032 |
| Retained earnings (accumulated deficit) | 233,350 | (25,056) |
| Cumulative translation adjustment | (1,822) | (928) |
| Unrealized loss on investment securities | (106) | -- |
| Total stockholders' equity | 1,535,527 | 1,194,732 |
| Total liabilities and stockholders' equity | $2,298,561 | $1,574,500 |

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

DIAMOND OFFSHORE DRILLING, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT PER SHARE DATA)

| | YEAR ENDED DECEMBER 31, | | |
|---|---|---|---|
| | 1997 | 1996 | 1995 |
| Revenues | $ 956,093 | $611,430 | $336,584 |
| Operating expenses: | | | |
| Contract drilling | 406,343 | 341,654 | 259,560 |
| Depreciation and amortization | 108,335 | 75,767 | 52,865 |
| General and administrative | 22,556 | 15,640 | 13,857 |
| Gain on sale of assets | (1,014) | (35,122) | (1,349) |
| Total operating expenses | 536,220 | 397,939 | 324,933 |
| Operating income | 419,873 | 213,491 | 11,651 |
| Other income (expense): | | | |
| Interest income | 19,379 | 879 | 1,226 |
| Interest expense | (10,270) | (2,326) | (27,052) |
| Other, net | 1,079 | 661 | 372 |
| Income (loss) before income tax (expense) benefit | 430,061 | 212,705 | (13,803) |
| Income tax (expense) benefit | (151,456) | (66,317) | 6,777 |
| Net income (loss) | $ 278,605 | $146,388 | $ (7,026) |
| Net income per share: | | | |
| Basic | $ 2.01 | $ 1.18 | $ -- |
| Diluted | $ 1.93 | $ 1.18 | $ -- |
| Pro forma (Note 1) | $ -- | $ -- | $ 0.10 |
| Weighted average shares outstanding: | | | |
| Common shares | 138,560 | 124,462 | |
| Dilutive potential common shares | 8,929 | -- | |
| Total weighted average shares outstanding | 147,489 | 124,462 | |

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

DIAMOND OFFSHORE DRILLING, INC.
AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(IN THOUSANDS, EXCEPT NUMBER OF SHARES)

| | COMMON STOCK | | ADDITIONAL PAID-IN CAPITAL | RETAINED EARNINGS (ACCUMULATED DEFICIT) | CUMULATIVE TRANSLATION ADJUSTMENT | LOSS ON INVESTMENT SECURITIES | TOTAL STOCKHOLDERS' EQUITY |
|---|---|---|---|---|---|---|---|
| | SHARES | AMOUNT | | | | | |
| December 31, 1994 | 100 | $ 1 | $ 289,685 | $(164,418) | $(1,202) | $ -- | $ 124,066 |
| Net loss | -- | -- | -- | (7,026) | -- | -- | (7,026) |
| Capital contribution | -- | -- | 39,676 | -- | -- | -- | 39,676 |
| 350,500-for-one stock split | 35,049,900 | 350 | (350) | -- | -- | -- | -- |
| Issuance of common stock | 14,950,000 | 149 | 338,214 | -- | -- | -- | 338,363 |
| Dividend to Loews | -- | -- | (2,118) | -- | -- | -- | (2,118) |
| Exchange rate changes, net | -- | -- | -- | -- | (67) | -- | (67) |
| December 31, 1995 | 50,000,000 | 500 | 665,107 | (171,444) | (1,269) | -- | 492,894 |
| Net income | -- | -- | -- | 146,388 | -- | -- | 146,388 |
| Merger with Arethusa | 17,893,344 | 179 | 550,507 | -- | -- | -- | 550,686 |
| Stock options exercised | 460,065 | 5 | 4,418 | -- | -- | -- | 4,423 |
| Exchange rate changes, net | -- | -- | -- | -- | 341 | -- | 341 |
| December 31, 1996 | 68,353,409 | 684 | 1,220,032 | (25,056) | (928) | -- | 1,194,732 |
| Net income | -- | -- | -- | 278,605 | -- | -- | 278,605 |
| Issuance of common stock | 1,250,000 | 12 | 82,270 | -- | -- | -- | 82,282 |
| Two-for-one stock split | 69,649,474 | 696 | -- | (696) | -- | -- | -- |
| Dividends to stockholders | -- | -- | -- | (19,503) | -- | -- | (19,503) |
| Stock options exercised | 57,065 | 1 | 410 | -- | -- | -- | 411 |
| Exchange rate changes, net | -- | -- | -- | -- | (894) | -- | (894) |
| Loss on investments, net | -- | -- | -- | -- | -- | (106) | (106) |
| December 31, 1997 | 139,309,948 | $1,393 | $1,302,712 | $ 233,350 | $(1,822) | $(106) | $1,535,527 |

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

DIAMOND OFFSHORE DRILLING, INC.
AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)

| | YEAR ENDED DECEMBER 31, | | |
|---|---|---|---|
| | 1997 | 1996 | 1995 |
| Operating activities: | | | |
| Net income (loss) | $ 278,605 | $ 146,388 | $ (7,026) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | | |
| Depreciation and amortization | 108,335 | 75,767 | 52,865 |
| Gain on sale of assets | (1,014) | (35,122) | (1,349) |
| Gain on sale of investment securities | (1,529) | -- | -- |
| Accrued interest converted to notes payable to Loews | -- | -- | 27,044 |
| Deferred tax provision (benefit) | 34,650 | 17,278 | (7,472) |
| Accretion of discount on investment securities | (10,505) | (159) | (115) |
| Amortization of debt issuance costs | 456 | 2,570 | -- |
| Changes in operating assets and liabilities: | | | |
| Accounts receivable | (32,959) | (64,715) | (16,692) |
| Rig inventory and supplies and other current assets | (3,319) | (2,789) | (4,896) |
| Other assets, non-current | 949 | (1,747) | -- |
| Accounts payable and accrued liabilities | 15,256 | 22,155 | 10,984 |
| Taxes payable | 3,893 | 46,149 | (706) |
| Other liabilities, non-current | 3,885 | 4,093 | -- |
| Other, net | (335) | 365 | 29 |
| Net cash provided by operating activities | 396,368 | 210,233 | 52,666 |
| Investing activities: | | | |
| Cash acquired in the merger with Arethusa | -- | 20,883 | -- |
| Capital expenditures | (281,572) | (267,000) | (66,646) |
| Acquisition of drilling rigs and related equipment | (80,990) | -- | -- |
| Proceeds from sale of assets | 8,277 | 40,589 | 1,516 |
| Net change in short-term investment securities | (2,522) | 5,200 | -- |
| Purchases of long-term investment securities | (124,242) | -- | -- |
| Proceeds from sales of long-term investment securities | 125,082 | -- | -- |
| Net change in investments through repurchase agreements | (350,000) | -- | -- |
| Net cash used in investing activities | (705,967) | (200,328) | (65,130) |
| Financing activities: | | | |
| Payment of dividends | (19,503) | -- | (2,118) |
| Issuance of common stock | 82,282 | -- | 338,363 |
| Debt (repayments) borrowings, net | (73,000) | 5,523 | (331,245) |
| Issuance of convertible subordinated notes | 400,000 | -- | -- |
| Debt issuance costs | (6,062) | (2,570) | -- |
| Proceeds from stock options exercised | 660 | 5,016 | -- |
| Net cash provided by financing activities | 384,377 | 7,969 | 5,000 |
| Net change in cash and cash equivalents | 74,778 | 17,874 | (7,464) |
| Cash and cash equivalents, beginning of year | 28,180 | 10,306 | 17,770 |
| Cash and cash equivalents, end of year | $ 102,958 | $ 28,180 | $ 10,306 |

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

DIAMOND OFFSHORE DRILLING, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## 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 50.3 percent of the outstanding common stock of the Company (see Note 3).

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. The Company's fleet of 46 mobile offshore drilling rigs is one of the largest in the world and includes the largest fleet of semisubmersible rigs currently working in the world. The fleet is comprised of 30 semisubmersible rigs (including an accommodation vessel), 15 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 which are considered part of the Company's cash management activities, rather than part of its investing activities, are considered cash equivalents.

### Short-Term Investments

The Company invests its excess cash under repurchase agreements with third parties, primarily major brokerage firms, for a set rate of return callable at any time or for periods generally less than three months. The third parties are required to collateralize the investments with securities having fair values of at least 102 percent of the invested amount.

The Company's investments in equity securities are classified as available for sale and stated at fair value. Accordingly, any unrealized gains and losses, net of applicable deferred income taxes, are recorded as a separate component of stockholders' equity until realized. The cost of securities sold is based on the specific identification method and realized gains or losses and declines in value, if any, judged to be other than temporary are reported in the Consolidated Statements of Operations in "Other income (expense)."

### Supplementary Cash Flow Information

Non-cash financing activities for the year ended December 31, 1997 included $0.7 million for the issuance of 69.6 million shares of common stock in connection with a two-for-one stock split in the form of a stock dividend (see Note 3).

Non-cash financing activities for the year ended December 31, 1996 included $550.7 million for the issuance of 35.8 million shares of common stock and the assumption of stock options for the purchase of 1.0 million shares in connection with the merger between the Company and Arethusa (Off-Shore) Limited ("Arethusa"). Non-cash investing activities for the year ended December 31, 1996 included $532.9 million of net assets acquired in the merger with Arethusa (see Note 2).

Non-cash financing activities for the year ended December 31, 1995 included a capital contribution by Loews in September 1995 of $39.7 million which reduced the outstanding debt to Loews. In addition,

$27.0 million of interest expense was accrued and included in the notes payable to Loews prior to such notes being repaid with a portion of the proceeds from the Common Stock Offering (see Note 3). In connection with the Common Stock Offering, the tax sharing agreement with Loews was terminated and all liabilities were settled by offsetting $50.9 million owed by Loews to the Company under the agreement against the notes payable to Loews.

Cash payments made for interest on long-term debt, including commitment fees, during the years ended December 31, 1997 and 1996 were $8.7 million and $3.5 million, respectively. No cash payments for interest were made in 1995. Cash payments made for income taxes during the years ended December 31, 1997, 1996, and 1995 were $112.1 million, $3.9 million, and $0.8 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. The Company believes that certain offshore drilling rigs, due to their upgrade and design capabilities and their maintenance history, have an operating life in excess of their depreciable life as originally assigned. For this reason, a change in accounting estimate, effective January 1, 1996, increased the estimated useful lives for certain classes of offshore drilling rigs. As compared to the original estimate of useful lives, the effect of such change reduced depreciation expense and increased net income for the year ended December 31, 1996 by approximately $8.5 million and $5.5 million ($0.04 per share), respectively. The estimated useful lives of the Company's offshore drilling rigs, after the change in estimate, range from 10 to 25 years. Other property and equipment is estimated to have useful lives ranging from 3 to 10 years.

