Company In-Depth

13 August 2007 | 15 pages

Aban Offshore (ABAN.BO)

Rating change
Target price change
Estimate change

Buy: Raising Target; Market Conditions Remain Favourable

- **Increasing target to Rs3530** — On the back of improving earnings visibility and continued robust day rates as evidenced by recent order win announcements. Our new target is based on a P/E of 8x fully evolved earnings, likely to be achieved by FY10E (and discounted back), at the lower end of global peer comps. Aban remains a material, leveraged play on the tight offshore services market. We rate the stock a Buy (1M).
- **Jackup market strong despite supply addition concerns** — Though the international (ex-GOM) jackup market remains strong with utilizations in excess of 95%, supply additions are a risk. Deficits in several international markets should, however, result in absorption of newbuilds entering the market over the next 9-12 months without impacting day rates. The long-term outlook for the sector remains solid, with steadily rising long-term oil price expectations.
- **Revising FY08-10E earnings** — We are revising our FY08E EPS downwards by 21% to factor in delays to the drilling schedules of a couple of rigs. Our FY09E EPS remains relatively unchanged, while we have modestly increased our FY10E EPS forecasts by 5%, driven by a combination of new contract wins, updated newbuild delivery dates, FY07 annual report details, and a lower diluted share count following fixing of the FCCB conversion price.
- **Risks** — Slowdown in offshore services demand growth, downturn in global jackup day rates, and delays in rig deliveries could have a significant impact on Aban given its high gearing. Re-pricing of some of Aban's assets, in particular four domestic rigs, could be catalysts for stock performance in the near term.

Buy/Medium Risk	1M
from Buy/High Risk	
Price (10 Aug 07)	Rs2,859.05
Target price	Rs3,530.00
from Rs2,850.00	
Expected share price return	23.5%
Expected dividend yield	0.2%
Expected total return	**23.6%**
Market Cap	Rs105,759M
	US$2,613M

Price Performance (RIC: ABAN.BO, BB: ABAN IN)

See Appendix A-1 for Analyst Certification and important disclosures.

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	715	18.56	32.4	154.0	37.6	28.6	0.1
2007A	-502	-13.04	-170.3	nm	47.0	-19.9	0.1
2008E	3,900	101.25	876.4	28.2	17.8	95.3	0.2
2009E	13,657	354.58	250.2	8.1	4.3	90.0	0.3
2010E	19,050	494.59	39.5	5.8	2.5	56.5	0.3

Source: Powered by dataCentral

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[1]Citigroup Global Markets India Private Limited

Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	154.0	nm	28.2	8.1	5.8
EV/EBITDA adjusted (x)	41.0	45.8	13.3	6.9	5.4
P/BV (x)	37.6	47.0	17.8	4.3	2.5
Dividend yield (%)	0.1	0.1	0.2	0.3	0.3
Per Share Data (Rs)					
EPS adjusted	18.56	-13.04	101.25	354.58	494.59
EPS reported	18.56	-13.04	101.25	354.58	494.59
BVPS	76.10	60.86	160.59	660.95	1,164.95
DPS	2.60	3.00	5.00	8.00	10.00
Profit & Loss (RsM)					
Net sales	4,902	7,187	23,425	41,515	49,662
Operating expenses	-3,112	-4,978	-10,093	-15,154	-18,440
EBIT	**1,790**	**2,209**	**13,331**	**26,361**	**31,221**
Net interest expense	-436	-2,686	-7,570	-7,660	-6,625
Non-operating/exceptionals	148	881	425	364	705
Pre-tax profit	**1,501**	**403**	**6,186**	**19,066**	**25,302**
Tax	-678	-747	-1,982	-4,020	-4,214
Extraord./Min.Int./Pref.div.	-108	-159	-305	-1,389	-2,038
Reported net income	**715**	**-502**	**3,900**	**13,657**	**19,050**
Adjusted earnings	715	-502	3,900	13,657	19,050
Adjusted EBITDA	2,804	3,474	15,338	29,152	34,484
Growth Rates (%)					
Sales	69.3	46.6	225.9	77.2	19.6
EBIT adjusted	85.6	23.4	503.6	97.7	18.4
EBITDA adjusted	86.7	23.9	341.5	90.1	18.3
EPS adjusted	32.4	-170.3	876.4	250.2	39.5
Cash Flow (RsM)					
Operating cash flow	**2,295**	**2,270**	**1,739**	**16,777**	**25,253**
Depreciation/amortization	1,014	1,266	2,007	2,791	3,263
Net working capital	458	1,348	-4,472	-1,059	903
Investing cash flow	**-8,341**	**-35,383**	**-15,595**	**-7,600**	**-2,000**
Capital expenditure	-8,341	-35,383	-15,595	-7,600	-2,000
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**3,894**	**97,302**	**-817**	**-8,027**	**-16,342**
Borrowings	3,919	97,427	-690	-7,770	-16,000
Dividends paid	-109	-130	-216	-346	-432
Change in cash	**-2,153**	**64,189**	**-14,672**	**1,150**	**6,911**
Balance Sheet (RsM)					
Total assets	**17,163**	**121,520**	**122,677**	**139,429**	**144,336**
Cash & cash equivalent	135	13,264	3,744	10,836	17,376
Accounts receivable	699	2,033	4,136	6,002	6,470
Net fixed assets	15,466	49,647	63,298	68,170	66,971
Total liabilities	**14,359**	**119,272**	**116,745**	**112,833**	**97,389**
Accounts payable	771	4,539	3,130	4,950	4,442
Total Debt	12,598	111,585	110,895	103,125	87,125
Shareholders' funds	**2,804**	**2,248**	**5,932**	**26,597**	**46,948**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	57.2	48.3	65.5	70.2	69.4
ROE adjusted	28.6	-19.9	95.3	90.0	56.5
ROIC adjusted	9.0	2.6	11.0	19.7	23.1
Net debt to equity	444.4	nm	nm	347.0	148.6
Total debt to capital	81.8	98.0	94.9	79.5	65.0

