

## ADNOC Drilling

Expansion in rigs fleet supported profitability

### 1Q23 Net Profit slightly higher than our estimate

ADNOC Drilling Co. PJSC (ADNOC DRILL/the Company) net profit grew 25.4% YOY to USD 219 Mn in 1Q23, slightly higher than our estimate of USD 211 Mn. The increase in net profit was primarily attributable to a substantial growth in revenue across all the segments owing to the addition of new rigs entering the operational fleet as well as an increase in EBITDA partially offset by a rise in operating expenses and increase in finance charges.

### P&L Highlights

ADNOC Drilling revenue grew significantly 19.1% YOY to USD 716 Mn in 1Q23 due to strong growth in the Offshore Jack Up and Oil-field segment. Onshore Segment revenue grew 11.2% YOY to USD 355 Mn in 1Q23 due to strong growth in the drilling activity and addition of eight new rigs entering the operational fleet in 2H22. Offshore Jack-up recorded strong 27.5% YOY growth to USD 184 Mn in 1Q23 driven by increased activity from five new additional rigs put in operation. Revenue from the Offshore Island Segment grew marginally 2.8% YOY to USD 51 Mn in 1Q23 owing to the mobilization revenue from a reactivated island rig. Furthermore, the OFS segment witnessed 43.0% YOY growth in revenue to USD 126 Mn in 1Q23 mainly due to the increased volumes across the portfolio. The number of IDS rigs also grew from 36 rigs in 1Q22 to 40 rigs in 1Q23. Company's direct cost grew 15.6% YOY to USD 420 Mn in 1Q23. Resultantly, gross profit grew 24.3% YOY to USD 300 Mn in 1Q23 with an increase in gross profit margin from 40.2% in 1Q22 to 41.9% in 1Q23. ADNOC DRI's G&A expenses grew 10.5% YOY to USD 71 Mn in 1Q23 mainly due to an increase in activity levels along with the impact of inflation on cost of materials equipment and other cost. Thus, EBITDA grew 19.1% YOY to USD 333 Mn in 1Q23. Onshore segment's EBITDA grew 13.0% YOY to USD 173 Mn with a margin of 48.8% in 1Q23 whereas the Offshore Jackup segment's EBITDA grew 24.0% YOY to USD 105 Mn with a margin of 57.0% owing to an increase in drilling activity. Similarly, offshore island and OFS segment EBITDA margins stood at 62.0% and 18.6% in 1Q23 with an EBITDA of USD 32 Mn and USD 23 Mn respectively. Other income rose from USD 1.2 Mn in 1Q22 to USD 1.3 Mn in 1Q23. While, Finance costs increased significantly from USD 4.2 Mn in 1Q22 to USD 12.0 Mn in 1Q23 due to higher benchmark rates.

### Balance sheet highlights

ADNOC DRI's working capital rose 55.0% to USD 442 Mn in 1Q23. The rise in working capital was mainly attributed to an increase in activity and rise in inventories and related party balances. The company incurred a capex of USD 76 Mn in 1Q23 as compared to USD 78 Mn in 1Q22. Furthermore, the Company plans to incur a capex of USD 1.3- 1.8 Bn in 2023. Free cash flow declined 53.0% YOY to USD 153 Mn mainly due to an increase in working capital activity coupled with rise in activity level. In addition, the Company maintained strong cash and cash equivalents worth USD 463 Mn in 1Q23. Gross debt remained stable at USD 1.5 Bn in 1Q23. While Net debt/EBITDA declined marginally from 3.4x in 4Q22 to 3.2x in 1Q23.

**Rating : ACCUMULATE**

### First Look Note – 1Q23

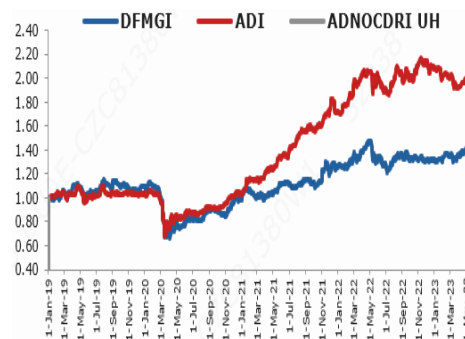
**Sector: Oil & Gas**

#### Recommendation

Current Price (25-May-23)	3.78
Target Price (AED)	4.30
Upside/Downside (%)	+14%

#### Stock Information

Market Cap (mm)	60,480.00
Shares Outstanding (mm)	16,000.0
52 Week High	4.33
52 Week Low	2.90
3M Avg. daily value (AED)	23,506,920