Capitalized Interest

Interest cost for construction and upgrade of qualifying assets is capitalized. During the years ended December 31, 1997 and 1996, the Company incurred interest cost, including amortization of debt issuance costs, of $14.7 million and $6.3 million, respectively. Interest cost capitalized during 1997 and 1996 was $4.4 million and $4.0 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.

Goodwill

Goodwill from the merger with Arethusa (see Note 2) is amortized on a straight-line basis over 20 years. Amortization charged to operating expense during the years ended December 31, 1997 and 1996 totaled $6.6 million and $4.5 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.

## Income Taxes

Taxable income (loss) of the Company and its domestic subsidiaries was included in the consolidated U.S. federal income tax return of Loews and other members of the Loews affiliated group for all taxable periods ending prior to the Common Stock Offering. Thereafter, the taxable income (loss) of the Company and its domestic subsidiaries is included in the consolidated U.S. federal income tax return of the Company and its affiliated group.

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. Except for selective dividends, the Company's practice has been 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 earnings of these non-U.S. subsidiaries. However, beginning in 1997, the Company changed its practice and intends to repatriate these earnings in the foreseeable future. As a result, beginning January 1, 1997, the Company has accrued U.S. taxes on all undistributed non-U.S. earnings. 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.

## 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. Absent a contract, mobilization costs are 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 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 contracts are recognized when it becomes apparent that expenses to be incurred on a specific contract will exceed the revenue from the 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 "Cumulative translation adjustment." Currency transaction gains and losses are included in the Consolidated Statements of Operations in "Other income (expense)." Additionally, translation gains and losses of subsidiaries operating in hyperinflationary economies are included in operating results currently.

## Net Income Per Share

In February 1997, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings per Share," which requires dual presentation of basic and diluted earnings per share for entities with complex capital structures. Accordingly, basic earnings per share was computed by dividing net income by the weighted average number of common shares outstanding for the year. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. Diluted earnings per share was calculated by dividing net income, adjusted to eliminate the after-tax effect of interest expense, by the weighted average number of common shares outstanding and the weighted average number of shares issuable assuming full conversion of the convertible subordinated notes as of the issuance date, February 4, 1997 (see Note 8).

Because the Company does not maintain an ongoing plan for the issuance of stock options, the options to 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 per share earnings, had the Arethusa Options been included, was not material. At December 31, 1997 and 1996, there were Arethusa Options outstanding for the purchase of approximately 0.1 million and 0.2 million shares of common stock, respectively.

Weighted average shares outstanding and all per share amounts included herein for all periods presented have been restated to include the retroactive effect of the July 1997 two-for-one stock split in the form of a stock dividend (see Note 3).

Pro Forma Net Income Per Share Data

As described in Note 3, after its initial public offering, the Company had 100.0 million shares of common stock outstanding. Assuming the Common Stock Offering had occurred as of January 1, 1995, the Company would have recognized net income of $10.0 million, or $0.10 per share, for 1995, after adjusting for the after-tax effects of a reduction in interest expense.

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. MERGER WITH ARETHUSA

In April 1996, the Company acquired 100 percent of the stock of Arethusa (the "Arethusa Merger"). Arethusa owned a fleet of 11 mobile offshore drilling rigs, operated two additional mobile offshore drilling rigs pursuant to bareboat charters and provided drilling services worldwide to international and government-controlled oil and gas companies. The consideration consisted of the following (in thousands):

| | |
|---|---|
| Common stock issued to Arethusa shareholders................ | $539,305 |
| Arethusa stock options assumed............................. | 11,381 |
| Total equity consideration........................ | $550,686 |

The Company issued 35.8 million common shares to the Arethusa shareholders based on an exchange ratio of 1.76 shares for each share of issued and outstanding Arethusa common stock. The shares were valued for financial reporting purposes at $15.07 based on a seven-day average of the closing price of the Company's common stock at the time the Arethusa Merger was announced (December 7, 1995). In addition to equity consideration, the Company incurred approximately $16.9 million of cash acquisition costs associated with the Arethusa Merger.

The Arethusa Merger was accounted for as a purchase. The purchase price included, at estimated fair value, current assets of $67.2 million, drilling and other property and equipment of $505.5 million, and the assumption of current liabilities of $19.0 million, other net long-term liabilities of $2.2 million, and debt of

$67.5 million. In addition, a deferred tax liability of $66.8 million was recorded primarily for the difference in the basis for tax and financial reporting purposes of the net assets acquired. The excess of the purchase price over the estimated fair value of net assets acquired amounted to approximately $133.5 million, which has been accounted for as goodwill and is being amortized over 20 years using the straight-line method (see Note 6).

The accompanying Consolidated Statements of Operations reflect the operating results of Arethusa since April 29, 1996, the effective date of the Arethusa Merger. Pro forma consolidated operating results of the Company and Arethusa for the year ended December 31, 1996 and 1995, assuming the acquisition had been made as of January 1, 1996 and 1995, are summarized below:

| | YEAR ENDED DECEMBER 31, | |
|---|---|---|
| | 1996 | 1995 |
| | (IN THOUSANDS, EXCEPT PER SHARE DATA) | |
| Revenue | $667,543 | $456,750 |
| Net income(loss) | 153,409 | (963) |
| Net income(loss) per share | 1.13 | (0.02) |

The pro forma information for the years ended December 31, 1996 and 1995 includes adjustments for additional depreciation based on the fair market value of the drilling and other property and equipment acquired and the amortization of goodwill arising from the transaction. The pro forma information for the year ended December 31, 1995 also includes adjustments for (i) the acquisition of the Arethusa Yatzy by Arethusa, which occurred May 3, 1995, (ii) the sale of the Treasure Stawinner by Arethusa, which occurred June 30, 1995, (iii) the dividend and capital distribution declared by Arethusa on June 30, 1995 and paid July 28, 1995, (iv) the Common Stock Offering and, in connection therewith, the use of the proceeds to repay all of the Company's then outstanding indebtedness to Loews and to fund the payment of a special dividend to Loews, and (v) interest expense for working capital borrowings, and commitment and other fees, under a credit facility as if each had occurred at January 1, 1995. The pro forma information is not necessarily indicative of the results of operations had the transactions been effected on the assumed dates.

3. COMMON STOCK

In July 1997, the Board of Directors declared a two-for-one stock split in the form of a stock dividend which was distributed on August 14, 1997 to stockholders of record on July 24, 1997. The dividend was charged to retained earnings in the amount of $0.7 million, which was based on the par value of 69.6 million shares of common stock.

In April 1997, the Company completed a public offering of 2.5 million shares of common stock generating net proceeds of approximately $82.3 million. The net proceeds were used to acquire the Polyconfidence, a semisubmersible accommodation vessel (see Note 5).

Pursuant to the Common Stock Offering, the Company sold 29.9 million shares of common stock, including 3.9 million shares from an over-allotment option.

4. SHORT-TERM INVESTMENTS

Equity securities classified as available for sale at December 31, 1997 are stated at fair value of $13.1 million, including gross unrealized holding losses of $0.2 million. Investments through repurchase agreements with third parties at December 31, 1997 are stated at their contracted amounts totaling $350.0 million.

During the year ended December 31, 1997, short-term debt securities purchased at various times during 1997 were sold for proceeds of $710.1 million, resulting in realized gains which were immaterial. In addition, long-term debt securities purchased in March 1997 and April 1997 were sold in July 1997 for proceeds of $125.1 million, resulting in an after-tax gain of $0.7 million included in the Consolidated Statements of Operations in "Other income (expense)."

During 1996, the Company was party to a pledge agreement with a bank whereby the bank would extend various financial accommodations to or for the account of the Company, including issuing letters of credit, entering into foreign exchange contracts or permitting intra-day overdrafts. In consideration of and as a condition precedent to the making of such financial accommodations by the bank, the Company was required to maintain a pledged collateral account in which the bank had a continuing security interest. The Company had $5.0 million in U.S. Treasury Bills deposited in such pledged collateral account until November 1996 when the bank no longer required the maintenance of collateral.

5. DRILLING AND OTHER PROPERTY AND EQUIPMENT

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

| | DECEMBER 31, 1997 | DECEMBER 31, 1996 |
|---|---|---|
| | (IN THOUSANDS) | |
| Drilling rigs and equipment | $1,781,107 | $1,332,980 |
| Construction work in progress | 17,696 | 116,770 |
| Land and buildings | 12,552 | 13,154 |
| Office equipment and other | 10,551 | 8,181 |
| Cost | 1,821,906 | 1,471,085 |
| Less accumulated depreciation | (370,165) | (272,925) |
| Drilling and other property and equipment, net | $1,451,741 | $1,198,160 |

Asset Acquisitions

In May 1997, the Company acquired the Polyconfidence (soon to be renamed Ocean Confidence), a semisubmersible accommodation vessel with dynamic-positioning capabilities, for approximately $81.0 million in cash. The Company chartered the vessel to the seller until December 1997. The Polyconfidence will be converted to a semisubmersible drilling rig in connection with a five-year contract in the Gulf of Mexico anticipated to commence in the fourth quarter of 1999.

Asset Dispositions

During the year ended December 31, 1997, the Company sold a semisubmersible drilling rig, the Ocean Zephyr, located offshore Brazil, for a $5.4 million note receivable due July 1998 which generated an after-tax gain of $0.6 million. Also in 1997, the Company sold a warehouse facility on approximately 6.6 acres of land near Houston, Texas, which was acquired in the Arethusa Merger, for approximately $0.6 million (see Note 2). No gain or loss was recognized on this sale.

During the year ended December 31, 1996, the Company sold all of the operational assets of Diamond M Onshore, Inc., a wholly owned subsidiary of the Company, for approximately $26.0 million in cash which generated an after-tax gain of $15.6 million, or $0.12 per share on a diluted basis. The assets sold consisted of ten land drilling rigs, all of which were operating, 18 trucks, a yard facility in Alice, Texas and various other associated equipment. In addition, two of the Company's shallow water jack-up drilling rigs (the Ocean Magallanes and the Ocean Conquest) and a semisubmersible (the Ocean Zephyr II), all of which had previously been stacked, were sold during 1996 increasing net income by $7.0 million, or $0.05 per share on a diluted basis.

Construction Work in Progress

As of December 31, 1997, $1.7 million, $9.3 million, and $6.7 million of construction work in progress was related to the upgrades of the Polyconfidence, the Ocean Warwick, and the Ocean Tower, respectively. As of December 31, 1996, $64.8 million, $36.5 million and $15.5 million of construction work in progress was related to the upgrades of the Ocean Star, the Ocean Clipper I, and the Ocean Victory, respectively.

