الراجحي المالية
alrajhi capital

US$2.87bn	30.00%	US$10.14mn
Market Cap.	Free Float	Avg. Daily Value traded

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Arabian Drilling Co.

Most of the negatives priced in, we turn Overweight

Overweight

Price Target (SAR): 140.00

Current (7th August 2024): 121.00
Upside/Downside: 16% above current

Valuation Multiples	23	24E	25E
P/E (x)	17.8	21.0	17.3
P/B (x)	1.8	1.7	1.6

Major Shareholders	% Ownership
Manufacturing & Energy Services Co.	35.70
Services Petroliers Schlumberger	34.30

Price Performance	YTD	3M	1M
Absolute	-7.1%	-20.0%	-35.0%
Relative to TASI	-7.5%	-14.9%	-33.0%

Earnings

(SARmn)	2023	2024E	2025E
Revenue	3,477	3,645	3,832
Revenue Growth	28.6%	4.8%	5.1%
Gross Profit	976	951	1,082
Gross Margin	28.1%	26.1%	28.2%
EBITDA	1,561	1,605	1,655
EBITDA margin	44.9%	44.0%	43.2%
Net profit	605	514	624
Net Profit Growth	8.4%	-15.1%	21.5%
Net margin	17.4%	14.1%	16.3%
EPS (SAR)	6.8	5.8	7.0
DPS (SAR)	5.1	2.6	3.5
Payout ratio	74.5%	45.0%	50.0%
P/E (Curr)	17.8x	21.0x	17.3x
P/E (Target)	20.6x	24.3x	20.0x

Source: Company data, Al Rajhi Capital

Arabian Drilling's (ADC) Q2 2024 results were hurt by start-up cost pressures related to the unconventional rig deployment and the suspension of the offshore rigs. At the same time, the reported numbers were marred by the one-off impairment charge worth SAR105mn. The revenue was just 1% below expectations, while adjusted EBITDA was broadly in line with our expectations. On the positive side, the negative impact on the topline from offshore suspension was mostly offset by the early deployment of the unconventional land rigs. Hence, the active rig count for the quarter held strong at 48 (versus 47 in Q1 2024). Despite the additional offshore rig suspension, ADC has reiterated its FY 2024 revenue guidance as it now plans to deploy all the 13 unconventional rigs by the end of the year (earlier 3 rigs were to be deployed in Q125).

The street has largely shrugged off the Q2 earnings and is now weighing the impact of additional rig suspension in the offshore (in total 4 rigs now), possibility of rig suspension in onshore oil and the positive benefits from the gas rig awards for Jafurah phase 2. In our view, the suspension of land oil rigs could be a blessing in disguise as the company can redeploy the same oil rig for the unconventional gas contract in a quicker timespan and at a minimal upgradation capex of SAR 5-10 mn per rig. Moreover, the higher day rates and better margins in the unconventional gas rig should be earnings accretive. On the offshore front, the additional suspension does impact the topline and the margins, however, in our view the recent stock price correction is pricing in the impact to a large extent and ignoring the prospects of the unconventional gas story. Thus, we upgrade our recommendation to Overweight, albeit our target price is lowered to SAR 140/share now.

Early deployment of gas rigs to offset impact of offshore suspension: *The company has already deployed 5 rigs (4 were deployed in Q2) out of the 13 unconventional gas rigs for Aramco ahead of time. Moreover, ADC is all* set to deploy additional 5 rigs before the end of September and the remaining 3 rigs by the end of year, which earlier were to be deployed in Q1 2025. Consequently, H2 2024 revenues will be underpinned by the early deployment of the unconventional gas rigs and offset the impact of offshore rig suspension to a large extent. However, the startup costs related to the unconventional rigs will continue to exert pressure on the near-term margins in FY24. The ongoing margin compression can also be partly attributed to the changing onshore: offshore mix. Nevertheless, the outlook from FY25 onwards continues to be strong as the company is poised for margin expansion primarily due to normalization of start-up costs and full operational impact of 13 unconventional rigs. At the moment, our financial projections do not incorporate the revenue accrual from securing of Jafurah phase 2 awards due to lack of official confirmation, but we do incorporate the option value to arrive at our target price. We trim our 2024 and 2025 estimates versus before to account for the suspension of the offshore rigs and do not consider redeployment of these rigs in our estimates yet.

