

ADNOC Drilling PJSC (ADNOC DRI)

Target Price: AED 4.9
Upside: 20.9%

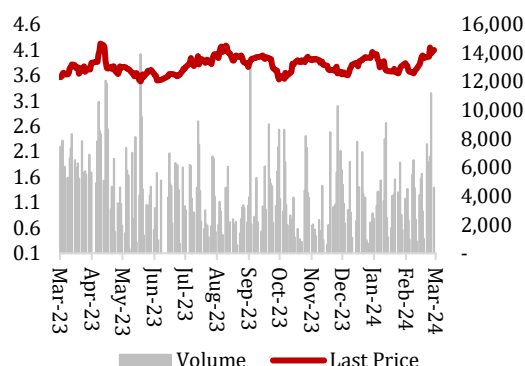
Recommendation	Buy
Bloomberg Ticker	ADNOC DRI UH
Current Market Price (AED)	4.07
52wk High / Low (AED)	4.33/3.45
12m Average Vol. (000)	3,548.9
Mkt. Cap. (USD/AED mn)	17,731.9/65,120
Shares Outstanding (mn)	16,000
Free Float (%)	11%
3m Avg Daily Turnover (AED'000)	15,200.0
6m Avg Daily Turnover (AED'000)	14,400.0
P/E'24e (x)	16.3 x
EV/EBITDA'24e (x)	11.1 x
Dividend Yield '24e (%)	4.1%

Price Performance:

1 month (%)	6.8%
3 month (%)	13.4%
12 month (%)	15.1%

Source: Bloomberg, values as of 18 March 2024

Price-Volume Performance



Source: Bloomberg

Neetika Gupta

Head of Research

neetika@u-capital.net

Tel: +968 24 94 90 36

- **ADNOC Drilling achieved a robust YoY revenue growth of 14% in FY23 driven by addition of 14 new drilling units in 2023**
- **A commitment from parent company which ensures ADNOC Drilling's IRR between 11-12% for onshore, 12-13% for Offshore**
- **Oil Field Services segment is expected to witness robust growth in coming years**

We review our coverage of ADNOC Drilling PJSC (ADNOC DRI: Abu Dhabi) post FY23 financial result and maintain our **Buy** rating on the stock with **target price of AED 4.9/share** implying an upside potential of 20.9% from current levels. ADNOC drilling had impressive FY23 results and has announced its FY24 and medium-term guidance. Currently, the stock is trading at a 2024e P/E of 16.3x, compared to the historical average 1-year forward P/E of 16.8x.

FY24 guidance update:

ADNOC Drilling anticipates an increase in revenue for FY24, projected to range between USD 3.6-3.8bn, with notable growth anticipated in the Offshore Jack-up and Oilfield Services segment. The EBITDA margin is forecasted to sustain its upward trajectory, with expectations set between 48-50% (FY23: 49%). However, the net income margin is anticipated to experience a slight decrease, primarily due to a positive one-off in D&A during 4Q23, resulting in higher margins in FY23 (34%). The company foresees the net income margin to range between 30-33% in FY24. Despite this, capital spending is expected to remain steady with a guidance of USD 750-950mn for FY24, while aiming for a leverage target of <2.0x.

Investment Summary

- Backed by solid performance in FY23 revenues are expected to expand as production capacity accelerates until 2027 with rig count set to increase to 142 by 2024 and is expected to increase going ahead till 2027
- ADNOC Drilling formed a strategic partnership with Alpha Dhabi providing opportunity for ADNOC's upstream operations and access to wider Middle East markets
- Cash flow from operations are projected to grow from \$1,355mn in 2021 to \$2,209mn by 2027 (U Capital estimates), effectively supporting its planned capex and dividend policy.

Key indicators

Year	FY22	FY23	FY24e	FY25e	FY26e
Revenues	2,673	3,057	3,687	4,192	4,520
Gross profit	1,093	1,208	1,465	1,666	1,796
EBITDA	1,226	1,470	1,756	1,989	2,151
Operating profit	824	1,082	1,261	1,451	1,571
Net income	802	1,033	1,088	1,246	1,360
EPS	0.18	0.24	0.25	0.29	0.31
P/E	16.1x	17.2x	16.3x	14.2x	13.0x
EV/EBITDA	11.6x	13.3x	11.1x	9.8x	9.1x
Dividend yield	3.8%	3.9%	4.1%	4.3%	4.6%

Source: Company Reports, U-Capital Research *P/E, EV/EBITDA and EV/Sales from 2024 onwards calculated on current price