### Impairment of Assets

During 1995, the Company recorded impairment losses of $2.1 million to decrease the carrying value of a semisubmersible drilling rig located in the Gulf of Mexico which was sold in the fourth quarter of 1995. The impairment loss, reflected in "Depreciation" in the Consolidated Statements of Operations, reduced the carrying value of the rig to zero. The operating loss incurred by the rig during the year ended December 31, 1995 was not material.

## 6. GOODWILL

The Arethusa Merger generated an excess of the purchase price over the estimated fair value of the net assets acquired (see Note 2). Cost and accumulated amortization of such goodwill is summarized as follows:

| | DECEMBER 31, | |
|---|---|---|
| | 1997 | 1996 |
| | (IN THOUSANDS) | |
| Goodwill | $129,746 | $134,331 |
| Less: Accumulated amortization | (11,123) | (4,506) |
| Total | $118,623 | $129,825 |

During the years ended December 31, 1997 and 1996, adjustments of $2.9 million and $0.8 million, respectively, were recorded to reduce goodwill before accumulated amortization. These adjustments represent the tax benefit of the excess of tax deductible goodwill over the reported amounts of goodwill when realized on the tax return. In addition, an adjustment of $1.7 million was recorded to reduce goodwill before accumulated amortization during the year ended December 31, 1997 due to a change in the fair value of the net assets acquired in the Arethusa Merger.

## 7. ACCRUED LIABILITIES

Accrued liabilities consist of the following:

| | DECEMBER 31, | |
|---|---|---|
| | 1997 | 1996 |
| | (IN THOUSANDS) | |
| Personal injury and other claims | $23,960 | $18,629 |
| Payroll and benefits | 15,951 | 8,336 |
| Interest payable | 5,684 | 172 |
| Other | 3,340 | 1,314 |
| Total | $48,935 | $28,451 |

## 8. LONG-TERM DEBT

### Convertible Subordinated Notes

In February 1997, the Company issued $400.0 million of convertible subordinated notes (the "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 percent and an effective interest rate of 3.93 percent. Interest is payable semi-annually on each February 15 and August 15.

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.

Credit Agreements

In August 1997, the Company terminated its revolving credit facility with a group of banks (the "Credit Facility"), which was available through December 2001 and provided a maximum credit commitment of $200.0 million, increased from $150.0 million in December 1996. The unused credit available under the Credit Facility at December 31, 1996 was $137.0 million. The weighted average interest rate, including commitment and arrangement fees, was 8.5 percent for the year ended December 31, 1996.

In connection with the Arethusa Merger, the Company assumed long-term debt (including the current portion) of $67.5 million on two credit agreements with a group of banks. During May 1996, using cash acquired in the Arethusa Merger supplemented by borrowings under the Credit Facility, both Arethusa loans were repaid in full. Interest expense for the year ended December 31, 1996 includes interest for the period from the effective date of the Arethusa Merger to the date of repayment of the loans and the payment of breakage and prepayment penalty charges.

9. COMMITMENTS AND CONTINGENCIES

The Company leases office facilities under operating leases which expire through the year 2002. Total rent expense amounted to $1.8 million, $1.6 million, and $1.5 million for the years ended December 31, 1997, 1996, and 1995, respectively. Minimum future rental payments under leases are approximately $0.9 million, $0.4 million, $0.1 million, $0.1 million, and $43,000 for the years 1998 to 2002, respectively. There are no minimum future rental payments under leases after the year 2002.

The Company is contingently liable as of December 31, 1997 and 1996 in the amount of $22.6 million under certain performance, bid, and export bonds and bonds securing obligations in connection with litigation. On the Company's behalf, banks have issued letters of credit securing certain of these bonds.

The survivors of a deceased employee of a subsidiary of the Company, Diamond M Onshore, Inc., sued such subsidiary in Duval County, Texas, for damages as a result of the death of the employee. The plaintiffs obtained a judgment in the trial court for $15.7 million plus post-judgment interest. The Company has appealed the judgment and is currently awaiting the opinion of the appellate court. The Company has received notices from certain of its insurance underwriters reserving their rights to deny coverage on the Company's insurance policies in excess of $2.0 million for damages resulting from such lawsuit. Management believes that the Company has complied with all conditions of coverage for final unappealable damages, if any, in the case. While the ultimate liability in this matter is difficult to assess, it is management's belief that the final outcome is not reasonably likely to have a material adverse effect on the Company's consolidated financial position, results of operations, or cash flows. The Company has not established a liability for such claim at this time.

A former subsidiary of Arethusa, which is now a subsidiary of the Company, defended and indemnified Zapata Off-Shore Company and Zapata Corporation (the "Zapata Defendants"), pursuant to a contractual defense and indemnification agreement, in a suit for tortious interference with contract and conspiracy to tortiously interfere with contract. The plaintiffs sought $14.0 million in actual damages and unspecified punitive damages, plus costs of court, interest and attorneys' fees. In November 1997, the jury awarded a take nothing judgment in favor of the Zapata Defendants. It is not yet known whether the plaintiffs will appeal the judgment. No provision for any liability has been made in the financial statements.

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 Risk

Financial instruments which potentially subject the Company to significant concentrations of credit risk consist primarily of periodic temporary investments of excess cash, trade accounts receivable, and investments through repurchase agreements with third parties. 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. Because of the protection of collateral and the short terms of the transactions, investments through repurchase agreements with third parties do not impose significant credit risk on the Company. The collateral provided for such transactions is generally valued daily and adjusted frequently for changes in the market price of the securities comprising the collateral.

### Fair Values

The amounts reported in the Consolidated Balance Sheets for cash and cash equivalents, short-term investments, accounts receivable, accounts payable and short-term borrowings approximate fair value. At December 31, 1997, the fair value of the Notes was approximately $527.0 million, as compared to a carrying amount of $400.0 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, 1997 and 1996. 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 and short-term borrowings -- The carrying amounts approximate fair value because of the short maturity of these instruments.

Short-term investments -- The fair values of equity securities available for sale were based on quoted market prices as of December 31, 1997. The carrying amount of investments through repurchase agreements approximates fair value because of the nature and short maturity of these instruments.

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.

## 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. Prior to the Common Stock Offering, Loews provided such services at an allocated rate. The Company was charged $0.3 million, $0.2 million, and $0.7 million by Loews for these support functions during the years ended December 31, 1997, 1996, and 1995, respectively.

## 12. INCOME TAXES

Prior to the Common Stock Offering, the Company and its subsidiaries were party to a tax sharing agreement with Loews. Subsequently, the tax sharing agreement was terminated and all assets and liabilities were settled by offsetting amounts owed by Loews to the Company under the agreement against notes payable to Loews.

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

| | YEAR ENDED DECEMBER 31, | | |
|---|---|---|---|
| | 1997 | 1996 | 1995 |
| | (IN THOUSANDS) | | |
| U.S. -- current | $ (99,001) | $(44,950) | $ -- |
| U.S. -- deferred | (34,650) | (17,278) | 7,472 |
| Non-U.S. -- current | (17,300) | (3,486) | (489) |
| State and other | (505) | (603) | (206) |
| Total | $(151,456) | $(66,317) | $6,777 |

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

| | DECEMBER 31, | |
|---|---|---|
| | 1997 | 1996 |
| | (IN THOUSANDS) | |
| Deferred tax assets: | | |
| Net operating loss carryforwards | $ 19,143 | $ 18,686 |
| Investment tax credit carryforwards | -- | 3,066 |
| Worker's compensation accruals(1) | 6,188 | 4,562 |
| Foreign tax credits | 9,023 | 7,186 |
| Other | 2,007 | 1,574 |
| Total deferred tax assets | 36,361 | 35,074 |
| Deferred tax liabilities: | | |
| Depreciation and amortization | (196,546) | (173,471) |
| Undistributed earnings of non-U.S. subsidiaries | (17,668) | (7,486) |
| Non-U.S. deferred taxes | (15,236) | (14,466) |
| Other | (10,236) | (11,385) |
| Total deferred tax liabilities | (239,686) | (206,808) |
| Net deferred tax liability | $(203,325) | $(171,734) |

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

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. However, beginning in 1997, the Company intends to repatriate these earnings in the foreseeable future. As a result, the Company has accrued U.S. taxes on all undistributed non-U.S. earnings generated since January 1, 1997. Undistributed earnings of non-U.S. subsidiaries generated prior to 1997 for which no deferred income tax provision has been made for possible future remittances totaled approximately $67.2 million at December 31, 1997. In addition, the Company has negative undistributed earnings of non-U.S. subsidiaries generated prior to 1997 of $69.6 million for which no deferred tax benefit has been recognized. It is not practicable to estimate the amount of taxes, if any, that might be payable on the eventual remittance of such earnings. On 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 that it is probable that its deferred tax assets of $36.4 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. Approximately $21.1 million of such carryforwards were utilized during the year ended December 31, 1996.

In connection with the Arethusa Merger, the Company acquired net operating loss ("NOL") carryforwards available to offset future taxable income. The utilization of these NOL carryforwards is limited pursuant to Sections 382 and 383 of the Internal Revenue Code of 1986, as amended (the "Code"). For the year ended December 31, 1997, the Company utilized $10.5 million of such carryforwards and has recorded a deferred tax asset for the benefit of the remaining NOL carryforwards available to be carried forward to future years. Such carryforwards expire as follows:

| YEAR | TAX BENEFIT OF NET OPERATING LOSSES (IN THOUSANDS) |
|---|---|
| 2005 | $ 176 |
| 2006 | 3,185 |
| 2007 | 3,147 |
| 2008 | 3,169 |
| 2009 | 3,838 |
| 2010 | 5,628 |
| Total | $19,143 |

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

| | YEAR ENDED DECEMBER 31, | | |
|---|---|---|---|
| | 1997 | 1996 | 1995 |
| | (IN THOUSANDS) | | |
| Income (loss) before income tax (expense) benefit: | | | |
| U.S. | $ 373,319 | $153,615 | $(19,591) |
| Non-U.S. | 56,742 | 59,090 | 5,788 |
| Worldwide | $ 430,061 | $212,705 | $(13,803) |
| Expected income tax (expense) benefit at federal statutory rate | $(150,521) | $(74,447) | $ 4,831 |
| Non-U.S. income (loss): | | | |
| Impact of taxation at different rates | -- | -- | 1,270 |
| Utilization of net operating loss carryforwards | -- | 6,843 | -- |
| Impact of non-U.S. losses for which a current tax benefit is not available | -- | (1,642) | (1,004) |
| Adjustment to prior year return | -- | 1,737 | -- |
| State taxes and other | (935) | 1,192 | 1,680 |
| Income tax (expense) benefit | $(151,456) | $(66,317) | $ 6,777 |

## 13. EMPLOYEE BENEFIT PLANS

### Defined Contribution Plans

The Company maintains defined contribution retirement plans for its U.S. and U.K. employees. The plan for U.S. employees (the "401(k) Plan") is designed to qualify under Section 401(k) of the Code. Under the 401(k) Plan, each participant may elect to defer taxation on a portion of his or her eligible earnings, as defined by the 401(k) 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 401(k) Plan. The Company contributes 3.75 percent of a participant's defined compensation and matches 25 percent of the first 6 percent of each employee's compensation contributed, subject to a vesting schedule which entitles the employee to a percentage of the matching contributions depending on years of service. For the years ended December 31, 1997, 1996, and 1995, the Company's provision for contributions was $4.1 million, $2.5 million, and $2.4 million, respectively.

