

ADNOC Drilling PJSC (ADNOC DRI UH)

Target Price: AED 4.9
Upside: 24.8%

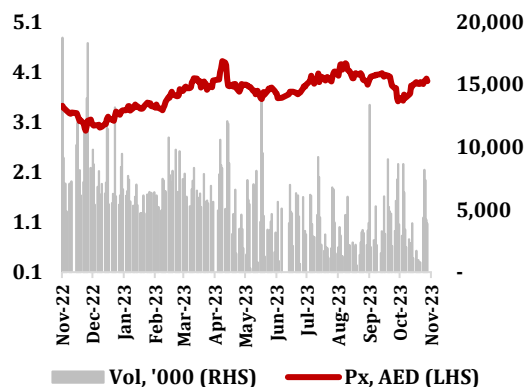
Recommendation	Buy
Bloomberg Ticker	ADNOC DRI UH
Current Market Price (AED)	3.89
52wk High / Low (AED)	4.330/2.900
12m Average Vol. (000)	5,398.4
Mkt. Cap. (USD/AED mn)	16,948/62,240
Shares Outstanding (mn)	16,000.00
Free Float (%)	11%
3m Avg Daily Turnover (AED'000)	13,606.8
6m Avg Daily Turnover (AED'000)	14,611.9
P/E'23e (x)	17.1 x
EV/EBITDA'23e (x)	12.6 x
Dividend Yield '23e (%)	4.1%

Price Performance:

1 month (%)	11.5%
3 month (%)	-4.7%
12 month (%)	14.7%

Source: Bloomberg, values as of 16 November 2023

Price-Volume Performance



Source: Bloomberg

- **Operational visibility based on long-term contracts with parent company, ADNOC, the flagship company of Abu Dhabi.**
- **A commitment from parent company which ensures ADNOC Drilling's IRR between 11-12% for onshore, 12-13% for Offshore.**
- **Oil Field Services segment to drive sustained growth.**

We review our coverage of ADNOC Drilling PJSC (ADNOC DRI: Abu Dhabi) post 3Q23 guidance update. We maintain **Buy** rating with **target price of AED 4.9** implying an upside potential of 24.8% from current levels. ADNOC Drilling had impressive Q3'23 results. The stock is currently trading at a 2023e P/E of 17.1x, compared to historical average 1y forward P/E of 17.5x.

FY2023 guidance update

Revenue is guided to come in at the lower end of guidance range for 2023. EBITDA margin guidance is now updated to a range of 47% - 49% (vs. prior 45% - 47%) for FY23e due to better cost management. Net Income is expected between 28%-31% (vs. 29% - 32%). Capex for 2023e is guided to be at the lower end of USD 1.3-1.7bn guidance range due to favorable rates for additional rig acquisition. Additionally, the company will be subject to a 9% corporate tax starting January 1, 2024; however, this is not expected to impact the group's mid-term target. Medium-term guidance was reiterated. We include the updated guidance in our estimates.

Investment summary

- Firm commitments from parent company ADNOC, assures a stable IRR of 11-12% for onshore and 12-13% for offshore operations. This provides defensive characteristics unlike other upstream companies.
- Revenues are expected to expand as production capacity accelerates until 2027. Rig count is set to increase from 124 rigs to 142 by 2024.
- Strategic partnership with Baker Hughes equips ADNOC Drilling with specialized equipment and technologies, significantly boosting its competitive edge.
- Cash flow from operations are projected to grow from \$1,179mn in 2021 to \$2,093mn by 2027 (U Capital estimates), effectively supporting its planned capex and dividend policy.

Key indicators

Year	FY21	FY22	FY23e	FY24e	FY25e
Revenues	2,269	2,673	3,108	3,540	3,935
Gross profit	884	1,093	1,259	1,452	1,633
EBITDA	1,027	1,226	1,494	1,759	1,972
Operating profit	611	824	1,039	1,229	1,409
Net income	604	802	993	1,047	1,224
EPS	0.14	0.18	0.23	0.24	0.28
P/E	24.4x	16.1x	17.1x	16.2x	13.9x
EV/EBITDA	17.0x	11.6x	12.6x	10.7x	9.5x
Dividend yield	7.2%	3.9%	4.1%	4.3%	4.5%

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Investment Thesis

Company positioning:

- UAE is currently the world's eighth-largest oil producer, with ambitions to increase its daily production capacity from 4 million barrels per day (currently) to 5mn by 2027. ADNOC (parent company) owns all the reserves and ADNOC Drilling is the sole contractor that provides drilling services to the parent company.
- ADNOC Drilling increased its fleet from 52 rigs in 2014 to 124 in Q3'23. Its strategic partnership with Baker Hughes has bolstered the company's technological advancement, enhancing exploration and production efficiency.
- ADNOC Drilling's has substantial visibility in the drilling segment providing a clear revenue stream.

