Target Price: SAR200/share
Current Price: SAR187.6/share
Upside: +6.8% (+4.1% Div. Yield)
Rating: Neutral

Arabian Drilling Co.

Raise TP to SAR200/share on faster fleet expansion

- New contract wins (10 land rigs contracts) along with the commencement of additional jack-ups to deliver robust growth ahead of our prior expectations.
- A significant jump in backlog along with longer contract tenure provides strong visibility; EBITDA is expected to improve from 2024.
- We raise our target price (TP) to SAR200/share on faster-than-expected onshore fleet expansion, and higher day rates, mainly for offshore rigs amid tight supply.

Aramco unconventional gas contracts: ADC recently won multiple contracts from Aramco to deploy 10 additional land rigs (out of a 13-rig tender) for Aramco's unconventional program in the Jafurah field. All these rigs will be new-build (US$40-50mn per rig capex) with a contract tenure of 5 years. This will increase the company's land rig fleet to 48 rigs by 2024e from 38 currently. The total value of these contracts is estimated to be above SAR3bn, implying a robust onshore day rate of around US$44k per land rig (including rig day rate, mobilization and rig move revenues; higher than the average day rate of the existing fleets). We expect the company to deploy all 10 rigs (in phases) during 2Q24 with the first rig likely to deploy in April 2024. Overall, we expect ADC to start generating revenues during 3Q24 in a phased manner. Earlier, we had expected 6 onshore fleet rig expansions (vs. 5-10 onshore rigs guidance at the time of IPO) over 2024-26e. However, the latest 10 rigs contracts should enable the company in delivering the growth much earlier than expected. Overall, these impressive 10 land rigs contracts, along with the deployment of the additional jack-ups this year (3 rigs - AD130, AD140, AD150 - started the operations in July 2023), are expected to drive robust top-line growth (20% CAGR vs 7% CAGR earlier) over 2022-25e.

Expanding contracted backlog provides visibility: As of 2Q23, the company contracted backlog stood at SAR7.6bn (56% offshore; 70% Aramco), down from SAR8.1bn in 1Q23 and SAR8.9bn in 4Q22. However, post winning the mega Aramco contracts, the company's backlog is expected to increase significantly (+SAR3bn; ~40% of 2Q23 backlog). In addition, the company has recently extended 4 onshore (out of 6 due for renewals this year) and one offshore (AD60; out of 2 for renewal) rig contracts for a tenure of 3 to 10 years (Figure 2). This should further increase its backlog by up to SAR3bn, providing strong growth visibility over the medium term.

Figure 1: Key financial metrics

SARmn	2022a	2023e	2024e	2025e
Revenue	2,704	3,446	4,084	4,617
Revenue growth	*23%*	*27%*	*19%*	*13%*
Gross Profit	801	1,031	1,335	1,526
Gross Profit margin	*30%*	*30%*	*33%*	*33%*
EBITDA	1,144	1,444	1,753	2,008
Op. income	619	842	1,106	1,291
Net profit	558	676	862	1,031
Net profit margin	*21%*	*20%*	*21%*	*22%*
EPS (SAR)	6.3	7.6	9.7	11.6
P/E	29.9x	24.7x	19.4x	16.2x

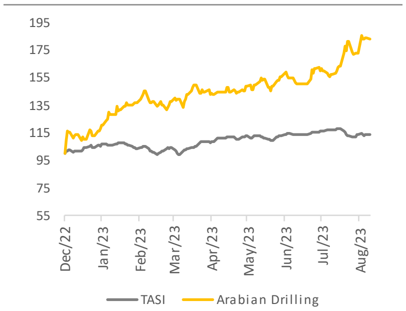
Source: Company data, GIB Capital

Stock data

TASI Ticker	2381
Mkt cap (SARmn)	16,696
Trd. Val 3m (SARmn)	35.6
Free float	30.0%
QFI holding	4.7%
TASI FF weight	0.25%

Source: Bloomberg

Prices indexed to 100



Source: Bloomberg

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Figure 2: ADC's contract renewal update

Rigs	Contract tenure	Day rates	Aggregated backlog
Land rig #1	3 years	In line with the current day rates	SAR3bn of firm contract
Land rig #2	3 years		
Land rig #3	5 years		
Land rig #4	10 years		
Offshore rig (AD60)	10 years		

Source: Company data, GIB Capital

EBITDA margin to remain firm in 2H23 before gradually improving from next year: Despite the commencement of additional jack-up rigs last month with higher-than-averaged day rates, the company has guided the EBITDA margin of around 42% in 2H23, in line with 1H23 levels. This is mainly due to i) higher pre-operating and one-off costs related to these jack-ups, ii) its focus on employees' retention program amid the stiff competition, and iii) a rise in headcount (guidance: +16% from the current level) with the 10 new rigs. However, post-deployment of the 10 land rigs in 2Q24, we expect the EBITDA margin to start improving to ~43% by 2024e and further to ~44% by 2025e.

2023 guidance: i) The company has maintained its earlier 2023e revenue guidance at SAR3.3-3.5bn (GIBC estimate: SAR3.4bn). 2) ADC has raised its capex guidance to SAR2.2-2.4bn (SAR1.2-1.4bn earlier guidance; GIBC capex: +SAR2.5bn) for 2023e to reflect a portion (assumed 50% in our forecast) related to the build-up of the additional 10 rigs. 3) Leverage ratio is likely to rise due to increased capex (net debt to EBITDA: 1.9x for 2024e vs 0.8x in 2022). and 4) 2H23 EBITDA margin would be mostly in-line with the 1H23 level due to increased costs.

