

Target Price: SAR165/share
Current Price: SAR144/share
Upside: +15% (+3.7% Div. Yield)
Rating: Overweight

Arabian Drilling Co.

Attractive valuation post recent pullback

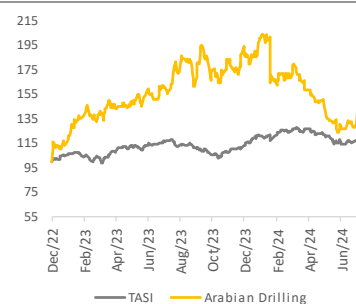
- Actively marketing the suspended rigs outside KSA, although it may take some time to deploy; growing onshore fleet remains a key performance driver in the near future.
- Cut 2024-25e top-line and EBITDA estimates by 5-7% and 10-14% to reflect the suspended rigs, and new conventional rig contracts; EBITDA margin to remain under pressure this year before improving from next year.
- Post revision in our estimates, we revise our TP to SAR165/share (SAR200 earlier) based on DCF and EV/EBITDA (9x on 2024-25e avg. EBITDA). After the recent pullback, ADC is trading an attractive EV/EBITDA of 8.0x for 2025e (8.8x 3Y historical 1Y fwd average), indicating a good buying level. Hence, we revise our rating to Overweight on the stock.

Stock data

TASI Ticker	2381
Mkt cap (SARmn)	12,816
Trd. Val 3m (SARmn)	34.6
Free float	30.0%
QFI holding	2.1%
TASI FF weight	0.17%

Source: Bloomberg

Prices indexed to 100



Source: Bloomberg

ADC may take longer period of time to deploy 3 suspended/non-renewal rigs... ADC has been witnessing a notable pressure following Aramco's decision to cancel 3 offshore rigs (out of 9 Aramco offshore rigs) for a period of 12 months. Of these, 2 were suspended at the end of May-24 (which had contracts until May-25 and July-25), and 1 was in early July-24 (which was due for renewal in the mid-June-24 but ADC decided not to renew it due to higher capex required to extend the contract). As per our estimates, ADC may witness a maximum annual impact of SAR400mn, implying ~22% impact on annualized 4Q23 offshore revenue and ~10% impact on annualized 4Q23 total revenue. Nonetheless, ADC is actively marketing 3 rigs outside KSA, either through partnerships and/or leasing agreements. However, despite the tight jack up market (~90% global utilization), it may take some time to deploy these rigs given that it is still not pre-qualified in any other markets (unlike ADES). Hence, we conservatively expect ADC to deploy 2 rigs during 2025e and 1 in 2026e. Overall, we expect the number of active offshore rigs to reach 9 by the end of 2024e, before rising to 11 by 2025e (12 rigs as of 1Q24).

... however deployment of 13 unconventional gas rigs to offset the impact: In 1Q24, ADC has signed multiple contracts to deploy 3 additional land rigs for Aramco's unconventional program. This is in addition to 10 new land rigs that it won from Aramco last year. All these rigs will be new-build (US\$40-50mn per rig capex) with a contract tenure of 5 years. The total value of these contracts is estimated to be above SAR3.8bn (SAR3bn for the earlier 10 rigs wins and SAR850mn for the recent 3 wins), implying a robust onshore day rate of over US\$43k (including rig day rate, mobilization/rig move revenues; higher than the avg. day rate of the existing fleets).

Figure 1: Key financial metrics

SARmn	2022a	2023a	2024e	2025e	2026e
Revenue	2,704	3,477	3,873	4,444	4,658
Revenue growth	23%	29%	11%	15%	5%
Gross Profit	801	976	1,038	1,266	1,408
Gross Profit margin	30%	28%	27%	28%	30%
EBITDA	1,144	1,485	1,596	1,863	2,004
Op. income	619	801	815	1,008	1,141
Net profit	558	605	542	685	815
Net profit margin	21%	17%	14%	15%	17%
EPS (SAR)	6.3	6.8	6.1	7.7	9.2
P/E	23.0x	21.2x	23.6x	18.7x	15.7x