The plan for U.K. employees provides that the Company contribute amounts equivalent to the employee's contributions generally up to a maximum of 3 percent of the employee's defined compensation per year. For the years ended December 31, 1997, 1996, and 1995, the Company's provision for contributions was $0.3 million, $0.3 million, and $0.2 million, respectively.

In connection with the Arethusa Merger, the Company assumed Arethusa's Profit Sharing Plan. The plan was established as a defined contribution profit sharing plan effective October 1, 1992 covering substantially all U.S. citizens, U.S. permanent residents and third country national expatriates employed by Arethusa Off-Shore Company, a wholly owned subsidiary of Arethusa. Participants could elect to make contributions by directing the Company to withhold a percentage of their earnings. A participating employee could also elect to make after-tax contributions to the plan. The Company contributed 3.75 percent of a participant's defined compensation. The Company's provision for such contributions for the year ended December 31, 1996 was $0.3 million. Effective January 1, 1997, the Company modified the 401(k) Plan by merging the Arethusa Profit Sharing Plan into the Company's existing plan.

### Deferred Compensation and Supplemental 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 percent of the base salary contribution and the matching contribution to the 401(k) Plan that cannot be contributed because of the limitations of Sections 401(a)(17), 401(k)(3), 401(m)(2), 402(g) and 415 of 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 percent of base compensation and/or up to 100 percent 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, 1997 and 1996 were 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 significant actuarial assumptions as of the plan's year end are set forth in the following table:

| | SEPTEMBER 30, | |
|---|---|---|
| | 1997 | 1996 |
| Discount rate | 7.25% | 7.5% |
| Expected long-term rate | 9.0% | 9.0% |
| Compensation projection rate | N/A | N/A |

The funded status is set forth in the following table:

| | SEPTEMBER 30, | |
|---|---|---|
| | 1997 | 1996 |
| | (IN THOUSANDS) | |
| Benefit obligation -- Vested | $(9,365) | $(8,536) |
| -- Non-vested | N/A | N/A |
| Accumulated benefit obligation | (9,365) | (8,536) |
| Effect of compensation projection | N/A | N/A |
| Projected benefit obligation | (9,365) | (8,536) |
| Plan assets at fair value | 12,285 | 10,119 |
| Plan assets in excess of projected benefit obligation | 2,920 | 1,583 |
| Unrecognized gain | (1,263) | (195) |
| Prepaid pension cost | $ 1,657 | $ 1,388 |

Net periodic pension credit includes the following components:

| | YEAR ENDED SEPTEMBER 30, | |
|---|---|---|
| | 1997 | 1996 |
| | (IN THOUSANDS) | |
| Service cost of benefits earned | $ -- | $ -- |
| Interest cost on projected benefit obligations | 633 | 259 |
| Actual return on plan assets | (902) | (356) |
| Net periodic pension credit | $(269) | $ (97) |

## 14. GEOGRAPHIC AREA ANALYSIS AND MAJOR CUSTOMERS

The following table summarizes, by geographic area, operating revenues and operating income (loss) for the years ended December 31, 1997, 1996, and 1995, and identifiable assets at the end of those periods. Interarea revenues from affiliates primarily represent intercompany charter revenues and are accounted for based on the estimated fair market value of the services.

| | UNITED STATES | EUROPE/ AFRICA | AUSTRALIA/ SOUTHEAST ASIA | SOUTH AMERICA | OTHER AREAS | ELIMINATIONS | TOTAL |
|---|---|---|---|---|---|---|---|
| | | | | (IN THOUSANDS) | | | |
| YEAR ENDED DECEMBER 31, 1997 | | | | | | | |
| Revenues from unaffiliated customers | $ 609,470 | $201,893 | $ 93,963 | $ 50,767 | $ -- | $ -- | $ 956,093 |
| Interarea revenues from affiliates | 74,096 | -- | -- | 971 | 14,658 | (89,725) | -- |
| Operating income (loss) | 367,148 | 38,190 | (3,822) | 4,670 | 13,687 | -- | 419,873 |
| Identifiable assets | 1,682,093 | 373,722 | 80,601 | 161,779 | 366 | -- | 2,298,561 |
| YEAR ENDED DECEMBER 31, 1996 | | | | | | | |
| Revenues from unaffiliated customers | $ 384,708 | $126,618 | $ 65,335 | $ 34,769 | $ -- | $ -- | $ 611,430 |
| Interarea revenues from affiliates | 31,147 | -- | -- | 1,921 | 6,156 | (39,224) | -- |
| Operating income (loss) | 192,765 | 14,621 | (6,106) | 6,055 | 6,156 | -- | 213,491 |
| Identifiable assets | 1,108,761 | 197,948 | 101,093 | 166,698 | -- | -- | 1,574,500 |
| YEAR ENDED DECEMBER 31, 1995 | | | | | | | |
| Revenues from unaffiliated customers | $ 213,998 | $ 47,645 | $ 53,113 | $ 21,828 | $ -- | $ -- | $ 336,584 |
| Interarea revenues from affiliates | 9,335 | 1,389 | -- | 1,460 | 4,563 | (16,747) | -- |
| Operating income (loss) | 25,488 | (6,755) | (7,675) | (3,970) | 4,563 | -- | 11,651 |
| Identifiable assets | 386,282 | 165,277 | 36,705 | 29,788 | -- | -- | 618,052 |

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.

The assets located outside the U.S. include cash and cash equivalents of $10.0 million, $6.2 million, and $1.3 million at December 31, 1997, 1996, and 1995, respectively.

The Company's customer base includes major and independent oil and gas companies and government-owned oil companies. During the year ended December 31, 1997, one customer contributed 14.3 percent of total revenues. During the year ended December 31, 1996, two customers contributed 13.8 percent and 13.5 percent of total revenues. During the year ended December 31, 1995, one customer contributed 16.5 percent of total revenues.

## 15. UNAUDITED QUARTERLY FINANCIAL DATA

Unaudited summarized financial data by quarter for the years ended December 31, 1997 and 1996 is shown below.

| | FIRST QUARTER | SECOND QUARTER | THIRD QUARTER | FOURTH QUARTER |
|---|---|---|---|---|
| | (IN THOUSANDS, EXCEPT PER SHARE DATA) | | | |
| 1997 | | | | |
| Revenues | $204,733 | $228,534 | $250,497 | $272,329 |
| Operating income | 84,306 | 98,229 | 117,013 | 120,325 |
| Income before income tax expense | 87,014 | 100,389 | 119,338 | 123,320 |
| Net income | 56,230 | 65,234 | 77,831 | 79,310 |
| Net income per share: | | | | |
| Basic | 0.41 | 0.47 | 0.56 | 0.57 |
| Diluted | 0.39 | 0.45 | 0.54 | 0.55 |
| 1996 | | | | |
| Revenues | $106,868 | $146,983 | $170,622 | $186,957 |
| Operating income | 25,696 | 46,614 | 57,520 | 83,661 |
| Income before income tax expense | 26,130 | 46,784 | 57,929 | 81,862 |
| Net income | 18,732 | 33,022 | 38,480 | 56,154 |
| Net income per share: | | | | |
| Basic | 0.19 | 0.27 | 0.28 | 0.41 |
| Diluted | 0.19 | 0.27 | 0.28 | 0.41 |

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

ITEM 11. EXECUTIVE COMPENSATION

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Reference is made to the information responsive to the Items comprising this Part III that is contained in the Company's definitive proxy statement for its 1998 Annual Meeting of Stockholders, which is incorporated herein by reference.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a) Index to Financial Statements, Financial Statement Schedules and Exhibits

(1) Financial Statements



(2) Financial Statement Schedules

No schedules have been included herein because the information required to be submitted has been included in the Company's Consolidated Financial Statements or the notes thereto, or the required information is inapplicable.



See Index of Exhibits for a list of those exhibits filed herewith, which index also includes and identifies management contracts or compensatory plans or arrangements required to be filed as exhibits to this Form 10-K by Item 601(10)(iii) of Regulation S-K.

(b) Reports on Form 8-K

There were no reports on Form 8-K filed during the quarter ended December 31, 1997.

(c) Index of Exhibits

| EXHIBIT NO. | DESCRIPTION |
|---|---|
| 3.1 | -- Restated Certificate of Incorporation of the Company (incorporated by reference to Exhibit 3.1 of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1995). |
| 3.2 | -- By-laws of the Company, as amended (incorporated by reference to Exhibits 3.2, 3.2.1 and 3.2.2 of the Company's Registration Statement No. 333-2680 on Forms S-4/S-1). |
| 4.1 | -- Indenture, dated as of February 4, 1997, between the Company and The Chase Manhattan Bank, as Trustee (incorporated by reference to Exhibit 4.1 of the Company's Current Report on Form 8-K filed February 11, 1997). |
| 4.2 | -- Supplemental Indenture, dated as of February 4, 1997, between the Company and The Chase Manhattan Bank, as Trustee (incorporated by reference to Exhibit 4.2 of the Company's Current Report on Form 8-K filed February 11, 1997). |
| 10.1 | -- Registration Rights Agreement (the "Registration Rights Agreement") dated October 16, 1995 between Loews and the Company (incorporated by reference to Exhibit 10.2 of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1995). |
| 10.2* | -- Amendment to the Registration Rights Agreement, dated September 16, 1997 between Loews and the Company. |
| 10.3 | -- Services Agreement dated October 16, 1995 between Loews and the Company (incorporated by reference to Exhibit 10.3 of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1995). |
| 10.4+ | -- Agreement ("Rose Employment Agreement"), dated November 1, 1992, between the Company and Robert E. Rose (incorporated by reference to Exhibit 10.7 of the Company's Registration Statement No. 33-95484 on Form S-1). |
| 10.5+ | -- Amendment, dated December 27, 1995, to the Rose Employment Agreement (incorporated by reference to Exhibit 10.5 of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1995). |
| 10.6*+ | -- Diamond Offshore Management Bonus Program, as amended and restated, and dated as of December 31, 1997. |
| 10.7+ | -- Diamond Offshore Executive Deferred Compensation and Supplemental Retirement Plan effective December 17, 1996 (incorporated by reference to Exhibit 10.10 of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1996). |
| 10.8*+ | -- First Amendment to Diamond Offshore Executive Deferred Compensation and Supplemental Retirement Plan dated March 18, 1998. |
| 10.9 | -- Credit Agreement among the Company, various lending institutions, Bankers Trust Company and Christiania Bank og Kreditkasse, New York Branch, as Co-Arrangers, Bankers Trust Company, as Administrative Agent, Christiania Bank og Kreditkasse, New York Branch, as Documentation Agent, and The Fuji Bank, Limited, as Co-Agent, dated as of February 8, 1996 and amended and restated as of March 27, 1996 and further amended and restated as of December 19, 1996 (incorporated by reference to Exhibit 10.1 of the Company's Registration Statement No. 333-19987 on Form S-3). |
| 10.10 | -- Diamond Offshore Drilling, Inc. Nonqualified Stock Option Plan for Certain Former Directors of Arethusa (incorporated by reference to Exhibit 10.17 of the Company's Registration Statement No. 333-2680 on Forms S-4/S-1). |