Expected suspension of land oil rigs could be a blessing in disguise- Under the purview of its strategic expansion in gas, Aramco has recently awarded contracts for phase 2 of the Jafurah gas field. Hence, tapping into contracts for additional gas rigs cannot be ruled out for Arabian Drilling. It is worth mentioning that materialization of the recent speculation around suspension of land rigs has the potential to impact the company, but any loss of revenue can be more than offset by the incremental rigs awarded in Jafurah Phase 2. The commendable execution of deployment of the 13 rigs ahead of schedule could play a key factor when Aramco starts the tendering for Jafurah phase 2. We believe the company can replicate a similar to higher win rate in phase 2 of the award (57% win rate in phase 1), but we prefer to be conservative and consider only 50% win rate. Assuming the phase 2 tender spans 10 rigs (in 2 batches of 5 rigs each), at a win rate of 50% we build in a possibility of ADC securing awards for 5 gas rigs. On onshore oil rig suspension, we expect suspension of 3 rigs, but at the same time we assume these oil rigs will be upgraded and deployed for the new contract. Our optimism stems from the fact that land rigs for oil can easily be upgraded and equipped to convert into a gas rig with minimal capex requirements (SAR5-10mn) and hence we foresee this to be a blessing in disguise. Moreover, unconventional gas rigs come at a higher day rate and better EBITDA margin (~40%) vis-à-vis land oil rigs (EBITDA margin: 25-30%) thereby being earnings accretive.

Figure 1 **Incremental Unconventional Rigs Calculation**

Incremental Unconventional Rigs	
Jafurah Phase 2 tender total expected rig count	10
Arabian Drilling win rate in Phase 1	57%
Arabian Drilling expected win rate in Phase 2 **	50%
Expected rig awarded in Jafurah Phase 2	5
Expected onshore rig suspension	3
Incremental onshore rigs added	**2**

Source: Company Data, Al Rajhi Capital; *Won 13 rigs out of the 23 tendered in Phase 1
**ARC estimate

Figure 2 **Incremental Revenue Calculation**

Incremental Revenue and EBITDA (SARmn)	
Jafurah Phase 2 awarded rigs	5
Assumed day rates ($k/d)	42
Revenue (SARmn)	**276**
Onshore rigs suspension	3
Assumed day rates ($k/d)	38
Loss of Revenue (SARmn)	**(148)**
Incremental Revenue (SARmn)	**128**
EBITDA margin for gas rigs	40%
EBITDA margin on oil rigs	30%
Absolute EBITDA from 5 gas rigs (SARmn)	110
Loss of EBITDA from 3 oil rigs (SARmn)	(44)
Incremental EBITDA (SARmn)	**66**

Source: Company Data, Al Rajhi Capital; Assumed 96% utilization rate

Jafurah Option valuation	Calculation	Comments
Incremental EBITDA (SARmn)	**66**	
Target Multiple	8.5x	
EV	**561**	
Expected capex:		
2 new builds	*281*	Capex per rig pegged at $35-40mn; we assume mid point
3 conversions	*30*	Capex for conversion pegged at SAR5-10mn per rig; we assume upper end
Total capex	311	
Debt funding	(78)	Assumed 25% debt financing
Equity value (SARmn)	**483**	
No. of shares (mn)	89	
Option value (SAR/sh)	**5**	

Company data, Al Rajhi Capital

Valuations: We value the company based on a blend of relative valuation methodologies (P/E and EV/EBITDA) and implied option valuation for opportunities in gas. Using the P/E approach with a target multiple of 21x on an average of 2024-2025e EPS, we arrive at a fair value of SAR134/sh. We assign lower multiple (20% discount) than ADES (target multiple 26x) due to Arabian Drilling's limited presence in the global market. On the other hand, the EV/EBITDA valuation method implies a fair value price of SAR135/sh at a target multiple of 8.5x (Ades' target multiple 10.5x) on an average of 2024-2025e EBITDA. In addition to this, we integrate the option value from Jafurah Phase 2 awards assigning a similar EBITDA multiple of 8.5x to incremental EBITDA to arrive at an option value of SAR5/sh. As we await detailed disclosures from the company and anticipate stiff competition, we consider only 50%-win rate compared to 57% in Phase 1. Our target price, explained below, is SAR 140/share, that implies upside of 16% from the current levels. Thus, we upgrade our recommendation to 'Overweight' from 'neutral'.