Source: Company data, GIB Capital

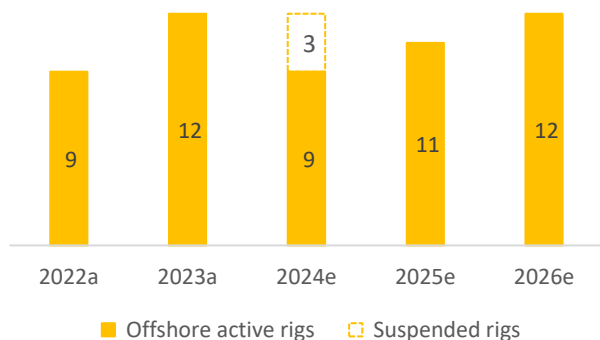
Kunal Doshi

+966-11-834 8372

Kunal.doshi@gibcapital.com

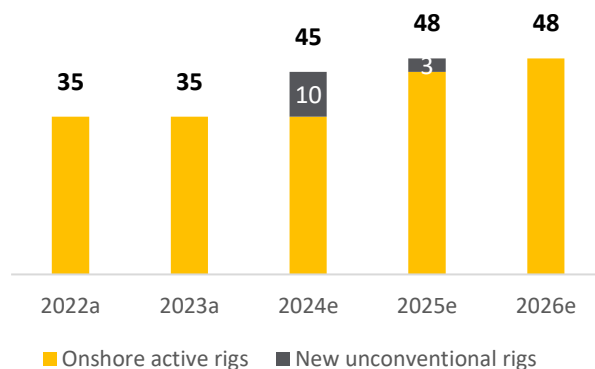
ADC has already deployed 4-5 onshore rigs (4 in 2Q and 1 likely in early July; well ahead of the schedule) to date out of the first 10 rigs and the remaining would likely be deployed gradually by mid-Sep 2024. Further, the company plans to deploy another 3 onshore rigs in 1Q25, taking the total land rig fleet count to 47 rigs by 2024e and 50 rigs by 1Q25e from 37 in 1Q24. These additional rigs should help the company generate ~SAR720mn annually, which should more than offset the impact of suspended rigs.

Figure 2: ADC's offshore active rigs



Source: Company data, GIB Capital

Figure 3: ADC onshore active rigs



Source: Company data, GIB Capital

EBITDA margin may remain under check in 2024e before gradually improving from next year:

Despite the commencement of 10 additional land rigs with higher-than-average land day rates, we expect the group-level EBITDA margin to decline from ~43% in 2023 to ~41% in 2024e. This is mainly due to i) increased contribution of low-margin onshore business post Aramco's suspended rigs, ii) higher pre-operating and one-off costs related to unconventional gas rigs, and iii) a rise in headcount (although the impact would be limited as most of the affected crews is expected to be repositioned towards the unconventional program). However, post-deployment of all 13 land rigs by 1Q25e, we expect the EBITDA margin to improve slightly to ~42% by 2025e and ~43% by 2026e.

2024e guidance remains unchanged: i) Despite the suspended rigs, ADC has maintained its earlier 2024e revenue guidance at SAR3.60-3.90bn (GIBC estimate: ~SAR3.87bn). 2) ADC has reiterated its capex guidance to SAR2.1-2.4bn (GIBC capex: ~SAR2.3bn) for 2024e to reflect spending related to the build-up of the additional rigs. 3) Leverage ratio is expected to rise due to increased capex (net debt to EBITDA: 2.0x for 2024e vs 1.2x in 2023).

Change in the estimates: Post factoring the suspended rigs and new unconventional rig contracts, we cut our top-line estimates by 5-7% and EBITDA estimates by 10-14% for 2024-25e. Further, we lower our EBITDA margin forecast by ~3ppts due to revenue mix changes.

Figure 4: Change in estimates

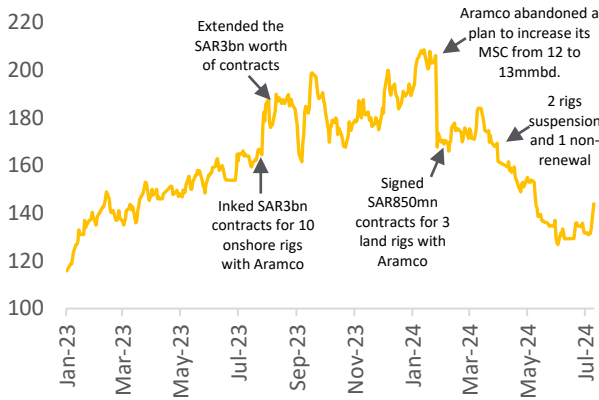
SARmn	2024e			2025e		
	Current	Earlier	% change	Current	Earlier	% change
Revenues	3,873	4,061	-5%	4,444	4,767	-7%
Gross profit	1,038	1,167	-11%	1,266	1,585	-20%
GPM %	26.8%	28.7%		28.5%	33.3%	
EBITDA	1,596	1,770	-10%	1,863	2,162	-14%
EBITDA margin %	41.2%	43.6%		41.9%	45.4%	

Source: GIB Capital

The recent pullback offers an attractive entry point: ADC’s stock price has corrected by over ~25% YTD, mainly due to concerns over suspended rigs post Aramco’s cancellation of the earlier plan of raising MSC from 12mmb/d to 13mmb/d. We acknowledge these concerns and believe that ADC is relatively more impacted than its locally listed peer, ADES, particularly due to its Saudi-focused strategy. However, the recent pulldown in stock price seems overdone, which has placed the stock at an attractive level, trading at an attractive EV/EBITDA of 8.0x for 2025e (3Y historical average of 8.8x), over a 23% discount to ADES’s EV/EBITDA of 10.5x for 2025e.