| EXHIBIT NO. | DESCRIPTION |
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| 10.11 | -- Diamond Offshore Drilling, Inc. Stock Option Plan for Certain Former Employees of Arethusa (incorporated by reference to Exhibit 10.18 of the Company's Registration Statement No. 333-2680 on Forms S-4/S-1). |
| 10.12 | -- Asset Purchase Agreement between Diamond M Onshore, Inc. and Drillers Inc. dated as of November 12, 1996 (incorporated by reference to Exhibit 10.2 of the Company's Registration Statement No. 333-19987 on Form S-3). |
| 10.13 | -- Amendment No. 1, dated as of December 31, 1996, to Asset Purchase Agreement between Diamond M Onshore, Inc. and Drillers Inc. dated as of November 12, 1996 (incorporated by reference to Exhibit 10.3 of the Company's Registration Statement No. 333-19987 on Form S-3). |
| 11.1* | -- Statement re Computation of Per Share Earnings. |
| 12.1* | -- Statement re Computation of Ratios. |
| 21.1* | -- List of Subsidiaries of the Company. |
| 23.1* | -- Consent of Deloitte & Touche LLP. |
| 24.1* | -- Powers of Attorney. |
| 27.1* | -- Financial Data Schedule. |

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* Filed herewith.

+ Management contracts or compensatory plans or arrangements.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on March 20, 1998.

DIAMOND OFFSHORE DRILLING, INC.

By: /s/ LAWRENCE R. DICKERSON*

Lawrence R. Dickerson
Senior Vice President
and Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| SIGNATURE | TITLE | DATE |
|---|---|---|
| /s/ ROBERT E. ROSE*<br>Robert E. Rose | President, Chief Executive Officer and Director (Principal Executive Officer) | March 20, 1998 |
| /s/ LAWRENCE R. DICKERSON*<br>Lawrence R. Dickerson | Senior Vice President and Chief Financial Officer (Principal Financial Officer) | March 20, 1998 |
| /s/ GARY T. KRENEK*<br>Gary T. Krenek | Controller (Principal Accounting Officer) | March 20, 1998 |
| /s/ JAMES S. TISCH*<br>James S. Tisch | Chairman of the Board | March 20, 1998 |
| /s/ HERBERT C. HOFMANN*<br>Herbert C. Hofmann | Director | March 20, 1998 |
| /s/ ARTHUR L. REBELL*<br>Arthur L. Rebell | Director | March 20, 1998 |
| /s/ MICHAEL H. STEINHARDT*<br>Michael H. Steinhardt | Director | March 20, 1998 |
| /s/ RAYMOND S. TROUBH*<br>Raymond S. Troubh | Director | March 20, 1998 |

*By: /s/ RICHARD L. LIONBERGER

Richard L. Lionberger
Attorney in Fact

# INDEX TO EXHIBITS

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| 27.1* | -- Financial Data Schedule. |

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* Filed herewith.

+ Management contracts or compensatory plans or arrangements.

EXHIBIT 10.2

LOEWS CORPORATION
667 MADISON AVENUE
NEW YORK, NY 10021-8087

Diamond Offshore Drilling, Inc.
15415 Katy Freeway
Houston, TX 77094

Attention: Richard L. Lionberger
Vice President, General Counsel and Secretary

Gentlemen:

Reference is made to the Registration Rights Agreement dated October 16, 1995 (the "Agreement") between you (the "Company") and the undersigned ("Loews"). Capitalized terms used and not otherwise defined herein are used with meanings given thereto in the Agreement.

1. Demand Registration. This letter constitutes Loews's written request (being the first of three such requests to which Loews is entitled) pursuant to Section 2.1 of the Agreement that the Company prepare and file, and use its best efforts to cause to become effective as soon as practicable (but not later than September 30, 1998), one or more registration statements under the Act for a continuous offering by Loews of shares of Registerable Common Stock under Rule 415 promulgated by the Commission under the Act (the "Registration Statement"). The shares of Registerable Common Stock covered by this request will underlie a proposed issuance by Loews of its Exchangeable Notes due 2007 ("Exchangeable Notes") through a public offering of such notes to be underwritten by Goldman, Sachs & Co. (the "Note Offering"). Loews expects to price the Note Offering on or about September 16, 1997 at which time Loews will advise the Company of the exact number of shares of Registerable Common Stock to be covered by this request and the Registration Statement.

2. The Registration Statement.

(i) Notwithstanding Section 5(h) of the Agreement, the Company agrees to keep effective the Registration Statement until the first to occur of (A) September 15, 2007 and (B) such time as no Exchangeable Notes remain outstanding.

(ii) Loews agrees that the Company may, by giving one business day's written notice to Loews, and the trustee and the exchange agent for the Exchangeable Notes (which notice shall specify that it is given on behalf of Loews under the indenture for the Exchangeable Notes (the "Indenture")), defer filing the Registration Statement to a date later than September 30, 1998, or, at any time and from time to time after the Registration Statement has been filed and declared effective, require Loews to suspend use of any resale prospectus or prospectus supplement included in the Registration Statement (A) for a reasonable period of time, but not in excess of ninety (90) days, if the Company (x) is at such time conducting or about to conduct an underwritten public offering of its securities for its own account and the Board of Directors of the Company determines in good faith that such offering would be materially adversely affected by such use, or (y) would, in the opinion of the Company's counsel, be required to disclose in such Registration Statement information not otherwise then required by law to be publicly disclosed and, in the good faith judgment of the Board of Directors of the Company, such disclosure would reasonably be expected to adversely affect any material business transaction or negotiation in which the Company is then engaged or (B) for any period during which the Company has notified Loews and the exchange agent for the Exchangeable Notes of the occurrence of an event requiring the preparation of a supplement to the resale prospectus included in the Registration Statement or an amendment to the Registration Statement so that, as thereafter delivered to holders of the Exchangeable Notes exchanging such notes for shares of Registerable Common Stock, such prospectus will not contain an untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading, and as promptly as practicable make available to Loews any such supplement or amendment. Notwithstanding the foregoing, such suspensions of use of any such resale prospectus or prospectus supplement shall not be in effect for more that 120 days in any twelve-month period.

(iii) Loews further agrees that the provision of paragraph (ii) above shall apply to any future request for registration made by Loews under Section 2.1 of the Agreement if such request relates to a "shelf" registration requested to be filed by the Company pursuant to Rule 415 promulgated under the Act.

3. Underwriting Agreement. Pursuant to Section 5(1) of the Agreement, the Company agrees to enter into the underwriting agreement, in the form attached hereto as Exhibit "A".

4. Limitations on Suspension Periods. Notwithstanding the provisions of Section 2(ii) hereof, the Company agrees with Loews that it will not suspend the use of any resale prospectus or prospectus supplement included in the Registration Statement (i) during the 14-day period preceding the final maturity date of the Exchangeable Notes or, subject to compliance by Loews with the provisions of this Section 4, during the 14-day period preceding any Redemption Date (as defined in Loews's prospectus supplement for the Exchangeable Notes (the "Prospectus Supplement")) with respect to the Exchangeable Notes. Loews agrees not to give notice under the Indenture to the holders of Exchangeable Notes of any proposed optional redemption at any time when use of any such prospectus or prospectus supplement has been suspended by the Company in accordance with this letter. Prior to giving notice under the Indenture to the holders of Exchangeable Notes of any proposed optional redemption, Loews agrees to provide the Company with at least three full Trading Days' (as defined in the Prospectus Supplement) written notice (or such shorter period as the Company may agree) of such proposed optional redemption (the "Redemption Notice"). On or before the close of business on the third Trading Day following actual receipt by the Company of the Redemption Notice, the Company will notify Loews if the Company elects to suspend the use of any resale prospectus or prospectus supplement pursuant to Section 2(ii) above. If the Company elects to suspend use of any resale prospectus or prospectus supplement, the Company will effect such suspension promptly and Loews will not give notice of any proposed optional redemption until the suspension period has terminated or expired.

5. Effect Hereof. This letter agreement constitutes an amendment to the Agreement pursuant to Section 12.5 thereof and the general provisions of such agreement apply to this letter agreement (except the notice provisions hereof will control over Section 12.7 thereof in the event of any inconsistency). As amended hereby, the Agreement is hereby confirmed to be and remain in full force and effect.

If this letter correctly sets forth our mutual understanding regarding the amendment to the Agreement proposed to be effected hereby, please so indicate by executing each copy hereof, whereupon this letter shall constitute an agreement between us to amend the Agreement, and otherwise as set forth above.

LOEWS CORPORATION

By: /s/ BARRY HIRSCH
---------------------------------
Name: Barry Hirsch
Title: Sr. Vice President

Agreed and accepted
this 16th day of September, 1997

DIAMOND OFFSHORE DRILLING, INC.

By: /s/ RICHARD L. LIONBERGER
--------------------------------
Name: Richard L. Lionberger
Title: Vice President

EXHIBIT 10.6

DIAMOND OFFSHORE MANAGEMENT BONUS PROGRAM

WHEREAS, Diamond Offshore Drilling, Inc. (the "Company") has heretofore adopted the Diamond Offshore Management Bonus Program (the "Plan"), effective as of January 1, 1995 and which was amended and restated effective as of January 1, 1995;

WHEREAS, the Company desires to restate the Plan and to amend the Plan in several respects;

NOW, THEREFORE, the Plan is hereby restated in its entirety as follows, effective for the 1997 Performance Year and thereafter.