#### Financial Ratios

Dividend Yield (12m)	4.14
Dividend Pay-out (%)	0.00
Price-Earnings Ratio (x)	19.35
Price-to-Book Ratio (x)	5.23
Book Value (AED)	0.20
Return-on Equity (%)	27.65
Earning Per Share (AED)	0.05
Adj. Beta	0.818

#### Stock Performance

5 Days	-1.05%
1 Months	-7.13%
3 Months	12.84%
6 Months	14.55%
1 Year	24.34%
Month to Date (MTD)	-11.89%
Quarter to Date (QTD)	-4.30%
Year to Date (YTD)	26.85%

### Target price and rating

We revise our rating from BUY to ACCUMULATE on ADNOC Drilling with an unchanged target price of AED 4.30. The stock price of the Company rose 13.7% since our last rating (1<sup>st</sup> March 2023). ADNOC DRIL delivered a solid performance owing to the strong 19.1% YOY rise in revenue and EBITDA. The growth in revenue was mainly supported by the addition of new rigs which come into operational fleet in 2H22. The Company also plans to accelerate its strategy for achieving the target of five million barrels of oil per day and gas self-sufficiency in the UAE by 2027 for ADNOC Upstream. As a result, its aims to increase the rigs count to 142 by 2024. The total owned rigs count of the Company reached to 115 in 1Q23 in line with its target. This will provide a boost to near-term earnings. Furthermore, the robust increase in the offshore segment was aided by the acquisition of five new rigs, and the Company further intends to integrate nine jack-ups over the next two years. The OFS segment performed Integrated Drilling Services on 40 rigs whereas the drilling efficiency improved 16.1% YOY in 1Q23. It also added new service in its OFS segment such as Mud logging and Coring, TRS, which will benefit to increase its market share growth going forward. Average drilling days increased for onshore drilling from 37 days in 1Q22 to 41 days in 1Q23 while offshore average drilling days declined from 81 days to 67 days in 1Q23. Recently, ADNOC DRIL announced the purchase of ten newbuild hybrid power and drilling rigs that are expected to deliver high-capacity batteries to improve power delivery which will fulfil ADNOC's expedited production capacity targets and sustainability plans. Furthermore, ADNOC DRIL expects its revenue to grow by USD 3.0-3.2 Bn and EBITDA by USD 1.4-1.5 Bn with an industry leading EBITDA margin of 45-47% in 2023 owing to an expansion in rig fleet and service offering. The company also remain committed to its dividend policy to grow dividend per share by 5.0% in the coming four years. It also approved a final dividend for 2H22 of USD 341 Mn in April 2023 bringing its total dividend to USD 683 Mn in 2022. Thus, considering the abovementioned factors, we assign an ACCUMULATE rating on the stock.

### Adnoc Drilling Relative Valuation

(at CMP)	2021	2022	2023F
P/E	27.6	20.8	17.7
P/B	6.0	5.7	5.3
EV/EBITDA	16.9	14.5	12.2
Dividend Yield	4.1%	4.1%	4.3%

FABS estimate & Co Data

### Adnoc Drilling - P&L

(USD mn)	1Q22	4Q22	1Q23	1Q23F	VAR	YOY Ch	QOQ Ch	2022	2023F	Change
Revenue	601	733	716	740	-3.3%	19.1%	-2.3%	2,673	3,174	18.7%
Direct Cost	-360	-420	-416	-443	-6.1%	15.6%	-0.9%	-1,581	-1,871	18.4%
<b>Gross Profit</b>	<b>242</b>	<b>313</b>	<b>300</b>	<b>298</b>	<b>0.9%</b>	<b>24.3%</b>	<b>-4.2%</b>	<b>1,093</b>	<b>1,303</b>	<b>19.2%</b>
G&A expenses	-64	-71	-71	-76	-7.1%	10.5%	-0.7%	-268	-333	24.2%
<b>EBITDA</b>	<b>280</b>	<b>353</b>	<b>333</b>	<b>339</b>	<b>-1.7%</b>	<b>19.1%</b>	<b>-5.7%</b>	<b>1,218</b>	<b>1,364</b>	<b>11.9%</b>
Other Income- Net	1	1	1	1	77.1%	6.8%	59.1%	6	7	18.7%
Finance Costs- Net	-4	-9	-12	-11	6.5%	184.3%	31.6%	-29	-38	31.1%
<b>Profit for the period</b>	<b>174</b>	<b>234</b>	<b>219</b>	<b>211</b>	<b>3.7%</b>	<b>25.4%</b>	<b>-6.4%</b>	<b>802</b>	<b>939</b>	<b>17.2%</b>