ADNOC Drilling on track to meet FY24 guidance

We have adjusted our estimates based on the FY24 guidance provided by the company's management. With the company's commitment to reaching 142 rigs by year-end and the potential addition of more rigs in the future. We anticipate ADNOC Drilling will meet its guidance driven by the addition of remaining 13 rigs by 2024-year end along with its fully four operational jack-ups which will start contributing to revenue from FY24 onwards. The company's ongoing and effective cost management initiatives have enabled it to achieve an industry-leading EBITDA margin of 49% and a net income margin of 34% in FY23. We anticipate that ADNOC Drilling's EBITDA margin will remain within a similar range as FY23 due to the company's efforts in cost management, although we expect minor setbacks on the net income side due to the implementation of a 9% corporate tax starting 2024.

FY24 Guidance with YoY growth:

USD millions	FY23 Actual	FY24 Guidance	U-Capital		FY 24 Guidance vs FY23 Actual		
			FY24 estimates	YoY Growth	Upper end	Mid Case	Lower end
Revenue	3,057	3,600-3,800	3,687	20.6%	24.3%	21.0%	17.8%
Onshore Revenue	1,495	1,600-1,700	1,642	9.8%	13.7%	10.4%	7.0%
Offshore Jack-up Revenue	800	1,000-1,100	1,069	33.7%	37.5%	31.3%	25.0%
Offshore Island Revenue	209	200-250	229	9.6%	19.6%	7.6%	-4.3%
Oilfield Services Revenue	553	700-800	747	35.0%	44.7%	35.6%	26.6%
EBITDA	1,483	1,700-1,900	1,756	18.4%	28.1%	21.4%	14.6%
EBITDA margin	49%	48% - 50%	48%				
Net Profit	1,033	1,050 - 1,200	1,088	5.4%	16.2%	8.9%	1.7%
Net Profit margin	34%	30% - 33%	30%				
CapEx	1,062	750-950	922	-13.2%	-10.6%	-20.0%	-29.4%
Leverage Target	1.2x	<2.0x	1.3x				

ADNOC Drilling and Alpha Dhabi Partner for \$1.5bn Investment in Oilfield and Energy Technology

ADNOC Drilling and Alpha Dhabi have formed a strategic partnership to invest \$1.5bn in technology-enabled companies within the oilfield and energy sectors. With ADNOC Drilling owning 51% and Alpha Dhabi 49%, the joint venture's first investment in Gordon Technologies highlights its commitment to cutting-edge solutions. This venture aims not only to enhance shareholder value and support the national economy but also to strategically integrate technology into ADNOC Drilling's operations, ensuring global competitiveness. With a focus on accretive investments and majority stakes in acquisitions, the venture is poised for innovation in the energy industry.

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 129 in FY23. Its strategic partnership with Baker Hughes has enhanced the company's technological advancement, enhancing exploration and production efficiency.

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.
- ADNOC Drilling has a solid cash conversion ratio in FY'23 with Cash and Cash equivalents reaching USD 354mn in FY23.
- ADNOC Drilling is also expected to have a dividend growth of at least 5% p.a. over the next four years between FY'23-26e.

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 6.2%, a cost of equity of 8.5%, a risk-free rate of 4.3%, a beta of 0.82, and a risk premium of 5.2%. This yields a fair value of AED 5.1 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 10.01x and P/E multiple of 19.6x. We then apply this multiple to EBITDA of AED 6,446mn and EPS of AED 0.25 per share, yielding fair values of AED 3.6 and 4.9 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	2,476
2024e	3,405
2025e	3,473
2026e	3,573
2027e	3,678
Terminal value	71,533
Total PV of Future Cashflows (Enterprise Value, AED mn)	88,138

Assumptions

Risk Free Rate (%)	4.3%
Adjusted Beta	0.82
Risk Premium (%)	5.2%
Cost of Equity (COE) (%)	8.5%
WACC (%)	6.2%
Equity value (AED mn)	81,432
Outstanding Shares (mn)	16,000.0
Target Price (AED)	5.1

P/E based Relative Valuation (10% weight)

Target P/E multiple for 2023e	19.60
EPS 2023e (AED)	0.25
Target Price (AED)	4.9

EV/EBITDA based Relative Valuation (10% weight)

Target EV/EBITDA multiple for 2023e	10.01
EBITDA 2023e (AED)	6,446
Net Debt (AED)	6,706
Target Price (AED)	3.6

Weighted Average Target Price (AED)

4.9

Current Market Price (AED)