Payout continues to be maintained at 80%. The company announced SAR2.53 DPS (~80% payout, in line with the guidance) for 1H23. Despite the ongoing capex cycle (10 rigs deployment), we expect the company to continue maintaining its payout at 80% in the future, aided by its healthy cash flow generation and comfortable leverage position. Accordingly, we expect the DPS at SAR6 for 2023e and SAR7.8 for 2024, implying more than 4% yield (2024e).

Valuation: Post revision in our estimates, we revise our target price to SAR200/sh. based solely on the DCF valuation method (8.6% WACC and 2% terminal growth). Earlier, we assigned a 50% weight to P/E-based valuation, which we believe is not relevant now, as the company is expected to witness the full benefit of Aramco's unconventional gas contracts only in 2025. We also present below the DCF-based target prices under various onshore and offshore day rates (on average during the forecasted periods).

Figure 3: DCF-based TP (SAR) based on various day rates

		Average onshore day rates (US$)*				
		34	**35**	**36**	**37**	**38**
Average offshore day rates (US$)*	**87**	165	172	180	187	195
	92	175	182	190	197	205
	97	185	192	**200**	207	215
	101	195	202	210	217	225
	106	205	212	220	227	235

*Source: GIB Capital. * On average during the forecasted periods.*

Key upside risks. i) The company currently has 3 stacked/suspended rigs. While the company plans to upgrade 2 of these rigs in case they see potential contract opportunities, the company is currently discussing a potential contract for the 3rd idle rig (AD29). However, given the uncertainty, we have not modeled any additional deployment of idle offshore rigs. Therefore, any additional deployment of rigs would act as an upside risk to our estimates and valuation. 2)

Any regional expansion (as announced during the IPO earlier) should further drive our valuation upwards. and 3) Any significant revision in day rates on renewals than expected should boost our estimates and thereby TP.

Key downside risks: Global economic slowdown/recession caused by geopolitical issues/high-interest rate environment, short-term stagnation in oil demand due to production cut measures adopted by OPEC+, oversupply in rig market leading to fall in day rates, high dependency on Saudi Aramco, delay in deployment of additional rigs, environmental concerns and change in the energy mix are key risks to our investment view.

Summarized Financial statements

Figure 4: Financials

Income statement	2022a	2023e	2024e	2025e
Revenue	**2,704**	**3,446**	**4,084**	**4,617**
revenue y/y	*23%*	*27%*	*19%*	*13%*
COGS	1,902	2,414	2,749	3,091
Gross Profit	**801**	**1,031**	**1,335**	**1,526**
Gross Profit margin	*30%*	*30%*	*33%*	*33%*
G&A	180	187	228	239
Operating profit	**619**	**842**	**1,106**	**1,291**
Operating margin	*23%*	*24%*	*27%*	*28%*
Finance costs	94	118	133	123
Net income	**558**	**676**	**862**	**1,031**
Net margin	*21%*	*20%*	*21%*	*22%*
y/y	*104%*	*21%*	*28%*	*20%*
EPS	**6.3**	**7.6**	**9.7**	**11.6**
DPS	0.0	6.0	7.8	9.3
Payout	0%	79%	80%	80%
EBITDA	**1,144**	**1,444**	**1,753**	**2,008**
Net debt	895	2,821	3,404	3,065

Balance Sheet	2022a	2023e	2024e	2025e
Inventories	173	219	249	280
Trade Receivables	825	1,052	1,246	1,409
Other Current Assets	1,020	20	20	20
Cash and Equivalents	832	387	187	411
Total Current Assets	**2,849**	**1,677**	**1,702**	**2,120**
Intangible Assets	0	0	0	0
Property, Plant & Equipment	6,491	8,447	9,114	8,925
Total Non-Current Assets	**6,705**	**8,670**	**9,319**	**9,115**
Total Assets	**9,554**	**10,347**	**11,021**	**11,235**
Current Liabilities	809	1,023	1,120	1,221
Non-current Liabilities	3,155	3,595	3,999	3,906
Equity	5,590	5,729	5,902	6,108
Total Equity and Liabilities	**9,554**	**10,347**	**11,021**	**11,235**
BVPS	62.8	64.4	66.3	68.6

Cashflow	2022a	2023e	2024e	2025e
Cashflow from Operations	1,242	1,177	1,404	1,677
Cashflow from Investing	(2,724)	(1,566)	(1,297)	(512)
Cashflow from Financing	1,903	(56)	(307)	(940)
Total Cashflows	**420**	**(445)**	**(200)**	**225**

Source: Company, GIB Capital

Summarized key ratios

Figure 5: Key ratios

Key ratios	2022a	2023e	2024e	2025e
Profitability ratios				
RoA	6%	7%	8%	9%
RoE	10%	12%	15%	17%
Sales/Assets	28%	33%	37%	41%
Net margin	20.6%	19.6%	21.1%	22.3%
EBITDA margin	42.3%	41.9%	42.9%	43.5%
Liquidity ratios				
Current Assets/ Current Liabilities	3.5	1.6	1.5	1.7
Debt to Total Equity	45%	52%	58%	54%
Receivable Days	111	111	111	111
Inventory Days	33	33	33	33
Payable days	112	112	112	112
Debt ratios				
Net Debt/EBITDA	0.8	2.0	1.9	1.5
Debt/Assets	0.3	0.3	0.3	0.3
Valuation ratios				
P/E	29.9	24.7	19.4	16.2
P/B	3.0	2.9	2.8	2.7
EV/EBITDA	15.6	12.4	10.2	8.9
FCF yield	-4.0%	-8.0%	1.3%	7.6%
Div Yield	0.0%	3.2%	4.1%	4.9%

Source: Company, GIB Capital

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