

ADNOC Drilling Company PJSC

Higher operational efficiency boosted drove profitability and raised guidance

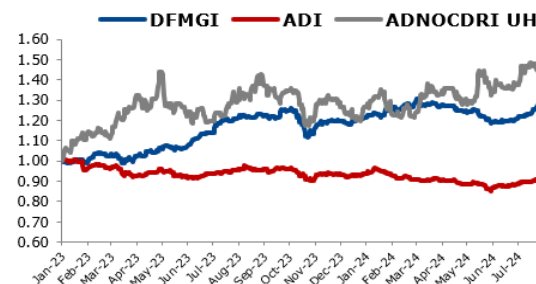
Current Price
AED 4.60

Target Price
AED 5.10

Upside/Downside (%)
+11%

Rating
ACCUMULATE

- ADNOC Drilling's net revenue grew 29.2% YOY to USD 935 Mn in 2Q24 due to the commencement of operations of new rigs and an overall increase in business activity across all segments.
- Revised its revenue guidance from 12-16% to 14-18% (from FY2023 base) in FY2024. In addition to an EBITDA margin guidance of c. 50% in FY2024.
- 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's board approved an interim dividend of USD 394 Mn which is expected to be distributed on the last week of August.



2Q24 Net Profit marginally higher than our estimate

ADNOC Drilling Co. PJSC (ADNOC DRILL/the Company) net profit grew 29.6% YOY to USD 295 Mn in 2Q24, higher than our estimate of USD 288 Mn. The increase in the net profit is mainly attributable to a strong growth in revenue driven by the commencement of operations of new rigs and increased business activity across all segments, partially offset by an increase in net finance costs.

P&L Highlights

ADNOC Drilling's net revenue grew 29.2% YOY to USD 935 Mn in 2Q24 due to increased business activity across all segments. Onshore Segment revenue grew 27.4% YOY to USD 441 Mn in 2Q24 owing to increased activity driven by the commencement of operations of new rigs. Offshore Jack-up revenue rose 48.1% YOY to USD 284 Mn in 2Q24 owing to increased rig activity from additional jack-up rigs added to production. Revenue from the Offshore Island grew 2.7% YOY to USD 53 Mn in 2Q24 mainly driven by the reactivation of A-80 rig. Furthermore, the OFS segmental revenue rose strongly 17.2% YOY to USD 157 Mn in 2Q24 owing to growth in activity from drilling fluids and wireline services. Moreover, the management expects the OFS activity to increase under their planned phasing of IDS ramp-up and unconventional. The direct cost grew 18.8% YOY to USD 539 Mn in 2Q24 owing to increased rig activity, costs associated with fleet expansion and maintenance costs. Thus, the Company's gross profit expanded 46.7% YOY to USD 396 Mn in 2Q24. Gross profit margin grew from 37.3% in 2Q23 to 42.3% in 2Q24. G&A expenses increased 36.2% YOY to USD 41 Mn in 2Q24. Thus, EBITDA rose 37.1% YOY to USD 472 Mn in 2Q24. EBITDA margin grew 292 bps YOY to 50.5% in 2Q24. Onshore segment EBITDA rose 33.5% YOY to USD 212 Mn in 2Q24, while Offshore jack-up EBITDA grew significantly from USD 126 Mn in 2Q23 to USD 191 Mn in 2Q24. Offshore island EBITDA remained

Stock Information

Market Cap (AED, mm)	73,600.00
Shares Outstanding(mm)	16,000.00
52 Week High	4.66
52 Week Low	3.45
3M Avg. daily value (AED)	99,023,690

2Q24 Result Review (USD, mm)

Total Assets	7,097
Total Liabilities	3,622
Total Equity	3,476
EBITDA	472
Net Profit	295

Financial Ratios

Dividend Yield (12m)	3.26
Dividend Pay-out (%)	69.39
Price-Earnings Ratio(x)	17.33
Price-to-Book Ratio (x)	5.77
Book Value (AED)	0.22
Return-on Equity (%)	35.51

Stock Performance

5 Days	8.49%
1 Months	5.75%
3 Months	17.05%
6 Months	27.42%
1 Year	16.75%
Month to Date (MTD%)	4.55%
Quarter to Date (QTD%)	12.20%
Year to Date (YTD%)	21.69%

unchanged at USD 33 Mn in 2Q24 compared with USD 32 Mn in 2Q23. Furthermore, Oilfield Services segment EBITDA increased 32% YOY to USD 37 Mn in 2Q24. Consequently, operating income increased 48.0% YOY to USD 355 Mn in 2Q24. Net finance costs increased significantly from USD 14 Mn in 2Q23 to USD 33 Mn in 2Q24 owing to an increase in borrowings. The corporate tax expense amounted to USD 29 Mn in 2Q24 owing to the introduction of corporate tax in UAE in FY2024. Additionally, the management updated their medium-term guidance and expects revenue growth of 14-18% compared to their previous range of 12- 16%. The overall EBITDA margin is expected c. 50%, with drilling segment margins anticipated to exceed 50% and an OFS segment margin in the 22% to 26% range in FY2024.