4.1

Upside/(Downside), %

20.9%

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 Drilling

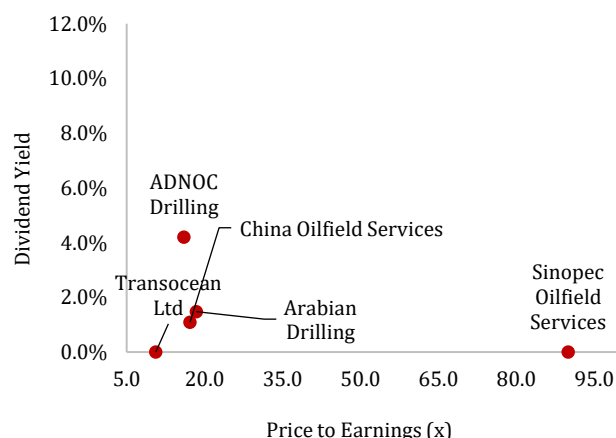
		Cost of Equity					Rig Rental Day rate (AED)				
		6.5%	7.5%	8.5%	9.5%	10.5%	770	1770	2770	3770	4770
Terminal Growth rate	0.50%	5.5	5.1	4.7	4.3	4.0	89	4.3	4.0	4.6	5.4
	0.75%	5.7	5.2	4.8	4.4	4.1	109	4.4	4.1	4.7	5.5
	1.00%	5.9	5.4	4.9	4.5	4.2	129	4.4	4.2	4.9	5.7
	1.25%	6.1	5.5	5.0	4.6	4.3	149	4.5	4.2	4.9	5.9
	1.50%	6.3	5.7	5.2	4.7	4.4	169	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 12M, %	EV/EBITDA' 24e, (x)	P/E'24e, (x)	Div Yield' 24e, (%)	ROE'24e	FCF Yield'24e (%)
ADNOC Drilling	65,120.0	4.1	7%	13%	15%	11.1	16.3	4.1%	32.0%	0.5%
Transocean Ltd	17,056.0	5.7	17%	-7%	-3%	6.9	10.6	NA	2.9%	-6.4%
Sinopec Oilfield Services	14,219.0	1.9	-1%	16%	16%	6.6	90.0	NA	3.4%	-1.2%
Arabian Drilling	15,846.0	181.8	2%	-4%	36%	8.8	18.4	1.5%	13.4%	-3.3%
China Oilfield services	30,378.0	15.7	7%	7%	0%	6.4	17.2	1.1%	9.3%	5.0%
Average						8.0	30.5	2.2%	12.2%	-1.1%
Median						6.9	17.2	1.5%	9.3%	-1.2%

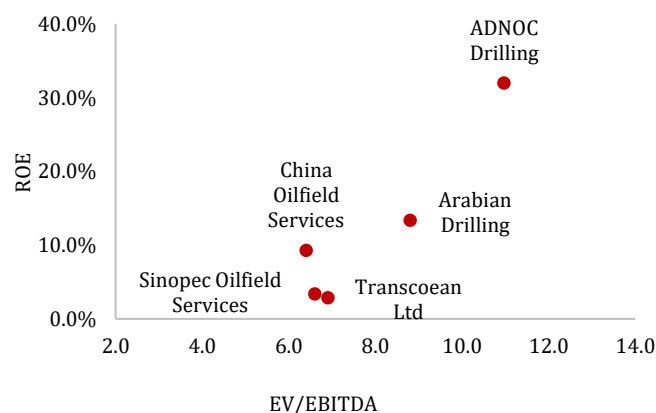
Source: Bloomberg, U Capital Research, na – not available, nm – not meaningful; *valued as of 18 March 2024 Market-cap weighted average multiples – EV/ EBITDA, and P/E