I. PURPOSE

The DIAMOND OFFSHORE MANAGEMENT BONUS PROGRAM (the "PLAN") is intended to provide a means whereby certain selected officers and key employees of DIAMOND OFFSHORE DRILLING, INC. (the "COMPANY"), and its Subsidiaries, may develop a sense of proprietorship and personal involvement in the development and financial success of the Company, and to encourage them to remain with and devote their best efforts to the business of the Company, thereby advancing the interests of the Company and its shareholders.

II. DEFINITIONS

Where the following words and phrases appear in the Plan, they shall have the respective meanings set forth below unless their context clearly indicates to the contrary:

(a) Annual Bonus Pool. For each Performance Period, an amount determined by the Committee based upon management performance and financial results for the Performance Period as well as such other factors as the Committee deems appropriate.

(b) Bonus Pool Carryforward. For any Performance Period, the Annual Bonus Pool for the Performance Period plus Bonus Pool Carryforwards for prior Performance Periods which have not yet been paid out, less total Incentive Awards paid for the Performance Period.

(c) Board. The Board of Directors of the Company.

(d) Committee. The Executive Committee of the Board.

(e) Company. Diamond Offshore Drilling, Inc.

(f) Disability. A Participant shall be considered to have terminated employment by reason of Disability if the Committee determines, based upon a written medical opinion unless waived by the Committee, that such Participant will be permanently incapable of performing his or her job for physical or mental reason.

(g) Effective Date. January 1, 1995, provided the effective date of the amendments effected by the amendment and restatement dated December 31, 1996 shall be effective as of January 1, 1996, and the effective date of the amendments effected by the amendment and restatement dated December 31, 1997 shall be effective as of January 1, 1997.

(h) Employee. Any individual employed by the Company or a Subsidiary.

(i) Incentive Award. An award granted to a Participant pursuant to Article V.

(j) Initial Payout Date. The Payout Date immediately following a Performance Period.

(k) Participant. Any Employee selected by the Committee to participate in the Plan pursuant to Article IV.

(l) Payout Date. A date during the month of February of any calendar year to be selected by the Committee.

(m) Performance Period. Any calendar year beginning on or after January 1, 1995.

(n) Plan. Diamond Offshore Management Bonus Program, as amended from time to time.

(o) Reduction in Force. The employment of a Participant shall be considered as having been terminated because of a Reduction in Force if, because of economic conditions or technological improvements, the services of such Participant are no longer needed and no replacement for such Participant is to be hired.

(p) Retirement. Termination of employment with the Company or any Subsidiary by a Participant on or after reaching age 60, other than a Termination for Cause.

(q) Subsidiary. At any given time, any other corporation of which an aggregate of 80% or more of the outstanding voting stock is owned of record or beneficially, directly or indirectly, by the Company or any other of its Subsidiaries.

(r) Termination for Cause. With respect to each Participant who has been granted one or more Incentive Awards under the Plan, any termination of such Participant's employment with the Company or any Subsidiary, whether voluntary or involuntary, at any time because of the Participant's (i) conviction of a felony or a misdemeanor involving moral turpitude (which, through lapse of time or otherwise, is not subject to appeal), (ii) participation in an act or acts of dishonesty intended to result in personal enrichment of the Participant or a third person at the expense of the Company or any Subsidiary, (iii) willful refusal without proper legal cause to perform any material duty or responsibility of the Participant or (iv) willful conduct which the Participant has reason to know is materially injurious to the Company or any Subsidiary. For purposes of (iii) and (iv) above, an act, or failure to act, on the part of a Participant shall not be deemed "willful" unless done, or omitted to be done, by the Participant in bad faith and without reasonable belief that such action or omission was in the best interest of the Company and its Subsidiaries. Further, a Participant shall not be deemed to have been Terminated for Cause pursuant to (iii) or (iv) above unless and until the Participant is notified in writing of the act or omission in question and is afforded at least 15 days to correct such act or omission.

(s) Total Bonus Pool. For each Performance Period, the sum of the Annual Bonus Pool for such Performance Period and the Bonus Pool Carryforward for prior Performance Periods.

## III. ADMINISTRATION OF PLAN

The Plan shall be administered by the Committee. The Committee shall have sole authority to (i) select Participants, (ii) establish any appropriate grouping of Participants for purposes of granting Incentive Awards, (iii) determine the amount in the Annual Bonus Pool, (iv) determine the amount of any special Incentive Awards outside the Annual Bonus Pool, (v) establish conditions for receipt of an Incentive Award for a Performance Period based upon corporate, group, or individual performance, or a combination thereof, or such other criteria as the Committee may determine to be appropriate, and (vi) establish the amount of an Incentive Award, if any, to be granted to a Participant with respect to a Performance Period and the terms thereof, including the establishment of any deferral period. The Committee may also, in its sole discretion, waive any eligibility, performance, or other criteria under the Plan in a manner favorable to a particular Participant or to Participants generally, upon such terms as the Committee deems appropriate. The Committee is authorized to interpret the Plan and may from time to time adopt such rules and regulations, consistent with the provisions of the Plan, as it may deem advisable to carry out the Plan. All decisions made by the Committee in selecting Participants, determining who shall be granted Incentive Awards and the amount thereof, and in construing the provisions of the Plan or the terms of any Incentive Award shall be final and binding on all Participants.

## IV. ELIGIBILITY

Any Employee who has been employed by the Company or one or more of its Subsidiaries for a continuous period of at least one year may be selected by the Committee to be a Participant in the Plan. The Committee, in its sole discretion, may waive the requirement of one year of continuous employment. Once an Employee is selected to participate in the Plan, he or she remains a Participant until (i) such designation is revoked by the Committee, which the Committee in its discretion may do at any time, but only prospectively, or (ii) such employee's employment with the Company or any Subsidiary is terminated, whichever occurs first. An Employee whose designation as a Participant is revoked by the Committee shall continue to participate in the Plan to the extent of any unpaid Incentive Awards but shall not otherwise be considered a Participant. No Employee shall be disqualified from eligibility merely by reason of his or her being a director of the Company or any Subsidiary.

## V. DETERMINATION OF INCENTIVE AWARDS

(a) The Committee is hereby empowered to make all determinations concerning the granting of an Incentive Award and the amount of such Incentive Award granted to each Participant; provided, however, that the Committee shall promptly notify each Participant as to the amount of such Incentive Award, and the terms, provisions, conditions, and limitations of such award. The Committee shall determine the individual objectives for each Participant for each Performance Period. As soon as administratively feasible after the end of such Performance Period, the Committee shall

(1) Determine the dollar amount of the Total Bonus Pool available for allocation as Incentive Awards for such Performance Period, and

(2) Review each Participant's individual objectives and determine, in its discretion, whether such Participant met his or her objectives during the Performance Period.

If (i) the Committee in its sole discretion finds that a Participant has met his or her individual objectives or otherwise should be awarded an Incentive Award and (ii) such Participant was employed with the Company or any Subsidiary during the Performance Period, then the Committee, in its sole discretion may award such Participant an Incentive Award for such Performance Period. The preceding sentence notwithstanding, in the event a Participant's employment with Company or any Subsidiary terminates during a Performance Period, the Committee may, in its sole discretion, award such Participant an Incentive Award for such Performance Period upon such terms as the Committee deems appropriate. If an award is granted, the Committee shall determine the amount of such Incentive Award based upon such Participant's level of achievement and overall performance, and on any other basis, as determined by the Committee in its discretion. Such a determination shall be in writing and shall be filed with the appropriate records of the Company.

(b) The aggregate amount of the Incentive Awards granted for any Performance Period under subsection (a) of this article V shall not exceed the Total Bonus Pool. The Committee has the right to allocate all or less than all of the Total Bonus Pool for any Performance Period.

(c) The Committee may at any time utilize amounts in the Bonus Pool Carryforward to provide bonuses to Employees who are not Participants.

(d) The Committee may, in its discretion, make Incentive Awards for special achievement, outstanding performance or other reasons determined by the Committee to be appropriate to Participants selected by the Committee. For instance special awards might be made in connection with capital market transactions; mergers, acquisitions and business combinations; asset purchases or dispositions; other transactions; or meeting goals of the Company. The Annual Bonus Pool may be increased by an amount equal to the amount of any such awards. Such special awards will be made upon such terms as are determined by the Committee to be appropriate, including, without limitation, any deferral of such awards.

## VI. PAYMENT OF INCENTIVE AWARDS

(a) Except as otherwise provided in this Article VI, Incentive Awards for each Performance Period shall be paid to Participants upon such terms as the Committee determines to be appropriate, including, without limitation, deferral of a portion of the Incentive Award. All portions of Incentive Awards that are not deferred shall be paid as soon as administratively feasible after the Initial Payout Date. In the event payment of any portion of Incentive Awards is deferred the deferred portion of the Incentive Award shall bear interest at a rate per annum equal to the Treasury rate in effect on the January 31 immediately preceding the Initial Payout Date for the Incentive Award being deferred. The applicable Treasury rate shall be the rate for Treasury bills, bonds or notes with a term closest to the midpoint of the deferral term of the Incentive Award. For instance, if a portion of an Incentive Award is deferred for 60 months that portion of the Incentive Award will bear interest at the Treasury rate closest to 30 months. Interest shall be payable with each deferred payment of Incentive Awards and shall be calculated on the balance outstanding since the immediately preceding payment of a portion of the Incentive Awards.

(b) Except as provided in subsection (c), (d), or (e) of this article VI or subsection (a) of Article V, if a Participant's employment with the Company or any Subsidiary is terminated voluntarily by the Participant or is Terminated for Cause, such termination shall cause the Participant to forfeit any and all amounts remaining to be paid to such Participant under the Plan, including, but not limited to, any Incentive Award as to which the Initial Payout Date has not been attained prior to the termination.

(c) In the event a Participant's employment with the Company or any Subsidiary terminates by reason of his or her death, Retirement, or Disability, the Company shall pay to such Participant (or to such Participant's estate) the full amount of his or her unpaid Incentive Awards. Such payment shall be made as soon as administratively feasible following the date of such Participant's termination, except that, in the case of any Incentive Award as to which the Initial Payout Date has not been attained prior to the date of termination, such payment shall be made on the Initial Payout Date, or as soon as administratively feasible thereafter.

(d) Unless a Participant's employment with the Company or any Subsidiary is terminated voluntarily by the Participant or is Terminated for Cause, the Company shall pay to such Participant the full amount of his or her unpaid Incentive Awards. Such payment shall be made as soon as administratively feasible following the date of such Participant's termination, except that, in the case of any Incentive Award as to which the Initial Payout Date has not been attained prior to the date of termination, such payment shall be made on the Initial Payout Date, or as soon as administratively feasible thereafter.