FABS estimate & Co Data

### Adnoc Drilling - Margins

	1Q22	4Q22	1Q23	YOY Ch	QOQ Ch	2022	2023F	Change
Gross Profit	40.2%	42.7%	41.9%	175	-81	40.9%	41.1%	18
EBITDA	46.5%	48.2%	46.5%	0	-164	45.6%	43.0%	-260
Net Profit	29.0%	31.9%	30.5%	152	-134	30.0%	29.6%	-39

FABS estimate & Co Data

## Valuation:

We use Discounted Free Cash flow (DCF) and Relative Valuation (RV) to value ADNOC Drilling. We have assigned 70% weight to DCF, and 30% to RV method.

Valuation Method	Target	Weight	Weighted Value
DCF	4.6	70.0%	3.2
Relative Valuation	3.5	30.0%	1.1
<b>Weighted Average Valuation (AED)</b>			<b>4.3</b>
<b>Current market price (AED)</b>			<b>3.78</b>
<b>Upside/Downside (%)</b>			<b>13.8%</b>

### 1) DCF Method:

ADNOC DRIL is valued using free cash flow to firm. We have discounted the cash flow using the weighted average cost of capital of 8.4%. It is arrived after using cost of equity of 8.7% and cost of debt of 5.1%. Cost of equity is calculated by using 10-year government bond yield of 4.3%, beta of 1.0 and equity risk premium of 4.4%. Government bond yield is calculated after adding Abu Dhabi 10-year spread over 10-year US risk free rate. Also, assumed a terminal growth rate of 2.0%.

Sum of PV (USD, Mn)	3,848
Terminal value (USD, Mn)	17,386
<b>FV to Common shareholders (USD, Mn)</b>	<b>21,234</b>
No. of share (Mn)	16,000
Current Market Price (AED)	3.78
<b>Fair Value per share (AED)</b>	<b>4.6</b>

#### DCF method

(All Figures in USD Mn)	FY 2023E	FY 2024E	FY 2025E	FY 2026E	FY 2027E
EBIT	970	1,072	1,192	1,281	1,370
Depreciation and Amortization	468	523	537	516	498
(-) Capex	-1,425	-825	-225	-235	-245
(-) Change in net working capital	-864	484	48	58	-41
<b>Free Cash Flow to Firm (FCFF)</b>	<b>-851</b>	<b>1,254</b>	<b>1,552</b>	<b>1,620</b>	<b>1,582</b>
Discounting Factor	0.95	0.88	0.81	0.75	0.69
<b>Discounted FCFF</b>	<b>-810</b>	<b>1,101</b>	<b>1,257</b>	<b>1,210</b>	<b>1,090</b>

## 2) Relative Valuation:

We have used local and international peers to value ADNOC Drilling and it is valued using the EV/EBITDA multiple. We have applied a premium to peer valuation since the majority of the Company revenue is earned on a contract basis from the parent ADNOC Group. In addition, ADNOC Group also plans to accelerate its production capacity from four million barrels per day to five million barrels of oil per day which is leading ADNOC Drilling to make investments in rigs to boost capacity to provide service to the parent. It is valued at EV/EBITDA multiple of 11.4x compared to the peer multiple of 9.1x.

Company	Market (USD Mn)	EV/EBITDA (x)		PE (x)		Dividend Yield (%)	
		2023	2024	2023	2024	2023	2024
Halliburton	31,827	7.4	6.1	12.3	10.3	1.6%	1.7%
Schlumberger (Us)	70,616	10.4	8.7	16.9	14.1	1.7%	1.8%
Baker Hughes Company	27,921	9.1	7.5	17.6	13.4	2.7%	2.7%
Valaris Ltd	4,573	16.2	5.5	15.3	6.7	-	-
Zhongman Petroleum and Natural Gas	1,100	7.0	4.5	9.7	7.3	-	-
<b>Average</b>		10.0	6.5	14.4	10.4	2.0%	2.1%
<b>Median</b>		9.1	6.1	15.3	10.3	1.7%	1.8%
<b>Max</b>		10.4	7.5	16.9	13.4	2.2%	2.2%
<b>Min</b>		7.4	5.5	12.3	7.3	1.6%	1.8%



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