ADNOC Drilling

Additions of new rigs drove profitability

Rating : BUY

First Look Note – 4Q22

Sector: Oil & Gas

4Q22 Net Profit higher than our estimates

ADNOC Drilling Co. PJSC (ADNOCDRI/the Company) net profit rose significantly from USD 144 Mn in 4Q21 to USD 234 Mn in 4Q22, higher than our estimate of USD 193 Mn. The increase in net profit was mainly driven by an increase in overall business revenue due to the commencement of operations from newly integrated rigs partially offset by a rise in operating expenses.

P&L Highlights

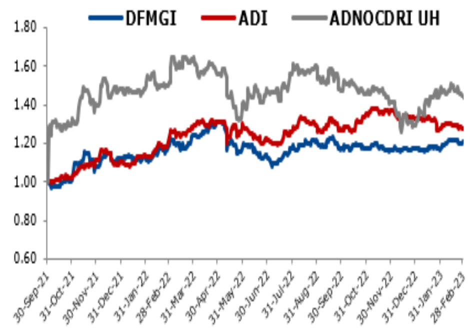
ADNOC Drilling reported the highest-ever quarterly revenue of USD 733 Mn in 4Q22, as compared to USD 575 Mn in 4Q21. The increase in revenue is mainly attributable to strong growth in the company's overall business segments. Onshore Segment revenue rose 29.5% YOY to USD 379 Mn in 4Q22 due to the commencement of operations of additional rigs which joined the fleet. Offshore Jack-up recorded revenue growth of 23.5% YOY to USD 180 Mn in 4Q22 driven by increased activity from five new additional rigs put in operation. Revenue from the Offshore Island Segment increased 35.2% YOY to USD 51 Mn in 4Q22 owing to the reversal of claims in 4Q21. In addition, the OFS segment witnessed 25.5% YOY growth in revenue to USD 123 Mn in 4Q22 mainly due to the introduction of new services to the portfolio along with increased volumes. On the other hand, the company's direct cost rose 13.6% YOY to USD 420 Mn in 4Q22 due to a rise in drilling activity, growth in material cost inflation, a hike in labor cost, increased maintenance cost, and other associated costs. The company plans to optimize the number of crew working on rigs to enhance cost savings. ADNOC Drilling's G&A expenses rose significantly 23.0% YOY to USD 71 Mn in 4Q22. Thus, EBITDA rose 34.8% YOY to USD 353 Mn in 4Q22. EBITDA of the onshore segment rose 42.9% YOY to USD 189 Mn with a margin of 49.7% in 4Q22 due to cost optimization and growth in volumes whereas the offshore jackup segment EBITDA rose 30.2% YOY to USD 108 Mn with a margin of 60.1% owing to commencement in operations of new jackups. Similarly, offshore island and OFS segment EBITDA margins stood at 54.4% and 23.5% in 4Q22 with an EBITDA of USD 28 Mn and USD 29 Mn respectively. Finance costs increased from USD 4.3 Mn in 4Q21 to USD 9.1 Mn in 4Q22 due to higher benchmark rates. Other income rose to USD 0.8 Mn in 4Q22 as compared to USD 0.6 Mn in 4Q21.

Balance sheet highlights

ADNOCDRI's working capital declined 46.7% to USD 314 Mn in 2022 due to rise in liabilities, efficient inventory management and focus on collections from related parties. The company incurred a capex of USD 942 Mn in 2022 as compared to USD 583 Mn in 2021 resulting in a marginal decline in free cash flow by 1.5% to USD 588 Mn in 2022. ADNOCDRI's capex increased due to the rig fleet expansion program and payments made towards Offshore Jack-up rigs. Furthermore, the Company plans to incur a capex of USD 1.3-1.8 Bn in 2023. In addition, the Company maintained strong cash and cash equivalents worth USD 326 Mn in 2022 and an unutilized syndicated term and revolving facility of USD 1.25 Bn.