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Adjusting FY08-10E earnings

The following table highlights key changes to our estimates for Aban over FY08-10E.

Figure 1. Aban – Earnings Revisions

Year to	Sales			Net Profit (Rs Mils.)			Diluted EPS (Rs)		
31-Mar	Old	New	% Chg	Old	New	% Chg	Old	New	% Chg
2008E	28,565	23,425	-18.0%	5,135	3,900	-24.0%	127.51	101.25	-20.6%
2009E	43,173	41,515	-3.8%	14,538	13,657	-6.1%	355.49	354.58	-0.3%
2010E	51,151	49,662	-2.9%	19,282	19,050	-1.2%	470.49	494.59	5.1%

Source: Citigroup Investment Research estimates

The changes to our earnings estimates are primarily on the back of the following:

1. Delays in rig schedules – timelines of drillship Aban Abraham have been delayed, with drilling operations now likely to commence in West Africa in Dec-07 (vs. our earlier assumption of Jul-07). Jackup Murmanskaya too has been delayed, and drilling is now likely to start in Oct-07 (vs. our assumption of Jun-07). This is the primary reason for the 21% reduction in our near-term (FY08E) earnings.

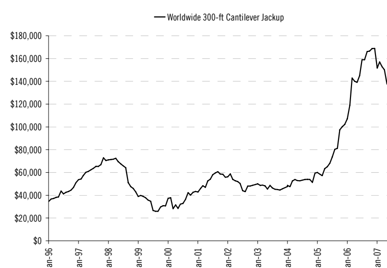
2. Modest changes to day rate assumptions – we have made minor adjustments to our day rate forecasts for Aban's various assets, principally on the back of new contract wins over the last few months. Our new day rate assumptions are illustrated in Figure 3 below. Key highlights include:

   - Increasing day rate forecasts for jackup rigs Aban III, IV, and V (coming up for renewal between Nov-07 and Jan-08) from US$130K to US$150K, slightly higher than the US$147.5K day rate for the contract that Transocean won from ONGC for similar rigs last year.

   - Slightly higher day rates for Aban VI (US$60K vs. US$40K earlier) and Aban VII (US$140K after the ongoing OVL contract ends vs. US$130K earlier), driven by the continued strength in global day rates, and for FPU Tahara (US$87.5K vs. US$80K earlier), as per the contract with Hardy Oil recently announced.

   - Day rate forecasts for Sinvest's premium jackup rigs in the US$200-220K range. This is based on some of the recent contracts announced by Aban (jackups Deep Driller 4, Deep Driller 5, and Murmanskaya have recently been contracted out at US$220K, US$200K, and US$195K respectively) and is in line with the day rates that similar high-end jackups are attracting globally.