Figure 1 **Valuation Summary**

Valuation Methodology	Relative Valuation P/E
Average 2024-2025e EPS	6.39
Target P/E Multiple	**21.0x**
Fair value per share (SAR)	**134**

Valuation Methodology	Relative Valuation EV/EBITDA
Average 2024-2025e EBITDA	1,630
Target EV/EBITDA multiple	**8.5x**
EV	13,857
Less:Net Debt	(1,850)
Equity Value	**12,007**
Fair value per share (SAR)	**135**

Valuation Summary	Fair Value (SAR/sh)	Weights (%)	Target Price (SAR/sh)
P/E based fair value	135	50	67
EV/EBITDA based fair value	134	50	67
Fair Value Price per share (SAR)			**135**
Jafurah Option Fair Value			**5.4**
Target Price per share (SAR)			**140**
Upside/ (Downside)			*15.7%*

Company data, Al Rajhi Capital; Net debt is based on Q12024

Financials

Figure 2 **Income Statement**

(SAR mn)	2023	2024E	2025E
Revenue	**3,477**	**3,645**	**3,832**
Cost of revenues	(2,501)	(2,694)	(2,750)
Gross profit	**976**	**951**	**1,082**
Provision for impairment on financial assets	(1)	0	0
General and administrative expenses	(181)	(186)	(195)
Other operating income	7	0	0
Operating profit	**801**	**765**	**886**
Finance costs	(161)	(222)	(227)
Finance income	48	48	49
Profit before zakat and income tax	**688**	**590**	**709**
Zakat and income tax	(83)	(77)	(85)
Profit for the period	**605**	**514**	**624**
EPS	6.79	5.77	7.01
EBITDA	**1,561**	**1,605**	**1,655**

Source: Al Rajhi Capital estimates * FY25 financials do not incorporate revenues and earnings from potential wins in Jafurah Phase 2

Figure 3 **Balance sheet**

(SAR mn)	2023	2024E	2025E
Assets			
Cash and cash equivalents	1,435	1,098	1,684
Inventories	280	207	203
Trade and other receivables	1,072	799	777
Assets held for sale	13	13	13
Total current Assets	**2,801**	**2,117**	**2,678**
Property, plant and equipment	7,738	9,080	8,850
Right-of-use assets	132	118	101
Long term deposits	16	16	16
Total non-current assets	**7,886**	**9,214**	**8,968**
Total assets	**10,686**	**11,332**	**11,645**
Liabilities			
Trade and other payables	729	650	641
Current portion of long-term borrowings	168	100	200
Current portion of lease liabilities	67	60	52
Mobilization of revenues	94	94	94
Provision for zakat and income tax	32	32	32
Total current liabilities	**1,091**	**936**	**1,019**
Long-term borrowings	2,886	3,386	3,286
Lease liabilities	68	61	52
Employee benefit obligations	304	330	357
Mobilization revenue	212	212	212
Deferred tax liabilities	164	164	164
Total non-current liabilities	**3,634**	**4,152**	**4,071**
Shareholders' equity			
Share capital	890	890	890
Additional paid-in capital	791	791	791
Statutory reserve	267	267	267
Retained earnings	4,014	4,296	4,608
Total equity	**5,961**	**6,244**	**6,556**
Total liabilities	**10,686**	**11,332**	**11,645**

Source: Al Rajhi Capital estimates

Figure 4 **Cash Flow Statement**

(SAR mn)	2023	2024E	2025E
Operating activities	1,360	1,566	1,508
Investing activities	(789)	(2,089)	(593)
Financing activities	33	186	(329)
Change in cash	**603**	**(337)**	**586**
Cash and cash equivalents, start of the period	832	1,435	1,098
Cash and cash equivalents, end of the period	**1,435**	**1,098**	**1,684**

Source: Al Rajhi Capital estimates

Figure 5 **Key Ratios**

KPIs	2023	2024E	2025E
Gross margin (%)	28.1%	26.1%	28.2%
EBITDA margin (%)	42.7%	41.8%	45.0%
Operating margin (%)	23.0%	21.0%	23.1%
Net margin (%)	17.4%	14.1%	16.3%
ROA (%)	5.7%	4.5%	5.4%
ROE (%)	10.1%	8.2%	9.5%
D/E (x)	0.5x	0.6x	0.5x
Net debt/EBITDA (x)	1.2x	1.6x	1.1x

Source: Al Rajhi Capital estimates

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