Competitive positioning

- ADNOC Drilling's operational stability and financial strength are significantly reinforced by its strategic synergies with ADNOC, its parent company. These synergies are marked by long-term contracts, fostering steady revenue, and reducing exposure to market fluctuations.
- ADNOC Drilling holds a unique position within the industry, due largely to the firm commitments from its parent company, ADNOC. ADNOC guarantees a stable IRR of 11-12% for onshore and 12-13% for offshore operations, providing ADNOC Drilling with an exceptional financial cushion. Further enhancing this stability is ADNOC's contractual obligation to pay 95% of the day rate to ADNOC Drilling, even during periods of rig inactivity. The day rate is a measure of the fees that drilling contractors charge oil and gas firms for each day of a drilling rig's operation, encompassing the costs of both services provided and equipment utilized during the drilling process. This arrangement provides a remarkable level of financial stability to ADNOC Drilling.
- Beyond finances, ADNOC's influence enhances ADNOC Drilling's technological prowess and talent pool.

Financial Analysis

- ADNOC Drilling exhibits unparalleled financial performance compared to industry peers. Its robust EBITDA margins significantly exceed industry averages, as a result of technological prowess leading to operational efficiency and strong cost management. This positions ADNOC Drilling advantageously within the industry.
- The company has a solid cash conversion ratio in FY'22 and is expected to reach 72.9% till FY'25e with Cash and Cash equivalents reaching USD 892mn compared to USD 326 mn in FY'22.
- The company aims to have a dividend growth of at least 5% p.a. over the next four years between FY'23-26e.

Valuation

Our DCF based valuation to capture the visibility of cash flows (80% weight) gives us an equity value per share of AED 4.80 and the relative stock market positioning (relative valuation P/E and EV/EBITDA, 10% weight each) gives as equity value per share of AED 5.9 and AED 3.9. The blended average target price is AED 4.9.

We reiterate 'Buy' on ADNOC Drilling with a target price of AED 4.90. At the current share price, this translates to an upside of 24.8%. Since our upgrade to Buy in June 2023, the stock has appreciated 7.6% compared with ADX performance of 2.4%.

Valuation

To value ADNOC Drilling PJSC, we employed two valuation methods: the Discounted Cash Flow (DCF, 80% weight) and Relative Valuation. In our DCF analysis, we use a WACC of 8.2%, a cost of equity of 9.7%, a risk-free rate of 3.5%, a beta of 0.82, and a risk premium of 7.5%. This yields a fair value of AED 4.8 per share.

For Relative Valuation we consider EV/EBITDA and P/E with a 10% weight each. We derive this multiple based on industry median values, resulting in an EV/EBITDA multiple of 12.11x and P/E multiple of 26.07x. We then apply this multiple to EBITDA of AED 5,481mn and EPS of AED 0.23 per share, yielding fair values of AED 3.9 and 5.9 per share respectively. Taking a weighted average of these valuations, we arrived at an overall fair value of **AED 4.9/share**.

Valuation

ADNOC Drilling

DCF (80% weight)

PV of Free Cash Flow (AED mn)

2023e	713
2024e	2,550
2025e	4,751
2026e	4,641
2027e	4,590
Terminal value	64,133
Total PV of Future Cashflows (Enterprise Value, AED mn)	81,379

Assumptions

Risk Free Rate (%)	3.5%
Adjusted Beta	0.82
Risk Premium (%)	7.5%
Cost of Equity (COE) (%)	9.7%
WACC (%)	8.2%
Equity value (AED mn)	77,425
Outstanding Shares (mn)	16,000.0
Target Price (AED)	4.8

P/E based Relative Valuation (10% weight)

Target P/E multiple for 2023e	26.07
EPS 2023e (AED)	0.23
Target Price (AED)	5.9

EV/EBITDA based Relative Valuation (10% weight)

Target EV/EBITDA multiple for 2023e	12.11
EBITDA 2023e (AED)	5481
Net Debt (AED)	3954
Target Price (AED)	3.9

Weighted Average Target Price (AED)

4.9

Current Market Price (AED)

3.9

Upside/(Downside), %

24.8%

Recommendation

Buy

Source: Company Financials, Bloomberg, U Capital Research

Sensitivity Analysis

Our TP for ADNOC Drilling (ADNOC DRI) is sensitive to valuation inputs such as Cost of Equity (CoE) (+/- 1%) and terminal growth rate (+/- 0.25%). Between them, the higher sensitivity is towards Cost of Equity. Our TP is also sensitive (although relatively much lower) to the No. of rigs and Rig rental daily rate (AED).