Figure 2. Jack-up Day Rates (US$)



Source: ODS, Citigroup Investment Research

Figure 3. Aban – Day Rate Assumptions for Assets (US$)

Asset	Contract validity	Client	Location	FY08	FY09	FY10
Jack-up – Aban II	May-10	ONGC	East Coast	$85,000	$85,000	$85,000
Jack-up – Aban III	Jan-08	ONGC	Mumbai High	$71,667	$150,000	$150,000
Jack-up – Aban IV	Nov-07	ONGC	Mumbai High	$86,460	$150,000	$150,000
Jack-up – Aban V	Jan-08	ONGC	Mumbai High	$70,833	$150,000	$150,000
Jack-up – Aban VI	Oct-07	Oriental Oil	Dubai	$50,000	$60,000	$60,000
FPU – TAHARA	Jul-09	Hardy Oil	East Coast	$71,433	$87,500	$85,625
DRILL SHIP – FRONTIER ICE	Mar-08	ONGC	Mumbai High	$81,667	$100,000	$100,000
Jack-up – Aban VII (ROWAN TEXAS)	Oct-07	OVL	Qatar	$160,000	$140,000	$140,000
DRILL SHIP – Aban Abraham	Jun-09	Kosmos Energy	West Africa	$325,000	$388,750	$410,000
Jack-up – Aban VIII	Q108*	—	—		$180,000	$180,000
Jack-up – Deep Driller 1	May-09	GSPC	India	$191,750	$200,000	$200,000
Jack-up – Deep Driller 2	Oct-07	Shell	Brunei	$195,000	$200,000	$200,000
Jack-up – Deep Driller 3	May-08	Petronas	Malaysia	$197,500	$220,000	$220,000
Jack-up – Deep Driller 4	Q307*	NA	South Asia	$220,000	$220,000	$220,000
Jack-up – Deep Driller 5	Mar-08	Cairn	Bangladesh	$200,000	$200,000	$200,000
Jack-up – Deep Driller 6	Q308*	—	—		$200,000	$200,000
Jack-up – Deep Driller 7	Q308*	—	—		$200,000	$200,000
Jack-up – Deep Driller 8	Q109*	—	—			$220,000
Drillship "Deep Venture" (50% stake)	Nov-08	Exxon Mobil	West Africa	$410,000	$410,000	$410,000
Jack-up – Murmanskya"	Mar-08	ROC OIL	China	$215,000	$200,000	$200,000

*Delivery dates for assets under construction

Source: Company reports and Citigroup Investment Research

3. Impact of rupee appreciation – our INR/USD exchange rate assumptions are now Rs40/$ over FY08-10E (vs. Rs44-42/$ earlier). The change in our exchange rate assumptions is the key reason for the reduction in our sales and net income estimates over FY09-10E. No change in INR assumptions would have resulted in a 2-3% increase in our FY09-10E revenues (vs. 3-4% decline now) and 2-5% increase in our FY09-10E net income (vs. 1-6% decline now).

4. Cost assumption modifications – we have adjusted some of our cost assumptions for Aban on the back of details from the FY07 annual report. This results in our consolidated EBITDA margins over our forecast horizon to increase from 65% in FY08E to 69% in FY10E.

5. No amortization of goodwill – goodwill arising on the Sinvest acquisition to be tested for impairment (we were earlier amortizing the same over 30 years).

6. Incorporation of details from the FY07 annual report (refer to the section titled *'FY07 Annual Report Takeaways'* for a discussion on the same).

7. Our EPS estimates over FY08-10E change by -21% to +5% (vs. earnings changes of -24% to -1%) due to decrease in the diluted share count to 38.5m (from our earlier assumption of 41.3m) following the conversion price for the foreign currency convertible bonds being fixed at Rs2,789.

Other key assumptions for our forecasts are highlighted in Figure 4 below:

Figure 4. Aban – Key Assumptions

	FY08E	FY09E	FY10E
No. of assets operational	16	19	20
- Aban	9	10	10
- Sinvest	7	9	10
Avg. capacity utilization	78%	89%	98%
Weighted average day rate per asset ('000 US$/day)	105	156	177
Capex (US$m)	549	190	50
INR/US$	40.0	40.0	40.0

Source: Citigroup Investment Research estimates

FY07 annual report takeaways

Aban recently released its FY07 annual report which for the first time reveals consolidated financials for the company. Line-by-line consolidation of Sinvest has, however, been done only for the three-month period from Jan-07 to Mar-07 when it became a wholly owned subsidiary of Aban following the completion of the tender offer. For FY07, Aban reported a consolidated loss of Rs344m (vs. our estimate of Rs605m profit). On a standalone basis, the key variance between reported numbers and our estimates was due to certain one off items.