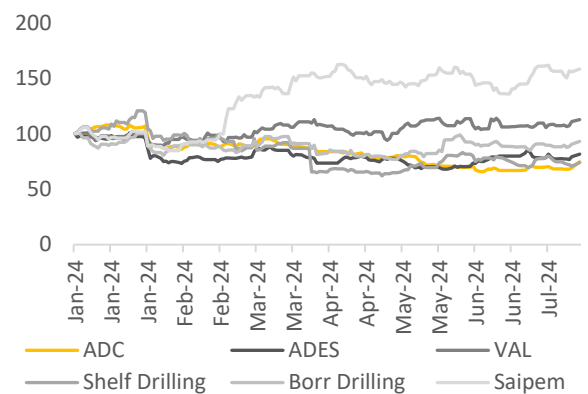
We see this as a good buying opportunity for the investors, due to i) expanding the onshore fleet by 13 rigs, ii) a further opportunity in conventional and unconventional gas drilling in the Jafurah gas field (although not factoring it in our forecasts), iii) likely deployment of most suspended rigs in 2025e (sooner-than-expected timeline would act as an upside risk to our valuation), iv) strong FCF yield (~10% post growth capex period with ~65% FCF conversion rate) and v) sustainable dividend payout (80% throughout our forecasted periods).

Figure 5: ADC’s price performance



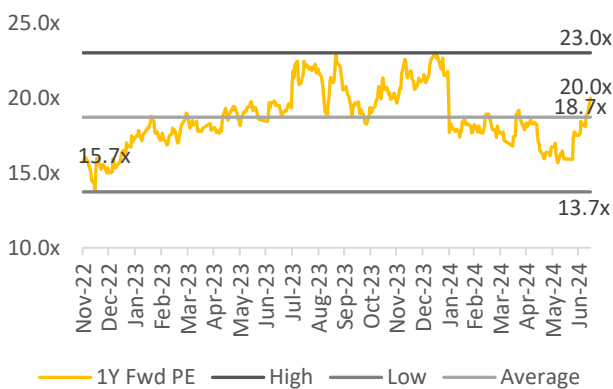
Source: Bloomberg, GIB Capital

Figure 6: ADC price performance YTD vs its peers (Rebased to 100)



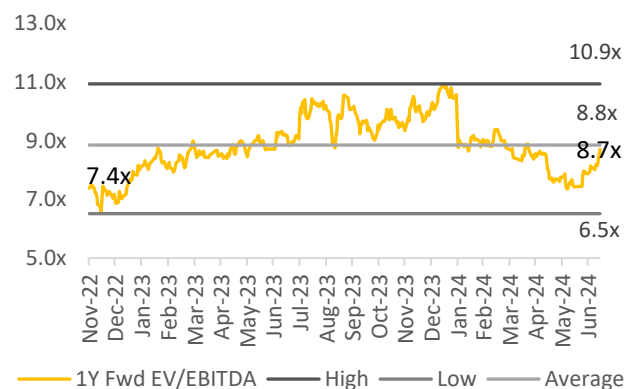
Source: Bloomberg, GIB Capital

Figure 7: ADC 1Y Forward P/E trend



Source: Bloomberg, GIB Capital

Figure 8: ADC 1Y Forward EV/EBITDA trend



Source: Bloomberg, GIB Capital

Valuation and risks: Post revision in our estimates, we revise our target price to SAR165/sh. (SAR200 earlier) based on the DCF valuation method (9.0% WACC and 2% terminal growth) and EV/ EBITDA (9x on 2024-25e average EBITDA). The upside risks include higher-than-expected deployment of idle rigs, any regional expansion (as announced during the IPO earlier), and better-than-expected revision in day rates on renewals. Key downside risks include 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.