ADNOC

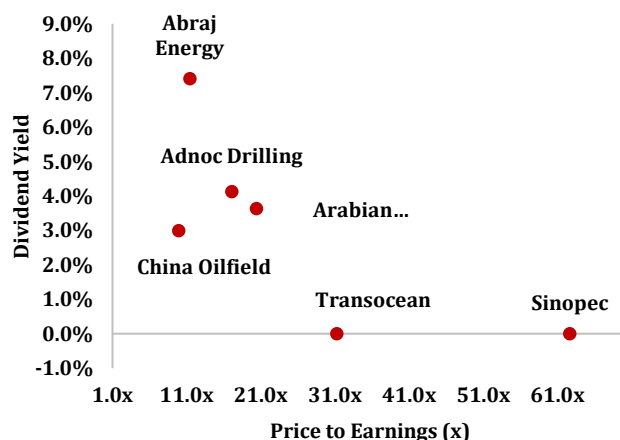
		Cost of Equity					Rig Rental Day rate (AED)				
		7.7%	8.7%	9.7%	10.7%	11.7%	770	1770	2770	3770	4770
Terminal Growth rate	0.50%	5.4	5.0	4.6	4.3	4.0	84	4.3	4.0	4.6	5.4
	0.75%	5.6	5.1	4.7	4.4	4.1	104	4.4	4.1	4.7	5.5
	1.00%	5.8	5.3	4.9	4.5	4.2	124	4.4	4.2	4.9	5.7
	1.25%	6.0	5.4	5.0	4.6	4.3	144	4.5	4.2	4.9	5.9
	1.50%	6.2	5.6	5.1	4.7	4.4	164	4.7	4.3	5.0	6.1

Peer Group Valuation

Name	Mkt Cap (AED mn)	Last Px	Px Change 1M, %	Px Change 3M, %	Px Change YTD, %	EV/EBITDA '23e, (x)	P/E'23e, (x)	ROE'23e, (%)	Div Yield' 23e, (%)	FCF Yield'23e (%)
Adnoc Drilling Co	62,240.0	3.89	11.5%	-4.7%	30.5%	12.6	17.1	32.8%	4.1%	0.9%
Transocean Ltd	19,315.2	6.50	-12.0%	-20.9%	42.5%	8.4	31.3	1.2%	0.0%	-5.1%
Sinopec Oilfield Services	14,276.6	1.88	-7.8%	-11.7%	-5.1%	6.7	62.7	6.4%	0.0%	-1.2%
Arabian Drilling Services	15,793.6	181.20	3.1%	-3.8%	60.9%	9.5	20.4	13.0%	3.6%	-3.1%
Abraj Energy Services	2,182.3	0.30	0.3%	1.4%	na	na	11.4	13.6%	7.4%	8.3%
China Oilfield Services	29,243.7	8.52	-7.6%	-7.7%	-10.2%	6.2	9.9	9.2%	3.0%	14.1%
Average						8.7	25.5	12.7%	3.0%	2.3%
Median						8.4	18.7	11.1%	3.3%	-0.1%

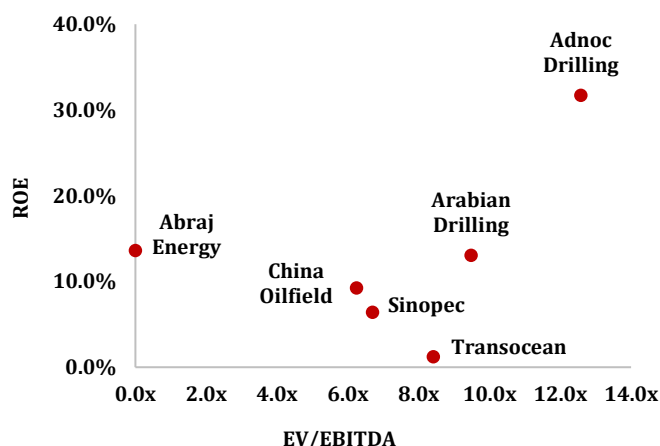
Source: Bloomberg, U Capital Research, na – not available, nm – not meaningful; *valued as of 16 November 2023 Market-cap weighted average multiples – EV/ EBITDA, and P/E