Figure 5. Aban – FY07 Results; Actual vs. Estimates (Rupees in Millions)

	Aban standalone		Aban Singapore		Aban consolidated		
	Actual	Estimate	Actual	Estimate	Actual	Estimate	Comments
Net sales	**4,953**	**5,272**	**2,234**	**5,700**	**7,187**	**10,972**	Aban standalone in line with estimates; Aban Singapore also in line if Sinvest consolidated for three months
Operating expenses	(2,476)	(2,520)	(1,237)	(2,075)	(3,713)	(4,595)	Higher than expected operating costs in Aban Singapore primarily due to certain one-off items; Aban standalone in line
EBITDA	**2,477**	**2,752**	**997**	**3,625**	**3,474**	**6,377**	
EBITDA margin	*50.0%*	*52.2%*	*44.6%*	*63.6%*	*48.3%*	*58.1%*	Lower than expected margins in Aban Singapore on account of higher one-off costs
Interest	(448)	(554)	(2,238)	(3,474)	(2,686)	(4,029)	In line with estimates; total consolidated debt of Rs108bn as on 31-Mar (incl. FCCBs of Rs4.3bn)
Depreciation	(1,011)	(918)	(255)	(726)	(1,266)	(1,644)	Goodwill arising on acquisition of Sinvest not amortized (as expected by us) but tested for impairment annually
Other income	693	16	188	925	881	941	Aban standalone other income includes a one off payment of Rs211m interest on loan to foreign subsidiaries
PBT	1,711	1,296	(1,308)	349	403	1,646	
Tax	(715)	(519)	(31)	(285)	(747)	(804)	No income tax payable by Aban Singapore, which is an Approved International Shipping Enterprise under Singapore tax laws
Tax rate	*41.8%*	*40.0%*	*-2.4%*	*81.5%*	*185.2%*	*48.8%*	
Reported net income	**996**	**778**	**(1,340)**	**64**	**(344)**	**842**	

Source: Company Reports and Citigroup Investment Research estimates

Jackup outlook – strong, but supply additions a concern

The jackup market is of primary significance for Aban given its high exposure to this segment of the offshore drilling space (16 of its 19 drilling assets are jackups, with drilling capability ranging between 250' and 375' water depth).

Our US offshore analyst, Geoff Kieburtz believes that though the international jackup market remains strong, supply additions are a concern.

Jackup utilization outside the Gulf of Mexico remains high at above 95% but newbuilds without contracts may put pressure on day rates. However, contract coverage for the existing fleet continues to grow and even if half of the 58 jackups being built on spec remain idle, utilization would be 90%. This would likely be high enough to prevent a collapse in day rates.

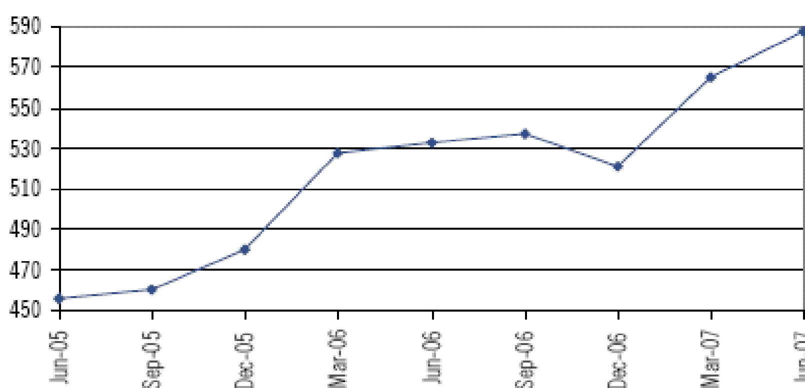
The following is an extract from "Offshore Drilling: 2Q07 Preview – Jackup Market in Focus", dated 17 July 2007, by our US analyst, Geoff Kieburtz.

We expect investor attention will be focused on the outlook for the jackup market, both U.S. and internationally, during the upcoming earnings season. The U.S. GOM market presents the greatest near-term uncertainty. Rates in this market have stabilized, but the anticipated improvement has not yet materialized. The unusually extended period of stability is feeding anticipation that conditions will either improve in 2H07 as more rigs leave the market, or deteriorate as gas price uncertainty and hurricane season further depress demand.