P/E & Dividend Yield



Source: Bloomberg, U Capital Research; As of 18 Mar 24

EV/EBITDA & ROE



Source: Bloomberg, U Capital Research; As of 18 Mar 24

Financial tables


(USD mn)	FY21	FY22	FY23	Prev. FY24e	FY24e	Prev. FY25e	FY25e	FY26e
Income Statement								
Sales	2,269	2,673	3,057	3,540	3,687	3,935	4,192	4,520
COGS	-1,385	-1,581	-1,849	-2,089	-2,222	-2,302	-2,526	-2,724
Gross profit	884	1,093	1,208	1,452	1,465	1,633	1,666	1,796
SG&A expenses	-274	-268	-126	-222	-204	-225	-215	-225
Operating profit	611	824	1,082	1,229	1,261	1,409	1,451	1,571
Other income – net	10	6	10	7	12	7	13	15
Finance charges	-17	-29	-59	-85	-77	-71	-95	-91
Income before tax	604	802	1,033	1,047	1,088	1,224	1,246	1,360
Income tax	0	0	0	0	0	0	0	0
Net income for the period	604	802	1,033	1,047	1,088	1,224	1,246	1,360
Balance Sheet								
Cash and bank balances	453	326	354	177	128	892	372	646
Prepayments and other current assets	960	929	987	797	987	797	987	987
Trade and other receivables	102	115	154	152	139	170	158	171
Inventories	175	153	206	202	228	223	260	280
Property, plant and equipment	3,363	3,922	4,848	5,164	5,277	4,931	5,606	5,957
Right of use assets	34	34	174	42	162	46	155	151
Total assets	5,096	5,493	6,740	6,545	6,938	7,070	7,555	8,209
Trade and other payables	315	404	849	496	422	548	483	519
Long-term borrowings	1,500	0	1,992	2,000	2,200	2,000	2,200	2,200
Lease liabilities	19	21	152	24	219	27	279	329
Share capital	436	436	436	436	436	436	436	436
Statutory reserve	60	141	218	240	141	240	141	141
Retained earnings	2,299	2,355	2,611	2,892	2,966	3,346	3,443	3,996
Total stockholders' equity	2,795	2,931	3,264	3,567	3,542	4,022	4,020	4,572
Total liabilities & stockholders' equity	5,096	5,493	6,740	6,545	6,938	7,069	7,555	8,209
Cash Flow Statement								
Cash from operating activities	1,179	1,524	1,355	1,681	1,235	1,887	1,895	2,040
Cash from investing activities	-582	-936	-1,049	-899	-930	-334	-856	-916
Cash from financing activities	-1,097	-716	-277	-1,319	-532	-838	-796	-850
Net changes in cash	-500	-128	29	-538	-226	715	244	274
Cash at the end of the period	453	326	354	177	128	892	372	646
Key Ratios								
Current ratio	2.5	0.6	1.5	1.7	1.9	2.5	2.0	2.2
Inventory turnover ratio	7.9	9.6	10.3	10.9	10.2	10.8	10.4	10.1
Debtors' turnover ratio	18.8	24.5	22.7	24.7	25.2	24.4	28.2	27.5
Creditors turnover ratio	3.8	4.4	3.0	4.4	3.5	4.4	5.6	5.4
Gross profit margin	39.0%	40.9%	39.5%	41.00%	39.7%	41.50%	39.7%	39.7%
Operating margin	26.9%	30.8%	35.4%	34.70%	34.2%	35.80%	34.6%	34.8%
Net profit margin	26.6%	30.0%	33.8%	29.60%	29.5%	31.10%	29.7%	30.1%
EBITDA margin	45.3%	45.9%	48.1%	49.70%	47.6%	50.10%	47.4%	47.6%
Average return on equity	20.0%	28.0%	32.9%	30.70%	32.0%	32.30%	33.0%	31.7%
Average return on assets	11.6%	15.6%	17.7%	18.60%	18.4%	20.70%	20.0%	19.9%
Debt/Equity (x)	0.6x	0.5x	0.7x	0.6x	0.7x	0.5x	0.6x	0.6x
Interest coverage ratio (x)	36.0x	28.8x	18.4x	14.4x	16.5x	19.9x	15.3x	17.3x
P/E	24.4x	16.1x	17.2x	16.2x	16.3x	13.9x	14.2x	13.0x
EV/EBITDA	17.0x	11.6x	13.3x	10.7x	11.1x	9.5x	9.8x	9.1x
EV/Sales	6.3x	5.3x	6.4x	5.3x	5.3x	4.8x	4.7x	4.3x
EPS (AED)	0.14	0.18	0.24	0.24	0.25	0.28	0.29	0.31
Dividend payout ratio	174.4%	83.1%	67.7%	70.10%	67.5%	63.00%	61.9%	59.5%
Dividend yield	7.2%	3.8%	3.9%	4.30%	4.1%	4.50%	4.3%	4.6%
Net debt (USD 'million)	1,086	1,214	1,827	1,870	2,344	1,159	2,174	1,962
Net debt/ EBITDA	1.1x	1.0x	1.2x	1.1x	1.3x	0.6x	1.1x	0.9x
ROCE	13.8%	18.0%	19.3%	21.30%	20.5%	22.60%	21.7%	21.6%

