

ADNOC Drilling PJSC

Increase in drilling activities and rig expansion boosted profitability

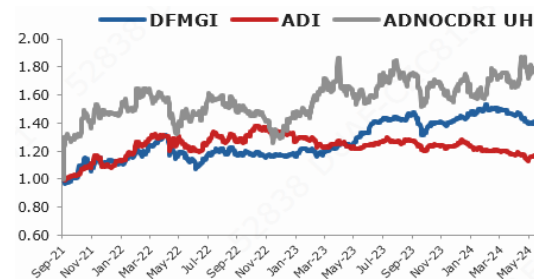
Current Price
AED 4.09

Target Price
AED 4.80

Upside/Downside (%)
+17%

Rating
BUY

- ADNOC Drilling's net revenue grew 23.7% YOY to USD 886 Mn in 1Q24 due to an increase in drilling activity and expansion of drilling fleet
- ADNOC Drilling secured a USD 1.7 Bn contract to offer drilling services for unconventional energy resources under which it will deliver 144 unconventional gas and oil wells
- ADNOC Drilling joint venture, "Enersol," increased its stake in Gordon Technologies from an initial 25% to an additional 42.2%, bringing its total ownership to 67.2%
- ADNOC Drilling board proposed a new progressive dividend policy, aiming for a 10% annual growth in DPS from FY2024-28



1Q24 Net Profit higher than our estimate

ADNOC Drilling Co. PJSC (ADNOC DRILL/the Company) net profit grew 25.6% YOY to USD 275 Mn in 1Q24, higher than our estimate of USD 259 Mn. The increase in the net profit is mainly attributable to a strong growth in revenue owing to an increase in drilling activity and expansion of drilling fleet partially offset by an increase in direct cost, operating expenses, and tax charges.

P&L Highlights

ADNOC Drilling's net revenue grew 23.7% YOY to USD 886 Mn in 1Q24 due to an increase in drilling activity and expansion in drilling fleet. Onshore Segment revenue grew 15.8% YOY to USD 411 Mn in 1Q24 owing to increased activity driven by the commencement of operations of new rigs. Offshore Jack-up revenue rose 50.8% YOY to USD 278 Mn in 1Q24 owing to increased rig activity from additional jack-up rigs. Revenue from the Offshore Island remained flat at USD 51 Mn in 1Q24 compared to 1Q23 mainly due to stable activity, while revenue declined QOQ due to lower operating days. Furthermore, the OFS segmental revenue rose strongly 15.9% YOY to USD 146 Mn in 1Q24 owing to growth in activity from drilling fluids and directional drilling. The direct cost increased 14.9% YOY to USD 518 Mn in 1Q24 owing to increased rig activity, costs associated with fleet expansion, maintenance costs, and mobilization costs related to Jordan operations. Thus, the Company's gross profit grew substantially 38.6% YOY to USD 368 Mn in 1Q24. Gross profit margin grew from 37.1% in 1Q23 to 41.6% in 1Q24. General and administrative expenses increased 13.4% YOY to USD 41 Mn in 1Q24. Thus, EBITDA rose 31.0% YOY to USD 437 Mn in 1Q24. EBITDA margin grew 276 bps YOY to 49.3% in 1Q24. Onshore segment EBITDA rose 9.5% YOY to USD 190 Mn in 1Q24, while Offshore jack-up EBITDA grew significantly from USD 105 Mn in 1Q23 to USD 182 Mn in 1Q24. Offshore island EBITDA declined 1.7% YOY to USD 31 Mn in 1Q24 due

Stock Information

Market Cap (AED, mn)	65,600.00
Shares Outstanding (mn)	16,000.00
52 Week High	4.60
52 Week Low	3.45
3M Avg. daily value (AED)	82,936,060

1Q24 Result Review (USD, mn)

Total Assets	6,809
Total Liabilities	3,628
Total Equity	3,181
EBITDA	437
Net Profit	275

Financial Ratios

Dividend Yield (12m)	4.01
Dividend Pay-out (%)	69.39
Price-Earnings Ratio(x)	16.40
Price-to-Book Ratio (x)	5.62
Book Value (AED)	0.20
Return-on Equity (%)	34.40

Stock Performance

5 Days	-0.24%
1 Months	-3.07%
3 Months	0.49%
6 Months	14.21%
1 Year	11.11%
Month to Date (MTD%)	2.50%
Quarter to Date (QTD%)	3.27%
Year to Date (YTD%)	8.47%

to slightly higher operating expenses. Furthermore, Oilfield Services segment EBITDA increased 42.8% YOY to USD 34 Mn in 1Q24. Consequently, Operating income increased 42.6% YOY to USD 327 Mn in 1Q24. Net finance costs increased significantly from USD 12 Mn in 1Q23 to USD 28 Mn in 1Q24 owing to an increase in borrowings. The corporate tax expense amounted to USD 28 Mn in 1Q24 owing to the introduction of corporate tax impacting profitability.