(e) Regardless of how a Participant's employment with the Company or any Subsidiary terminates, the Committee, in its sole discretion, may elect to have the Company pay to such Participant all or any part of his or her unpaid Incentive Awards. Such payment shall be made as soon as administratively feasible following the Committee's determination, except that, in the case of any Incentive Award as to which the Initial Payout Date has not been attained prior to the date of such determination, such payment shall be made on the Initial Payout Date, or as soon as administratively feasible thereafter.

(f) Any amounts forfeited by any Participant under the Plan shall not be restored to the Bonus Pool Carryforward. Furthermore, at all times the Total Bonus Pool and the Bonus Pool Carryforward amounts remain the property of the Company until such amounts are allocated as Incentive Awards and paid to Participants pursuant to the terms of the Plan.

(g) A Participant may file with the Committee a written designation of a beneficiary or beneficiaries to receive any payments of awards which would otherwise be paid to the Participant's estate hereunder. Any such designation may be changed or revoked by the Participant by written notice to the Committee.

(h) Incentive Awards to Participants will be treated for tax purposes the same as amounts paid to such Participant as salary.

## VII. NATURE OF THE PLAN

Neither the establishment of the Plan nor the granting of Incentive Awards shall be deemed to create a trust. The Plan shall constitute an unfunded, unsecured liability of the Company to make payments in accordance with the provisions of the Plan, and no Participant shall have any security or other interest in any assets of the Company.

## VIII. DURATION, AMENDMENT, AND TERMINATION

The Board shall have the right to amend the Plan from time to time, to terminate it entirely or to direct the discontinuance of Incentive Awards either temporarily or permanently. However, no amendment, discontinuance, or termination of the Plan shall operate to annul an Incentive Award that has already been made to a Participant. Upon termination of the Plan, all unpaid Incentive Awards shall be paid to the Participants as soon as administratively feasible following the termination in one lump sum cash payment.

## IX. GENERAL CONDITIONS

(a) No rights are created by the Plan in any Participant to claim or to be granted an Incentive Award.

(b) The Committee shall have the discretion and authority to adjust the performance standards set forth by the Committee for the granting of Incentive Awards if circumstances outside the control of the Participants have occurred during the Performance Period so as to make such adjustment appropriate in the opinion of the Committee.

(c) An Employee shall be considered to be in the employment of the company as long as he or she remains an employee of the Company or any Subsidiary. Transfers among the Company and the Subsidiaries shall not be considered a termination of employment. Further, a leave of absence authorized by the Company or any Subsidiary shall not be considered a termination of employment. Nothing in the adoption of the Plan or the granting of Incentive Awards shall confer on any Employee the right to continued employment by the Company or a Subsidiary, or affect in any way the right of the Company or such Subsidiary to terminate his or her employment at any time. Any question as to whether and when there has been a termination of an Employee's employment, and the cause of such termination, shall be determined by the Committee, and its determination shall be final.

(d) Except to the extent set forth herein as to the rights of the estate or beneficiaries of Participants to receive payments, awards under the Plan are non-assignable and non-transferable and are not subject to anticipation, adjustment, alienation, encumbrance, garnishment, attachment, or levy of any kind.

(e) Nothing contained in the Plan shall be deemed to give any Employee, Participant, or any personal representative or beneficiary, any interests in or title to any specific property of the Company, or any right against the Company other than as set forth in the Plan.

(f) Neither the officers nor the directors of the Company nor the members of the Committee shall under any circumstances have any liabilities with respect to the Plan or its administration except for gross and intentional malfeasance. The officers and directors of the Company and the members of the Committee may rely upon opinions of counsel as to all matters, including the creation and operation of the Plan.

(g) No portion of the Plan shall be effective at any time when such portion violates an applicable State or Federal law, regulation or governmental order or directive which is subject to sanctions, whether direct or indirect.

(h) All provisions of the Plan shall be construed in accordance with the laws of the State of Texas.

IN WITNESS WHEREOF, the Company has executed this instrument as of the 31st day of December, 1997.

DIAMOND OFFSHORE DRILLING, INC.

By: /s/ LAWRENCE R. DICKERSON
-----------------------------------
Title: Senior Vice President and
Chief Financial Officer

EXHIBIT 10.8

FIRST AMENDMENT TO
DIAMOND OFFSHORE DRILLING, INC.
DEFERRED COMPENSATION AND
SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN

WHEREAS, Diamond Offshore Drilling, Inc. (the "Corporation") has heretofore adopted and currently maintains the Diamond Offshore Drilling, Inc. Deferred Compensation and Supplemental Executive Retirement Plan (the "Plan") for the benefit of certain employees of the Corporation and certain of its subsidiaries and affiliates; and

WHEREAS, pursuant to authority granted in Paragraph 10 of the Plan, the Corporation desires to amend the Plan;

NOW, THEREFORE, the Plan is hereby amended as follows, effective as of January 1, 1996:

1. Paragraph 14 of the Plan shall be deleted and the following shall be substituted therefore:

"14. Effective Date

The Plan shall be effective January 1, 1996; provided however, that no Participant shall defer compensation pursuant to Paragraph 4 before the calendar year beginning January 1, 1997."

2. Paragraph 5 of the Plan shall be deleted and the following shall be substituted therefore:

"5. Company Deferrals

To the extent hereinafter provided in this Paragraph 5, the Company shall establish a memorandum account (a 'Company Account') for each Participant on its books.

The Company Account of each Participant shall be credited quarterly with the sum of the amounts described in (a) and (b):

(a) The excess, if any, of (i) or (ii) where:

(i) equals the Employer Profit Sharing Contributions (as defined in Diamond Offshore Drilling, Inc. 401(k) Plan (the "401(k) Plan")) to which such Participant would have been entitled under the 401(k) Plan for each calendar quarter if such Participant had not elected to defer compensation under this Plan and assuming none of the Limitations (as hereinafter defined) were imposed; and

(ii) equals the Employer Profit Sharing Contributions which were made on behalf of such Participant under the 401(k) Plan for each calendar quarter.

(b) If the Participant makes the maximum allowable elective deferrals (within the meaning of section 402(g) of the Internal Revenue Code of 1986, as amended (the "Code")) under the 401(k) Plan, the excess, if any, of (i) over (ii) where:

(i) equals the Employer Matching Contributions (as defined in the 401(k) Plan) to which such Participant would have been entitled under the 401(k) Plan for each calendar quarter if such Participant had not elected to defer compensation under this Plan and assuming none of the Limitations were imposed; and

(ii) equals the Employer Matching Contributions which were made on behalf of such Participant under the 401(k) Plan for each calendar quarter.

For purposes of the Plan, the term 'Limitations' means the benefit limitations imposed on the 401(k) Plan by sections 401(a)(17), 401(k)(3), 401(m)(2), 402(g) and 415 of the Code."

3. This First Amendment shall revoke, supersede, and entirely replace the First Amendment adopted by the Board of Directors on March 25, 1997.

4. As amended hereby, the Plan is specifically ratified and reaffirmed.

EXECUTED this 18th day of March, 1998.

DIAMOND OFFSHORE DRILLING, INC.

By: /s/ RICHARD L. LIONBERGER

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Name: Richard L. Lionberger

Title: Vice President

EXHIBIT 11.1

DIAMOND OFFSHORE DRILLING, INC.
STATEMENT RE COMPUTATION OF PER SHARE EARNINGS
(IN THOUSANDS, EXCEPT PER SHARE DATA)

| | FOR THE YEAR ENDED DECEMBER 31, 1997 | | | FOR THE YEAR ENDED DECEMBER 31, 1996 | | |
|---|---|---|---|---|---|---|
| | INCOME (NUMERATOR) | WEIGHTED AVERAGE SHARES(1) (DENOMINATOR) | PER SHARE AMOUNT | INCOME (NUMERATOR) | WEIGHTED AVERAGE SHARES(1) (DENOMINATOR) | PER SHARE AMOUNT |
| BASIC EPS | | | | | | |
| Net income............... | $278,605 | 138,560 | $2.01 | $146,388 | 124,462 | $1.18 |
| EFFECT OF DILUTIVE POTENTIAL SHARES(2) | | | | | | |
| Convertible notes issued 2/4/97(3).............. | 6,583 | 8,929 | | -- | -- | |
| DILUTED EPS | | | | | | |
| Net income + assumed conversions............ | $285,188 | 147,489 | $1.93 | $146,388 | 124,462 | $1.18 |

- ---------------

(1) The weighted average shares reflect the retroactive effect of the two-for-one stock split in the form of a stock dividend to stockholders of record on July 24, 1997.

(2) Because the Company does not maintain an ongoing plan to grant stock options, the options to purchase up to 1.0 million shares of common stock assumed in the merger with Arethusa (Off-Shore) Limited (the "Arethusa Options") have not been included as dilutive potential shares. The effect on the computation of per share earnings, had the Arethusa Options been included, was not material. At December 31, 1997 and 1996, there were Arethusa Options outstanding for the purchase of approximately 0.1 million and 0.2 million shares of common stock, respectively.

(3) On February 4, 1997, the Company issued $400.0 million of 3.75 percent convertible subordinated 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 year ended December 31, 1997 was increased to include the weighted average number of shares issuable assuming full conversion of the notes on February 4, 1997 and net income was adjusted to eliminate the after-tax effect of interest expense on these notes.

EXHIBIT 12.1

DIAMOND OFFSHORE DRILLING, INC.
STATEMENT RE COMPUTATION OF RATIOS
(THOUSANDS OF DOLLARS)

RATIO OF EARNINGS TO FIXED CHARGES:

| | YEAR ENDED DECEMBER 31, | | | | |
|---|---|---|---|---|---|
| | 1997 | 1996 | 1995 | 1994 | 1993 |
| COMPUTATION OF EARNINGS: | | | | | |
| Pretax income from continuing operations | $430,061 | $212,705 | $(13,803) | $(46,425) | $(21,670) |
| Less: Interest capitalized during the period and actual preferred dividend requirements of majority-owned subsidiaries and 50%-owned persons included in fixed charges but not deducted from pretax income from above | (4,382) | (3,973) | -- | -- | -- |
| Add: Previously capitalized interest amortized during the period | 192 | -- | -- | -- | -- |
| Total earnings, before fixed charge addition | 425,871 | 208,732 | (13,803) | (46,425) | (21,670) |
| COMPUTATION OF FIXED CHARGES: | | | | | |
| Interest, including interest capitalized | 15,241 | 6,831 | 27,052 | 31,346 | 25,906 |
| Total fixed charges | 15,241 | 6,831 | 27,052 | 31,346 | 25,906 |
| TOTAL EARNINGS AND FIXED CHARGES | 441,112 | 215,563 | 13,249 | (15,079) | 4,236 |
| RATIO OF EARNINGS TO FIXED CHARGES(1) | 28.94 | 31.56 | -- | -- | -- |

- ---------------

(1) The deficiency in the Company's earnings available for fixed charges for the years ended December 31, 1995, 1994, and 1993 was approximately $13.8 million, $46.4 million, and $21.7 million, respectively.

