Arabian Drilling Co
Energy
ARABIAND AB: Saudi Arabia
24 May 2023

US$3.750bn	30.00%	US$7.35mn
Market Cap	Free Float	Avg. Daily Volume

Target price	175.00	11.0% above current
Current price	158.00	as at 23/05/2023

Existing rating

Underweight | Neutral | **Overweight**

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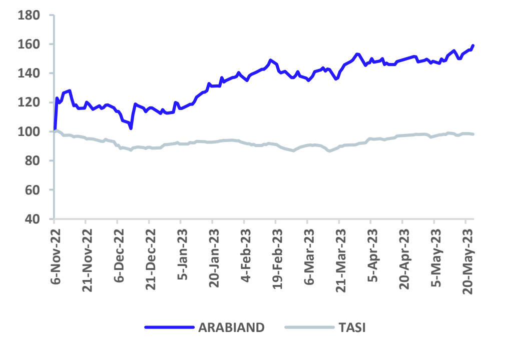
Performance(Rebased to 100)



Earnings

(SARmn)	2022A	2023E	2024E
Revenue	2,704	3,292	3,541
Y-o-Y	22.9%	21.8%	7.6%
Gross profit	801	937	1,118
Gross margin	29.6%	28.5%	31.6%
Net profit	558	689	833
Y-o-Y	103.9%	23.5%	20.9%
Net margin	20.6%	20.9%	23.5%
EPS (SAR)	6.8	7.7	9.4
DPS (SAR)	-	-	4.7
Payout ratio	0.0%	0.0%	50.0%
P/E (Curr)	23.1x	20.4x	16.9x
P/E (Target)	25.6x	22.7x	18.7x

Source: Company data, Al Rajhi Capital.

Arabian Drilling Co.

TP increased to SAR175/sh, fleet expansion to fuel growth

Arabian Drilling's Q1 2023 revenue growth was robust y-o-y on account of increase in active rigs with offshore revenues growing by 86% y-o-y and onshore revenues registering a growth of 10% y-o-y. On a sequential basis, the rig activity level and fleet utilisation levels primarily remained stable. Q1 2023 offshore revenues were higher as compared to Q4 2022 due to full impact of 2 new Jackups against a partial impact last quarter. However, the onshore revenues were marginally lower by 5% q-o-q due to ongoing maintenance activities.

In our view 2023 earnings for Arabian Drilling will continue to be healthy as the strong market share and additional rig deployment shall act as tailwinds for ADC. Besides the contribution of drilling revenues to the overall revenue mix is on a rising trajectory. We expect improvement in drilling revenues to be driven by increase in contribution from high margin offshore rigs. On the other hand, FY23 gross margins might witness a marginal drop owing to increase in cost of sales on account of an increase in employee costs in light of the retention plan for key personnels. Nevertheless, the impact cost of recruitment shall improve in the second half as and when the additional rigs are deployed. The company also has a strong order backlog (Book to bill ratio at 2.8x) in place with the offshore segment contributing ~55% to the backlog. Besides, we also believe the company is well placed to benefit from the rising rig demand in the Kingdom owing to strong oil market fundamentals and from the Jafurah oil field development which shall provide more legs to grow in form of incremental land drilling rigs. We continue to be positive on the company on account of the following reasons- i) ADC continues to be one of the largest land drilling rig contractors with 17% market share as of 1Q 2023, ii) 70% of the current order backlog pertains to contracts with Saudi Aramco, iii) High REI scores to pave way for future contract renewals and improvement in day rates, iv) Capex guidance of ~SAR1.2-1.4bn for 2023 of which about 50% is to be incurred towards growth and v) significant growth potential which the company shall tap by way of expanding its fleet size in Saudi Arabia as well as in other regional markets. Overall, post Q1 2023 earnings, we revise our TP to SAR175/sh from SAR152/sh earlier, implying an "Overweight" rating. We believe the steady oil demand in the Kingdom and the current fleet expansion plan shall continue to underpin the growth for Arabian Drilling Company.

Q1 2023 results: Top-line increased 30% y-o-y to ~SAR779mn, and was modestly above our estimate of SAR745mn, mainly driven by additional revenue from two new offshore active rigs. Gross profit and Operating profit too improved y-o-y but were lower than estimates, as a result of higher-than -expected cost of sales. Accordingly, net income was reported at ~SAR141mn marginally lower than our estimates.

Figure 1 **Q1 2023 Earnings**

(SAR mn)	Q1 2023	Q4 2022	Q1 2022	ARC est.	Cons est.	*q-o-q*	*y-o-y*	*vs ARC*	*vs Cons*
Revenue	779	750	599	745	806	*4%*	*30%*	*5%*	*-3%*
Gross Profit	207	241	157	244	NA	*-14%*	*32%*	*-15%*	*NM*
G. margin	27%	32%	26%	33%	NA				
Operating Profit	173	168	124	186	NA	*2%*	*39%*	*-7%*	*NM*
Op. margin	22%	22%	21%	25%	NA				
Net Profit	**141**	**137**	**94**	**149**	**148**	*4%*	*51%*	*-5%*	*-4%*
Net margin	*18%*	*18%*	*16%*	*20%*	*18%*				

Source: Company data, Al Rajhi Capital

Valuations: We value the company based on an equal mix of DCF and P/E. The DCF valuation method based on 8.68% cost of equity and WACC range of 6.92%-8.65% during the forecasted period implies a TP of SAR173/sh and P/E method implies a TP of SAR178/sh using a multiple of 23x on 2023e EPS. Our blended valuation gives a weighted average TP of SAR175/sh, implying a 11% upside from current levels. Based on the current TP we maintain our rating at “Overweight”.

Risks: The key downside risk to our valuation is lower than expected utilisation levels, deterioration in Rig Efficiency Index, increase in Non-Productive Time and delay in deployment of upcoming rigs.

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"Neutral": We expect the share price to settle at a level between 10% below the current share price and 10% above the current share price on a 12 month time horizon.

"Underweight": Our target price is more than 10% below the current share price, and we expect the share price to reach the target on a 12 month time horizon.

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