Balance Sheet Highlights

ADNOC DRILL cash and cash equivalent declined from USD 354 Mn in 4Q23 to USD 246 Mn in 1Q24 mainly due to payment for capex, dividend, and investment in Enersol. Net debt grew from USD 1.8 Bn in 4Q23 to USD 2.1 Bn in 1Q24, while the LTM net debt to EBITDA ratio marginally rose to 1.3x in 1Q24 compared to 1.2x in 4Q23. The Company's net working capital increased 42.7% QOQ to USD 341 Mn in 1Q24 primarily due to increase in receivables due from related parties owing to the commencement of new rig operations. Capex declined significantly from USD 484 Mn in 4Q23 to USD 80 Mn in 1Q24. Moreover, the Company is projected to incur a capex of c. USD 750-950 Mn in 2024. ADNOC Drilling's Free cash flow declined from USD 187 Mn in 4Q23 to USD 153 Mn in 1Q24 due to an investment of USD 88 Mn in Enersol and a decrease in net cash generated from operating activities. The Company reclassified its existing USD 1.5 Bn syndicated loan as non-current liability in 1Q24. The Company made a drawdown of AED 300 Mn from its Emirati dirham facility in 1Q24 and will be repaid in 2Q24.

Target Price and Rating

We maintain our BUY rating on ADNOC Drilling with a revised target price of AED 4.80. The Company's share price rose 10.9% since our previous rating. ADNOC Drilling's net profit grew significantly 25.6% YOY due to an increase in drilling activity and fleet expansion. The Company added eight hybrid land rigs in 1Q24 resulting in a fleet count of 137 rigs while the overall rig availability improved to 97% in 1Q24 compared to 96% in 1Q23. Newly added rigs are anticipated to start operating in the middle to end of 2Q24. Moreover, the Company plans to increase its fleet to 142 owned rigs, including 4 new lease-to-own land rigs by FY2024. Furthermore, the Company's joint venture, Enersol, increased its stake in Gordon Technologies from an initial 25% to an additional 42.2%, bringing its total ownership to 67.2%. This makes Enersol the majority shareholder in Gordon Technologies. In addition, ADNOC Drilling secured a USD 1.7 Bn contract to offer drilling services for unconventional energy resources. Under this contract, the company will deliver 144 unconventional gas and oil wells. ADNOC drilling will leverage Enersol and ADNOC's digitization and advanced technology capabilities for this project. To explore further opportunities in unconventional resources and service this contract, ADNOC Drilling established a new company "Turnwell Industries LLC OPC" and signed a term sheet with SLB and Patterson UTI for support with the latest technology and potential partnership in unconventional energy drilling space. Abu Dhabi currently holds an expected 220 Bn barrels of unconventional oil and 460 TCF of unconventional gas presenting a strong opportunity for the Company. ADNOC Drilling plans to retain a minimum of 55% stake in Turnwell. ADNOC Drilling boosted its growth plans to support ADNOC's strategic goal to increase production capacity from four to five million barrels per day by FY2027. The Company has more than 10 deals worth USD 1.6 Bn in the pipeline which provides solid revenue visibility in the near term. The Board of Directors proposed a new progressive dividend policy, aiming for a 10% annual growth in DPS from FY2024-28. Additional dividends may be considered at the board's discretion, while maintaining net debt/EBITDA up to 2x. Moreover, ADNOC successfully completed a placement of 880 Mn shares for AED 3.90 per share, representing 5.5% of the Company's total share capital to institutional investors in the GCC and internationally. The successful offering increases ADNOC Drilling's free float to 16.5%, enhancing liquidity and potentially facilitating the inclusion in the MSCI Emerging Market Index at the next quarter review. The likely inclusion in the MSCI index would diversify the company's investor base and significantly raise awareness of its unique value proposition. Thus, considering the above-mentioned reasons, we maintain our BUY rating on the stock.