Figure 9: DCF Valuation

DCF model (SARmn)	2024e	2025e	2026e	2027e	2028e	2029e	2030e
EBIT	815	1,008	1,141	1,153	1,173	1,177	1,192
Taxes	(80)	(102)	(122)	(130)	(137)	(143)	(149)
EBIT minus taxes	735	906	1,019	1,023	1,036	1,035	1,043
(+) Depreciation & amortization	781	855	863	860	860	861	862
(+/-) Change in working capital	(112)	(138)	(73)	(21)	(26)	(20)	(23)
(-) Capex	(2,324)	(1,022)	(540)	(542)	(546)	(547)	(549)
Free Cash Flow to Firm	(920)	601	1,269	1,320	1,325	1,329	1,333
Terminal value							19,514
PV of FCF (explicit period)	4,153						
PV terminal	11,202						
EV	15,356						
(-) Debt, incl. lease liabilities	(3,108)						
(+) Cash	1,258						
(-) Minority	0						
(-) Pension/other liabilities	(311)						
(+) Investments	0						
Equity value	13,195						
Number of Shares	89						
Equity value per share	148						
Target price (one year forward)	164						
Cost of Equity	10.5%						
Cost of debt	5.4%						
Target D/A	30.0%						
WACC	9.0%						

Source: GIB Capital. * Target price is rounded, and time value adjusted 1 year forward ** using 2% Terminal growth rate

Figure 10: Relative valuation and blended valuation

EV/EBITDA based valuation (SAR)		Blended valuation (SAR)	
EV/EBITDA	9	EV/EBITDA price	166
Avg. 2024-25e EBITDA (SARmn)	1,729	DCF price	164
EV/EBITDA-based price*	166	Average target price (SAR)*	165

Source: GIB Capital. * Target price is rounded, and time value adjusted 1 year forward

Summarized financial statements

Figure 11: Financials

Income statement	2023a	2024e	2025e	2026e
Revenue	3,477	3,873	4,444	4,658
revenue y/y	29%	11%	15%	5%
COGS	2,501	2,835	3,179	3,249
Gross Profit	976	1,038	1,266	1,408
Gross Profit margin	28%	27%	28%	30%
G&A	181	232	267	277
Other expenses / (income)	(6)	(9)	(9)	(9)
Operating profit	801	815	1,008	1,141
Operating margin	23%	21%	23%	24%
Finance costs	161	231	228	208
Net income	605	542	685	815
Net margin	17%	14%	15%	17%
y/y	8%	-10%	26%	19%
EPS	6.8	6.1	7.7	9.2
DPS	5.1	4.8	6.2	7.3
Payout	74%	79%	80%	80%
EBITDA	1,485	1,596	1,863	2,004
Net debt	1,754	3,269	3,409	2,966
Balance Sheet	2023a	2024e	2025e	2026e
Inventories	280	317	356	363
Trade Receivables	1,072	1,195	1,371	1,437
Other Current Assets	13	13	13	13
Cash and Equivalents	1,435	148	75	302
Total Current Assets	2,801	1,673	1,815	2,115
Intangible Assets	0	0	0	0
Property, Plant & Equipment	7,738	9,344	9,543	9,236
Total Non-Current Assets	7,886	9,429	9,596	9,273
Total Assets	10,686	11,102	11,410	11,388
Current Liabilities	1,091	1,138	1,199	3,192
Non-current Liabilities	3,634	3,887	3,998	1,820
Equity	5,961	6,077	6,214	6,377
Total Equity and Liabilities	10,686	11,102	11,410	11,388
BVPS	67.0	68.3	69.8	71.6
Cashflow	2023a	2024e	2025e	2026e
Cashflow from Operations	1,360	1,236	1,430	1,635
Cashflow from Investing	(789)	(2,324)	(1,022)	(540)
Cashflow from Financing	33	(199)	(481)	(869)
Total Cashflows	603	(1,287)	(73)	227

Source: Company, GIB Capital

Summarized key ratios

Figure 12: Key ratios

Key ratios	2023a	2024e	2025e	2026e
Profitability ratios				
RoA	6%	5%	6%	7%
RoE	10%	9%	11%	13%
Sales/Assets	33%	35%	39%	41%
Net margin	17.4%	14.0%	15.4%	17.5%
EBITDA margin	42.7%	41.2%	41.9%	43.0%
Liquidity ratios				
Current Assets/ Current Liabilities	2.6	1.5	1.5	0.7
Debt to Total Equity	51%	55%	55%	51%
Receivable Days	113	113	113	113
Inventory Days	41	41	41	41
Payable days	106	100	98	96
Debt ratios				
Net Debt/EBITDA	1.2	2.0	1.8	1.5
Debt/Assets	0.3	0.3	0.3	0.3
Valuation ratios				
P/E	21.2	23.6	18.7	15.7
P/B	2.1	2.1	2.1	2.0
EV/EBITDA	10.1	9.4	8.0	7.5
FCF yield	-5.3%	-7.2%	4.7%	9.9%
Div Yield	3.5%	3.3%	4.3%	5.1%

Source: Company, GIB Capital

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Contact us for queries:

Sell Side Research Department,
GIB Capital,
B1, Granada Business & Residential Park,
Eastern Ring Road, PO Box 89589, Riyadh 11692
www.gibcapital.com