P/E & Dividend Yield



Source: Bloomberg, U Capital Research; As of 16 Nov 23

EV/EBITDA & ROE



Source: Bloomberg, U Capital Research; As of 16 Nov 23

Financial tables


(USD mn)	FY21	FY22	Prev. FY23e	FY23e	Prev. FY24e	FY24e	Prev. FY25e	FY25e
Income Statement								
Sales	2,269	2,673	3,155	3,108	3,592	3,540	3,429	3,935
COGS	-1,385	-1,581	-1,877	-1,849	-2,119	-2,089	-2,112	-2,302
Gross profit	884	1,093	1,278	1,259	1,473	1,452	1,317	1,633
SG&A expenses	-274	-268	-271	-220	-274	-222	-315	-225
Operating profit	611	824	1,007	1,039	1,199	1,229	1,002	1,409
Other income – net	10	6	6	7	6	7	9	7
Finance charges	-17	-29	-52	-52	-86	-85	-33	-71
Income before tax	604	802	961	993	1,119	1,047	977	1,224
Income tax	0	0	0	0	0	0	0	0
Net income for the period	604	802	961	993	1,119	1,047	977	1,224
Balance Sheet								
Cash and bank balances	453	326	566	715	100	177	786	892
Prepayments and other current assets	960	929	797	797	797	797	960	797
Trade and other receivables	102	115	136	134	155	152	188	170
Inventories	175	153	182	179	205	202	260	223
Property, plant and equipment	3,363	3,922	4,921	4,794	5,296	5,164	4,518	4,931
Right of use assets	34	34	39	39	42	42	49	46
Total assets	5,096	5,493	6,652	6,669	6,606	6,545	6,769	7,070
Trade and other payables	315	404	466	451	517	496	498	548
Long-term borrowings	1,500	0	1,000	1,000	2,000	2,000	2,250	2,000
Lease liabilities	19	21	22	22	24	24	21	27
Share capital	436	436	436	436	436	436	436	436
Statutory reserve	60	141	237	240	237	240	234	240
Retained earnings	2,299	2,355	2,548	2,577	2,934	2,892	2,809	3,346
Total stockholders' equity	2,795	2,931	3,220	3,253	3,607	3,567	3,479	4,022
Total liabilities & stockholders' equity	5,096	5,493	6,652	6,669	6,605	6,545	6,769	7,069
Cash Flow Statement								
Cash from operating activities	1,179	1,524	1,427	1,446	1,766	1,681	1,636	1,887
Cash from investing activities	-582	-936	-1,436	-1,306	-913	-899	-205	-334
Cash from financing activities	-1,097	-716	250	249	-1,319	-1,319	-823	-838
Net changes in cash	-500	-128	241	389	-466	-538	609	715
Cash at the end of the period	453	326	566	715	100	177	786	892
Key Ratios								
Current ratio	2.5	0.6	0.7	0.8	1.6	1.7	2.6	2.5
Inventory turnover ratio	7.9	9.6	10.5	10.1	10.9	10.9	8.4	10.8
Debtors' turnover ratio	18.8	24.5	24.6	24.7	24.7	24.7	18.8	24.4
Creditors turnover ratio	3.8	4.4	4.4	4.3	4.3	4.4	4.4	4.4
Gross profit margin	39.0%	40.9%	40.5%	40.5%	41.0%	41.0%	38.4%	41.5%
Operating margin	26.9%	30.8%	31.9%	33.4%	33.4%	34.7%	29.2%	35.8%
Net profit margin	26.6%	30.0%	30.4%	32.0%	31.2%	29.6%	28.5%	31.1%
EBITDA margin	45.3%	45.9%	47.1%	48.1%	48.3%	49.7%	47.0%	50.1%
Average return on equity	20.0%	28.0%	31.1%	31.7%	32.8%	30.7%	28.9%	32.3%
Average return on assets	11.6%	15.6%	17.4%	17.6%	18.1%	18.6%	15.1%	20.7%
Debt/Equity (x)	0.6x	0.5x	0.8x	0.8x	0.6x	0.6x	0.7x	0.5x
Interest coverage ratio (x)	36.0x	28.8x	19.3x	19.9x	13.9x	14.4x	29.9x	19.9x
P/E	24.4x	16.1x	17.4x	17.1x	14.9x	16.2x	17.1x	13.9x
EV/EBITDA	17.0x	11.6x	12.6x	12.6x	10.8x	10.7x	11.0x	9.5x
EV/Sales	6.3x	5.3x	5.9x	6.0x	5.2x	5.3x	5.2x	4.8x
EPS (AED)	0.14	0.18	0.22	0.23	0.26	0.24	0.22	0.28
Dividend payout ratio	174.4%	83.1%	72.8%	70.5%	65.6%	70.1%	80.8%	63.0%
Dividend yield	7.2%	3.9%	4.2%	4.1%	4.4%	4.3%	4.7%	4.5%
Net debt (USD 'million)	1,086	1,214	1,976	1,828	1,947	1,870	1,506	1,159
Net debt/ EBITDA	1.1x	1.0x	1.3x	1.2x	1.1x	1.1x	0.9x	0.6x
ROCE	13.8%	18.0%	17.1%	17.5%	20.7%	21.3%	16.9%	22.6%