Adnoc Drilling - Relative valuation

(at CMP)	2020	2021	2022	2023	2024F
PE	NA	29.3	22.1	17.1	15.3
PB	NA	6.3	6.0	5.4	4.8
EV/EBITDA	NA	17.9	15.3	13.0	10.8
Dividend yield	NA	3.9%	3.9%	4.0%	4.4%

FABS estimate & Co Data
Adnoc Drilling – P&L

USD mn	1Q23	4Q23	1Q24	1Q24F	VAR	YOY Ch	QOQ Ch	2023	2024F	Change
Revenue	716	841	886	874	1.3%	23.7%	5.4%	3,057	3,700	21.0%
Direct Cost	-450	-456	-518	-497	4.2%	14.9%	13.6%	-1,849	-2,229	20.6%
Gross Profit	266	385	368	378	-2.5%	38.6%	-4.3%	1,208	1,471	21.8%
G&A expenses	-36	-40	-41	-83	-50.4%	13.4%	4.0%	-126	-155	23.0%
EBITDA	333	424	437	420	4.1%	31.0%	2.9%	1,483	1,809	22.0%
EBIT	229	345	327	295	11.0%	42.6%	-5.3%	1,082	1,316	21.6%
Share of results of a JV	0	0	2	0	NM	NM	NM	0	2	NM
Other Income- Net	1	4	1	4	-77.0%	-23.3%	-74.7%	10	11	12.7%
Finance Costs- Net	-12	-20	-28	-15	85.9%	NM	37.3%	-59	-60	1.6%
Profit before tax	219	329	302	284	6.4%	38.2%	-8.2%	1,033	1,269	22.9%
Corporate tax	0	0	-28	-26	7.8%	NM	NM	0	-114	NM
Profit for the period	219	329	275	259	6.2%	25.6%	-16.6%	1,033	1,155	11.8%

FABS estimate & Co Data
Adnoc Drilling - Margins

	1Q23	4Q23	1Q24	YOY Ch	QOQ Ch	2023	2024F	Change
Gross Profit	37.1%	45.8%	41.6%	447	-422	39.5%	39.8%	24
EBITDA	46.5%	50.5%	49.3%	276	-118	48.5%	48.9%	39
Net Profit	30.5%	39.1%	31.0%	46	-815	33.8%	31.2%	-257

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.

Valuation Method	Target	Weight	Weighted Value
DCF Method	5.09	70.0%	3.56
Relative Valuation (RV)	4.14	30.0%	1.24
Weighted Average Valuation (AED)			4.80
Current market price (AED)			4.09
Upside/Downside (%)			+17%

1) DCF Method:

Adnoc Drilling is valued using free cash flow to firm. We have discounted the cash flow using weighted average cost of capital of 8.6%. It is arrived after using the cost of equity of 8.9% and cost of debt 5.8%. The cost of equity is calculated using a 10-year government bond yield of 5.2%, a beta of 1.00, and an equity risk premium of 3.7%. 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)	5,574
Terminal value (USD, Mn)	18,512
FV to Common shareholders (USD, Mn)	22,175
No. of share (Mn)	16,000
Current Market Price (AED)	4.09
Fair Value per share (AED)	5.09

DCF Method

(All Figures in USD Mn)	FY 2024E	FY 2025E	FY 2026E	FY 2027E	FY 2028E
NOPAT	1,197	1,344	1,453	1,552	1,605
D&A	482	462	443	427	411
(-) Capex	-900	-225	-236	-242	-250
Change in working capital	-106	-86	-43	-33	-27
Free Cash Flow to Firm (FCFF)	505	1,495	1,617	1,704	1,740
Discounting Factor	0.96	0.88	0.81	0.75	0.69
Discounted FCFF	483	1,315	1,310	1,271	1,195

Source: FAB Securities

2) Relative Valuation:

We have used regional and global peers to value Adnoc Drilling, which 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 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 invest in rigs to boost capacity and provide service to the parent. It is valued at EV/EBITDA multiple of 11.0x compared to the peer multiple of 8.2x.

Company	Market (USD Mn)	EV/EBITDA (x)		P/E (x)	
		2024F	2025F	2024F	2025F
Halliburton	33,070	6.9	6.0	11.4	9.7
Schlumberger (Us)	69,100	8.2	6.9	13.7	11.5
Baker Hughes Company	32,860	8.2	6.9	15.7	13.3
Zhongman Petroleum and Natural Gas	1,387	3.3	2.7	7.9	6.7
Arabian Drilling Company	3,377	8.7	7.5	17.7	14.0
Petrovietnam Drilling & Well Service Corporation	709	8.4	5.8	20.2	12.3
Borr Drilling Limited	1,417	6.3	5.3	8.7	7.6
Diamond Offshore Drilling, Inc.	1,500	8.2	4.1	35.4	7.8
Average		7.3x	5.7x	16.3x	10.4x
Median		8.2x	5.9x	14.7x	10.6x
Max		8.3x	6.9x	18.3x	12.6x
Min		6.8x	5.0x	10.7x	7.7x

Source: FAB Securities

Research Rating Methodology:

Rating	Upside/Downside potential
BUY	Higher than +15%
ACCUMULATE	Between +10% to +15%
HOLD	Lower than +10% to -5%
REDUCE	Between -5% to -15%
SELL	Lower than -15%

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