Balance Sheet Highlights

ADNOC DRILL cash and cash equivalent increased from USD 246 Mn in 1Q23 to USD 331 Mn in 2Q24 mainly due to improved collections. Net debt declined to USD 1.8 Bn in 2Q24 compared to USD 2.1 Bn in 1Q24 and the net debt to LTM EBITDA ratio fell to 1.0x in 2Q24 compared to 1.3x in 1Q24. Additionally, the management guided on a conservative long-term leverage target of up to c. 2.0x net debt to EBITDA. The Company's net working capital fell from USD 391 Mn in 1Q24 to USD 250 Mn in 2Q24 mainly driven by increased focus on receivable collections, and the phasing of payments related to capital expenditure at the end of the quarter. Additionally, the management guided that in the medium term, the company maintains its net working capital to around c.12% of the total revenue. Capex increased from USD 194 Mn in 1Q24 to USD 236 Mn in 2Q24 mainly due to the progression of their rig fleets. Moreover, the Company is projected to incur a capex of c. USD 750-950 Mn in FY2024. ADNOC Drilling's free cash flow increased from USD 153 Mn in 1Q24 to USD 282 Mn in 2Q24 due to increase in net cash generated from operating activities, partially offset by increased capital expenditure.

Target Price and Rating

We maintain our ACCUMULATE rating on ADNOC Drilling with a revised target price of AED 5.10. The Company's share price rose 12% since our previous rating. ADNOC Drilling's net profit grew 29.6% YOY to USD 295 Mn due to a strong growth in revenue driven by the commencement of operations of new rigs and increased business activity across all segments. The Company added three hybrid land rigs in 2Q24 resulting in a fleet count of 140 rigs while the overall rig availability decreased to 94% in 2Q24 compared to 96% in 2Q23. Moreover, it plans to increase its fleet to 148 owned rigs, including 4 new lease-to-own land rigs by FY2026. Furthermore, the Company's joint venture, Enersol, increased its stake in Gordon Technologies from an initial 25% to 67.2%. Enersol also acquired a 51% stake in NTS Amega Global, a precision equipment manufacturer for energy sector and a 100% stake in EV Holdings Ltd., a vision-based solutions provider in the oil and gas sector. These acquisitions benefit ADNOC drilling, as ADNOC gets access to advanced technologies and intellectual properties of these companies, increasing its operating efficiency and providing the Company with additional streams of revenue. 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. The Company 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 retained 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 will provide solid revenue visibility in the near term. The Board of Directors approved an interim dividend of USD 394 Mn which is expected to be distributed on the last week of August. This is pursuant to the company's new progressive dividend policy, aiming for a 10% annual growth in dividend per share from FY2024-28. Additional dividends may be considered at the board's discretion while maintaining net debt/EBITDA up to 2x. Thus, considering the above-mentioned reasons, we assign an ACCUMULATE rating on the stock.

Adnoc Drilling - Relative valuation

(at CMP in USD)	2020	2021	2022	2023	2024F
PE	NA	33.1	24.9	19.3	16.5
PB	NA	7.1	6.8	6.1	5.4
EV/EBITDA	NA	20.1	17.2	14.6	11.7
Dividend yield	NA	3.4%	3.4%	3.6%	3.9%

FABS Estimates & Co Data
Adnoc Drilling – P&L

USD mm	2Q23	1Q24	2Q24	2Q24F	VAR	YOY Ch	QOQ Ch	2023	2024F	Change
Revenue	724	886	935	925	1.1%	29.2%	5.6%	3,057	3,764	23.1%
Direct Cost	-454	-518	-539	-540	-0.1%	18.8%	4.2%	-1,849	-2,160	16.9%
Gross Profit	270	368	396	385	3.0%	46.7%	7.6%	1,208	1,604	32.7%
G&A expenses	-30	-41	-41	-44	-7.4%	36.2%	-0.3%	-126	-158	25.1%
EBITDA	344	437	472	447	5.5%	37.1%	8.1%	1,483	1,873	26.3%
EBIT	240	327	355	340	4.3%	48.0%	8.5%	1,082	1,445	33.6%
Share of results of a JV		2	1	2	-37.3%	NM	-36.5%	0	6	NM
Other Income- Net	1	1	1	2	-40.2%	-30.4%	-1.0%	10	6	-42.7%
Finance Costs- Net	-14	-28	-33	-27	23.4%	143.6%	19.7%	-59	-124	110.0%
Profit before tax	228	302	324	317	2.2%	42.3%	7.2%	1,033	1,334	29.1%
Corporate tax	0	-28	-29	-29	1.3%	NM	4.9%	0	-120	NM
Profit for the period	228	275	295	288	2.3%	29.6%	7.4%	1,033	1,214	17.5%