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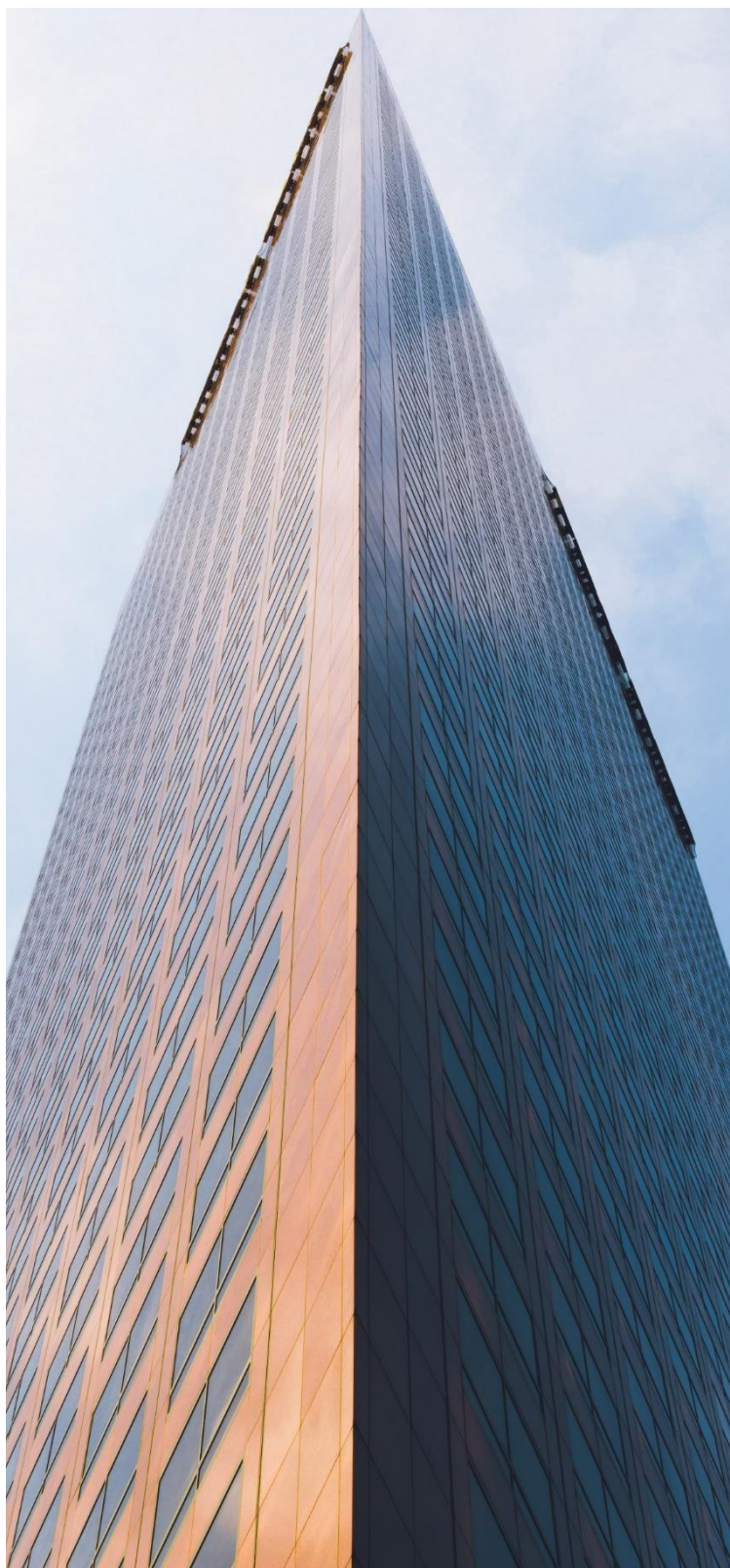
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Recommendation

BUY	Greater than 20%
ACCUMULATE	Between +10% and +20%
HOLD	Between +10% and -10%
REDUCE	Between -10% and -20%
SELL	Lower than -20%

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