EXHIBIT 21.1

# SUBSIDIARIES

| SUBSIDIARY | JURISDICTION OF INCORPORATION |
|---|---|
| Diamond Offshore Company | Delaware |
| Diamond Offshore (USA) Inc. | Delaware |
| Diamond Offshore International Corporation | Delaware |
| Diamond Offshore Enterprises, Inc. | Delaware |
| Diamond Offshore Limited | England |
| Diamond Offshore Drilling (UK) Limited | England |
| Diamond Offshore Development Company | Delaware |
| Diamond Offshore Finance Company | Delaware |
| Diamond Offshore Management Company | Delaware |
| Diamond Offshore Team Solutions, Inc. | Delaware |
| Diamond Offshore General Company | Delaware |
| Diamond Offshore Guardian Company | Delaware |
| Diamond Offshore Alaska, Inc. | Delaware |
| Diamond Offshore Atlantic, Inc. | Delaware |
| Diamond Offshore (Mexico) Company | Delaware |
| Diamond Offshore Drilling Services, Inc. | Delaware |
| Cumberland Maritime Corporation | Delaware |
| Brasdril-Sociedade De Perfuracoes Ltda. | Brazil |
| Ensenada Internacional, S.A. | Panama |
| Diamond Offshore Exploration (Bermuda) Limited | Delaware |
| Arethusa Off-Shore Company | Delaware |
| Concord Drilling Limited | Delaware |
| Lexington Drilling Limited | Delaware |
| Saratoga Drilling Limited | Delaware |
| Yorktown Drilling Limited | Delaware |
| Scotian Drilling Limited | Delaware |
| Heritage Drilling Limited (d/b/a Diamond Offshore Heritage Drilling Limited in Texas) | Delaware |
| Sovereign Drilling Limited | Delaware |
| Neptune Drilling Limited | Delaware |
| Whittington Drilling Limited | Delaware |
| Yatzy Drilling Limited | Delaware |
| Winner Drilling Limited | Delaware |
| Arethusa Finance (USA) Inc. | Delaware |

EXHIBIT 23.1

INDEPENDENT AUDITORS' CONSENT

We consent to the incorporation by reference in Registration Statement No. 333-19987 of Diamond Offshore Drilling, Inc. (the "Company") on Form S-3 of our report dated January 22, 1998, appearing in this Annual Report on Form 10-K of the Company for the year ended December 31, 1997.

DELOITTE & TOUCHE LLP

Houston, Texas
March 20, 1998

EXHIBIT 24.1

# POWER OF ATTORNEY

Robert E. Rose hereby designates and appoints Richard L. Lionberger and Lawrence R. Dickerson and each of them (with full power to each of them to act alone) as his attorney-in-fact, with full power of substitution and resubstitution (the "Attorneys-in-Fact"), for him and in his name, place and stead, in any and all capacities, to execute the Annual Report on Form 10-K (the "Annual Report") to be filed by Diamond Offshore Drilling, Inc. with the Securities and Exchange Commission and any amendment(s) to the Annual Report, which amendment(s) may make such changes in the Annual Report as either Attorney-in-Fact deems appropriate, and to file the Annual Report and each such amendment to the Annual Report together with all exhibits thereto and any and all documents in connection therewith.

| SIGNATURE | TITLE | DATE |
| --- | --- | --- |
| /s/ ROBERT E. ROSE<br>Robert E. Rose | President, Chief Executive Officer and Director (principal executive officer) | February 23, 1998 |

EXHIBIT 24.1

POWER OF ATTORNEY

Lawrence R. Dickerson hereby designates and appoints Richard L. Lionberger and Gary T. Krenek and each of them (with full power to each of them to act alone) as his attorney-in-fact, with full power of substitution and resubstitution (the "Attorneys-in-Fact"), for him and in his name, place and stead, in any and all capacities, to execute the Annual Report on Form 10-K (the "Annual Report") to be filed by Diamond Offshore Drilling, Inc. with the Securities and Exchange Commission and any amendment(s) to the Annual Report, which amendment(s) may make such changes in the Annual Report as either Attorney-in-Fact deems appropriate, and to file the Annual Report and each such amendment to the Annual Report together with all exhibits thereto and any and all documents in connection therewith.

| SIGNATURE | TITLE | DATE |
|---|---|---|
| /s/ LAWRENCE R. DICKERSON<br>Lawrence R. Dickerson | Senior Vice President and Chief Financial Officer (principal financial officer) | February 23, 1998 |

EXHIBIT 24.1

POWER OF ATTORNEY

Gary T. Krenek hereby designates and appoints Richard L. Lionberger and Lawrence R. Dickerson and each of them (with full power to each of them to act alone) as his attorney-in-fact, with full power of substitution and resubstitution (the "Attorneys-in-Fact"), for him and in his name, place and stead, in any and all capacities, to execute the Annual Report on Form 10-K (the "Annual Report") to be filed by Diamond Offshore Drilling, Inc. with the Securities and Exchange Commission and any amendment(s) to the Annual Report, which amendment(s) may make such changes in the Annual Report as either Attorney-in-Fact deems appropriate, and to file the Annual Report and each such amendment to the Annual Report together with all exhibits thereto and any and all documents in connection therewith.

| SIGNATURE | TITLE | DATE |
| --- | --- | --- |
| /s/ GARY T. KRENEK<br>Gary T. Krenek | Controller (principal accounting officer) | February 23, 1998 |

EXHIBIT 24.1

POWER OF ATTORNEY

James S. Tisch hereby designates and appoints Richard L. Lionberger and Lawrence R. Dickerson and each of them (with full power to each of them to act alone) as his attorney-in-fact, with full power of substitution and resubstitution (the "Attorneys-in-Fact"), for him and in his name, place and stead, in any and all capacities, to execute the Annual Report on Form 10-K (the "Annual Report") to be filed by Diamond Offshore Drilling, Inc. with the Securities and Exchange Commission and any amendment(s) to the Annual Report, which amendment(s) may make such changes in the Annual Report as either Attorney-in-Fact deems appropriate, and to file the Annual Report and each such amendment to the Annual Report together with all exhibits thereto and any and all documents in connection therewith.

| SIGNATURE | TITLE | DATE |
|---|---|---|
| /s/ JAMES S. TISCH<br>James S. Tisch | Chairman of the Board | February 23, 1998 |

EXHIBIT 24.1

POWER OF ATTORNEY

Herbert C. Hofmann hereby designates and appoints Richard L. Lionberger and Lawrence R. Dickerson and each of them (with full power to each of them to act alone) as his attorney-in-fact, with full power of substitution and resubstitution (the "Attorneys-in-Fact"), for him and in his name, place and stead, in any and all capacities, to execute the Annual Report on Form 10-K (the "Annual Report") to be filed by Diamond Offshore Drilling, Inc. with the Securities and Exchange Commission and any amendment(s) to the Annual Report, which amendment(s) may make such changes in the Annual Report as either Attorney-in-Fact deems appropriate, and to file the Annual Report and each such amendment to the Annual Report together with all exhibits thereto and any and all documents in connection therewith.

| SIGNATURE | TITLE | DATE |
| --- | --- | --- |
| /s/ HERBERT C. HOFMANN<br>Herbert C. Hofmann | Director | February 23, 1998 |

EXHIBIT 24.1

# POWER OF ATTORNEY

Arthur L. Rebell hereby designates and appoints Richard L. Lionberger and Lawrence R. Dickerson and each of them (with full power to each of them to act alone) as his attorney-in-fact, with full power of substitution and resubstitution (the "Attorneys-in-Fact"), for him and in his name, place and stead, in any and all capacities, to execute the Annual Report on Form 10-K (the "Annual Report") to be filed by Diamond Offshore Drilling, Inc. with the Securities and Exchange Commission and any amendment(s) to the Annual Report, which amendment(s) may make such changes in the Annual Report as either Attorney-in-Fact deems appropriate, and to file the Annual Report and each such amendment to the Annual Report together with all exhibits thereto and any and all documents in connection therewith.

| SIGNATURE | TITLE | DATE |
| --- | --- | --- |
| /s/ ARTHUR L. REBELL<br>Arthur L. Rebell | Director | February 23, 1998 |

EXHIBIT 24.1

POWER OF ATTORNEY

Michael H. Steinhardt hereby designates and appoints Richard L. Lionberger and Lawrence R. Dickerson and each of them (with full power to each of them to act alone) as his attorney-in-fact, with full power of substitution and resubstitution (the "Attorneys-in-Fact"), for him and in his name, place and stead, in any and all capacities, to execute the Annual Report on Form 10-K (the "Annual Report") to be filed by Diamond Offshore Drilling, Inc. with the Securities and Exchange Commission and any amendment(s) to the Annual Report, which amendment(s) may make such changes in the Annual Report as either Attorney-in-Fact deems appropriate, and to file the Annual Report and each such amendment to the Annual Report together with all exhibits thereto and any and all documents in connection therewith.

| SIGNATURE | TITLE | DATE |
|---|---|---|
| /s/ MICHAEL H. STEINHARDT<br>Michael H. Steinhardt | Director | February 23, 1998 |

EXHIBIT 24.1

# POWER OF ATTORNEY

Raymond S. Troubh hereby designates and appoints Richard L. Lionberger and Lawrence R. Dickerson and each of them (with full power to each of them to act alone) as his attorney-in-fact, with full power of substitution and resubstitution (the "Attorneys-in-Fact"), for him and in his name, place and stead, in any and all capacities, to execute the Annual Report on Form 10-K (the "Annual Report") to be filed by Diamond Offshore Drilling, Inc. with the Securities and Exchange Commission and any amendment(s) to the Annual Report, which amendment(s) may make such changes in the Annual Report as either Attorney-in-Fact deems appropriate, and to file the Annual Report and each such amendment to the Annual Report together with all exhibits thereto and any and all documents in connection therewith.

| SIGNATURE | TITLE | DATE |
|---|---|---|
| /s/ RAYMOND S. TROUBH<br>Raymond S. Troubh | Director | February 23, 1998 |

YEAR
DEC-31-1997
DEC-31-1997
102,958
363,137
205,589
0
33,714
718,775
1,821,906
370,165
2,298,561
131,145
400,000
0
0
1,393
1,534,134
2,298,561
0
956,093
0
406,343
129,877
0
10,270
430,061
151,456
278,605
0
0
0
278,605
2.01
1.93

Includes contract drilling expenses only.
Includes other operating expenses.
Per share amounts reflect the retroactive effect of the two-for-one stock split in the form of a stock dividend to stockholders of record on July 24, 1997.