FABS estimate & Co Data
Adnoc Drilling - Margins

	2Q23	1Q24	2Q24	YOY Ch	QOQ Ch	2023	2024F	Change
Gross Profit	37.3%	41.6%	42.3%	505	77	39.5%	42.6%	308
EBITDA	47.5%	49.3%	50.5%	292	117	48.5%	49.8%	124
Net Profit	31.4%	31.0%	31.5%	10	54	33.8%	32.2%	-155

FABS estimate & Co Data

Valuation:

We use Discounted Free Cash Flow (DCF) and Relative Valuation (RV) to value ADNOC Drilling. We have assigned 80% weight to DCF and 20% to RV.

Valuation Method	Target	Weight	Weighted Value
DCF Method	5.44	80.0%	4.35
Relative Valuation (RV)			
EV/EBITDA	2.92	10.0%	0.29
PE	4.59	10.0%	0.46
Weighted Average Valuation (AED)			5.10
Current market price (AED)			4.60
Upside/Downside (%)			+11%

1) DCF Method:

Adnoc Drilling is valued using free cash flow to the firm. We have discounted the cash flow using a weighted average cost of capital of 8.5%. It is arrived after using the cost of equity of 8.8% and the after tax cost of debt of 5.8%. The cost of equity is calculated using a 10-year government bond yield of 4.9%, a beta of 1.0, and an equity risk premium of 3.9%. Government bond yield is calculated after adding Abu Dhabi's 10-year spread over 10-year US risk-free rate. Also, assumed a terminal growth rate of 2.0%.

Sum of PV (USD, Mn)	5,485
Terminal value (USD, Mn)	20,020
FV to Common shareholders (USD, Mn)	25,505
No. of share (Mn)	16,000
Current Market Price (AED)	4.60
Fair Value per share (AED)	5.44

DCF Method

(All Figures in USD Mn)	FY 2024E	FY 2025E	FY 2026E	FY 2027E	FY 2028E
EBIT	1,325	1,388	1,509	1,603	1,664
D&A	421	480	459	442	425
(-) Capex	-850	-435	-236	-242	-250
Change in working capital	-122	-84	-47	-29	-23
Free Cash Flow to Firm (FCFF)	581	1,349	1,685	1,773	1,816
Discounting Factor	0.97	0.89	0.82	0.76	0.70
Discounted FCFF	282	1,205	1,386	1,344	1,269

Source: FAB Securities

2) Relative Valuation:

We have used regional and global peers to value Adnoc Drilling, which is valued using the EV/EBITDA and PE multiple. We have applied a premium to peer valuation since the majority of the Company's 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 and PE multiple of 7.8x and 16.5x, respectively, compared to the peer multiple of 6.5x and 13.7x.

Company	Market (USD Mn)	EV/EBITDA (x)		P/E (x)	
		2024F	2025F	2024F	2025F
Halliburton	27,138	6.5	6.0	9.7	8.6
Schlumberger (Us)	60,854	7.7	6.7	12.3	10.3
Baker Hughes Company	34,015	7.5	6.9	15.2	12.9
Petrovietnam Drilling & Well Service Corporation	578	6.5	4.9	15.7	9.6
Borr Drilling Limited	1,494	5.2	5.2	8.8	6.5
Diamond Offshore Drilling, Inc.	1,508	4.9	4.3	31.9	7.8
ADES Holding Co	6,112	11.1	10.2	28.3	22.8
China Oilfield Services	7,645	6.0	5.3	7.7	6.1
Weatherford International	7,924	6.2	5.6	15.4	12.0
Seadrill Limited	3,044	7.8	4.5	16.7	7.9
Arabian Drilling Co	2,769	8.1	7.3	18.3	15.2
Odfjell Drilling Ltd	1,205	5.7	4.4	21.1	7.3
Noble Corp PLC	5,627	6.3	4.6	11.7	7.5
Average		6.9x	5.7x	15.6x	9.3x
Median		6.5x	5.6x	13.7x	9.1x
Max		7.7x	6.5x	15.6x	10.1x
Min		6.0x	5.0x	10.3x	8.0x

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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