Recommendation	
Current Price (1-Mar-23)	3.36
Target Price (AED)	4.30
Upside/Downside (%)	+28%

Stock Information	
Market Cap (mm)	54,400.00
Shares Outstanding (mm)	16,000
52 Week High	3.92
52 Week Low	2.90
3M Avg. daily value (AED)	23,149,540



Financial Ratios	
Dividend Yield (12m)	4.50
Dividend Pay-out (%)	0.00
Price-Earnings Ratio (x)	18.22
Price-to-Book Ratio (x)	5.05
Book Value (AED)	0.18
Return-on Equity (%)	28.00
Earning Per Share (AED)	0.05
Adjusted BETA	0.829

Stock Performance	
5 Days	0.89%
1 Months	0.89%
3 Months	4.29%
6 Months	-4.23%
1 Year	-2.30%
Month to Date (MTD)	2.72%
Quarter to Date (QTD)	14.09%
Year to Date (YTD)	14.09%

Target price and rating

We maintain our BUY rating on ADNOC Drilling with a revised target price of AED 4.30. The revision is mainly due to the fast track of the growth plans announced with 4Q22 results and remains a key enabler to ADNOC Upstream growth plans. ADNOC Upstream accelerated its expansion strategy for achieving the target of five million barrels of oil per day and gas self-sufficiency in the UAE by 2027. Thus, ADNOCDRI plans to increase the rig count to 142 with a capex of USD 2.0-2.5 bn by 2024 as compared to the previous target of 127 rigs by 2030. This will provide a boost to near-term earnings. The Company drilled 620 wells in 2022 and integrated eight onshore H&P FlexRigs into operations which boosted the company's top line in FY2022. The OFS segment performed Integrated Drilling Services on 40 rigs whereas the drilling efficiency improved 14.3% YOY in 2022. Average drilling days increased for onshore drilling from 33 days in 4Q21 to 41 days in 4Q22 while offshore average drilling days declined by 1 day to 77 days in 4Q22 as compared to 4Q21. ADNOC Drilling's expansion program added 16 drilling units in 2022 which increased the rig fleet to 115 rigs as of 2022. ADNOC Drilling holds more than USD 10 Bn worth of contracted backlog as of 2022 which affirms long-term revenue visibility with robust cash flow. ADNOC Offshore Jack-up and Offshore Island segment received two contracts in 4Q22 worth USD 2.5 Bn for providing 14 jack-up rigs and 2 island rigs to ADNOC Offshore. Furthermore, OFS segment extended ADNOC Onshore and Offshore Integratd Drilling Services (IDS) contracts for two years with a total consideration of USD 2.7 Bn. The company released its financial guidance for the first time where it expects the revenue to range between USD 3.0-3.2 Bn in 2023 whereas the EBITDA is expected to range from USD 1.4-1.5 Bn with an EBITDA margin of around 45% to 47%. It is expected to record double digit growth in topline and bottom line during FY2022. Moreover, the company expects the dividend to grow by 5.0% in 2022 in line with its progressive 5-for-5 dividend policy. Thus, considering the abovementioned factors, we assign a BUY rating on the stock.

Adnoc Drilling Relative Valuation

(at CMP)	2020	2021	2022	2023F
P/E	NA	24.26	18.27	15.58
P/B	NA	5.24	5.00	4.70
EV/EBITDA	NA	14.99	12.84	11.87
Dividend Yield	NA	4.6%	4.8%	5.1%

FABS estimate & Co Data

Adnoc Drilling - P&L

(USD mn)	4Q21	3Q22	4Q22	4Q22F	Var.	YOY Ch	QOQ Ch	2021	2022	Change
Revenue	575	670	733	683	7.3%	27.5%	9.4%	2,269	2,673	17.8%
Direct Cost	-370	-405	-420	-405	3.7%	13.6%	3.7%	-1,385	-1,581	14.1%
Gross Profit	**206**	**265**	**313**	**278**	**12.6%**	**52.4%**	**18.1%**	**884**	**1,093**	**23.6%**
G&A expenses	-58	-69	-71	-75	-5.1%	23.0%	3.0%	-274	-268	-1.9%
EBITDA	**262**	**299**	**353**	**305**	**15.7%**	**34.8%**	**18.1%**	**1,047**	**1,218**	**16.4%**
Other Income- Net	1	1	1	1	-39.7%	44.6%	-39.3%	10	6	-39.2%
Finance Costs- Net	-4	-9	-9	-11	-18.3%	113.6%	4.4%	-17	-29	68.5%
Profit for the period	**144**	**189**	**234**	**193**	**20.9%**	**62.4%**	**23.8%**	**604**	**802**	**32.8%**

FABS estimate & Co Data

Adnoc Drilling - Margins

	4Q21	3Q22	4Q22	YOY Ch	QOQ Ch	2021	2022	Change
Gross Profit Margin	35.8%	39.6%	42.7%	698	315	39.0%	40.9%	191
EBITDA Margin	45.5%	44.6%	48.2%	263	357	46.1%	45.6%	-56
Net Profit Margin	25.0%	28.2%	31.9%	685	371	26.6%	30.0%	338

FABS estimate & Co Data

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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