Investment Research

Ubhar-Research@u-capital.net

Head of Research


Neetika Gupta


 +968 2494 9036

 neetika@u-capital.net


Research Team


Ahlam Al-Harathi

 +968 2494 9024


 ahlam.harathi@u-capital.net

Said Ghawas

 +968 2494 9034

 said.ghawas@u-capital.net


Amira Al Alawi


 +968 2494 9112

 amira.alalawi@u-capital.net

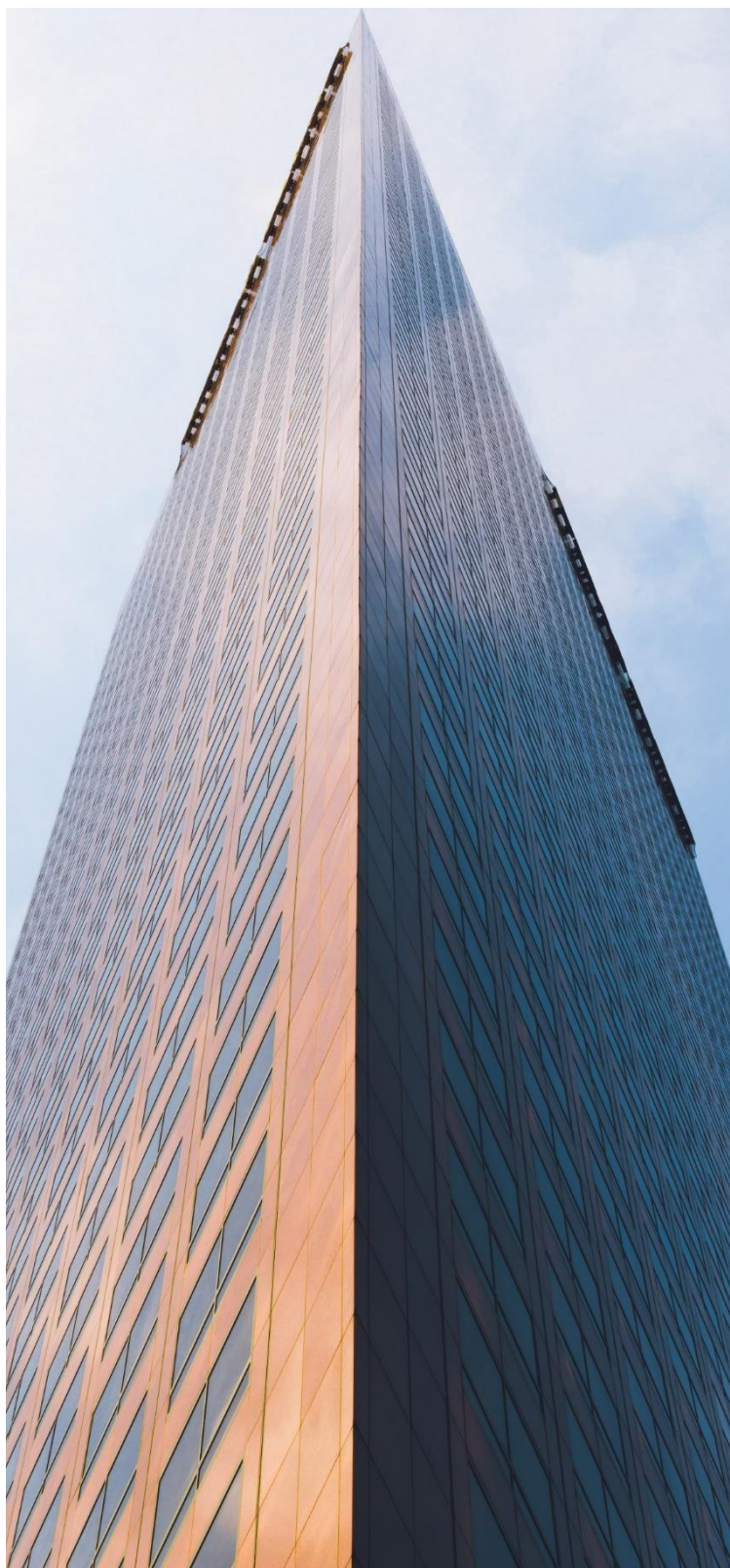
Head of Brokerage

Talal Al Balushi

 +968 2494 9051

 talal@u-capital.net

Visit us at: **www.u-capital.net**



Disclaimer

Recommendation

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

Disclaimer: This report has been prepared by Ubhar Capital (U Capital) Research and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell or solicitation of any offer to buy. While all reasonable care has been taken to ensure that the information contained therein is not untrue or misleading at the time of publication, we make no representation as to its accuracy or completeness and it should not be relied upon as such. The company accepts no responsibility whatsoever for any direct or indirect consequential loss arising from any use of this report or its contents. All opinions and estimates included in this document constitute U Capital Research team's judgment as at the date of production of this report and are subject to change without notice. This report may not be reproduced, distributed or published by any recipient for any other purpose.