Forward demand of the existing jackup fleet has risen about 30%

The international market issue is in the medium term as newbuild deliveries accelerate into 2008. The graph below offers some comfort that international jackup trends remain constructive to date. It shows that forward demand of the existing active fleet has risen from 456 days in June 2005 to 588 days in June 2007, an increase of about 30%. More significantly, in every three-month period, except for October-December 2006, forward jackup demand grew enough to more than offset the decline in forward demand resulting from the passage of time. For example, at the end of first quarter 2006, forward demand stood at 528 days, up from 480 days at the end of fourth quarter 2005. If forward demand had grown only enough to offset the approximate 90 days lost in the quarter due to the passage of time, forward demand would have remained at 480 days. Instead, it grew by 48 days.

Figure 6. Forward Jackup Demand, in Days (Active Rigs Only)



Source: ODS-Petrodata and Citigroup Investment Research. Note: Excludes rigs under construction, on order, stacked, or out of service.

Oil prices would have to fall to well below $50/bbl before operators cut back their investment programs

Outside the Gulf, jackup demand remains strong and utilization is well above 95%. Jackup and floater day rates outside the shallow water Gulf of Mexico market remained at or near peak levels throughout 2Q07 and appear poised to continue to do so, in our opinion, as rig utilization remains well above 90% and oil prices are at levels that produce significant cash flows for operators even with rising service costs. According to the results of our most recent E&P Spending Survey, oil prices would have to fall to well below $50/bbl before operators cut back their investment programs.

It appears that there is sufficient demand to absorb new construction without pushing rates lower

Concern among investors is on the supply side and fear that an influx of new capacity over the next 3+ years will dampen day rates. As we note below, it appears at this time that there is sufficient demand to absorb new construction without pushing rates lower. The current jackup supply and demand figures outside the U.S. Gulf of Mexico are 319 and 308, respectively, resulting in utilization of 96.6%. Of the 79 jackups under construction, 58 are without a contract. Assuming a worst case scenario that none of these jackups are contracted upon exiting the shipyard, supply and demand would be 398 and 329, with utilization of 82.7%. If we were to assume that half of the 58 jackups under construction without contracts remain idle after delivery, demand would be 358 rigs and utilization would be 89.9%.

Even if half of the 58 jackups under construction and without contracts remain idle, jackup utilization would likely be high enough (90%) to prevent a collapse in day rates

Given the level of oil prices and indications of higher exploration and production spending on the part of operators it seems unlikely that all of the jackups being built without contracts will remain idle, in our view. Even half of the 58 remaining idle appears to be a conservative assumption but if this were to happen jackup utilization would likely be high enough (89.9%) to prevent a collapse in day rates.

Our confidence in the sustainability of floating rig day rates stems from the fact that the majority of newbuild floaters scheduled to enter the market over the next several years have already received contracts, at very attractive day rates.

As of the end of June, according to ODS-Petrodata, of the 55 semis and drillships under construction with delivery dates in the 2008-2010 time period, only 20 are without a contract (36%). A year ago, more than 70% of the 29 floaters under construction were without commitments. In addition, we believe delivery dates may be overly optimistic given shipyard tightness and the limited experience many new rig owners have in building rigs.

Strong Demand Should Absorb Jackup Supply

The market has attached a discount to jackup earnings and a premium to floater earnings in part because of the difference in newbuild contract coverage

In our view, there is sufficient jackup demand to absorb in influx of equipment, as most international markets appear undersupplied. However, the market has attached a discount to jackup earnings and a premium to floater earnings in part because of the difference in newbuild contract coverage.

Since the beginning of the decade, the two regions that experienced the greatest increase in jackup rig count are Mexico and the Middle East. The future demand outlook in both regions remains bright, in our view. Mexico needs to grow its shallow and deepwater rig counts in order to offset declining production at the Cantarell field. Mexico's jackup rig count has grown at the highest rate of any market over the past seven years, to 30 currently from just four in June 2000, a compound annual growth rate of 33%. While we do not expect a similar growth rate over the next seven years, the need to grow production and

indications of greater E&P spending this year ($12.5 billion versus $11.4 billion in 2006 according to our E&P Spending Survey) suggests the Mexican rig count will continue to rise. Proposed fiscal reform that could lessen Pemex's tax burden, thereby providing more funds for exploration and production, is also a positive development, in our view.

In the Middle East, Noble's recent estimate of a jackup shortfall of between 5-15 units appears plausible as ODS-Petrodata recently indicated that Saudi Aramco may soon tender for six to eight incremental jackups for three year contracts. Like Mexico, the Middle East has seen significant growth in its rig count over the past seven years, rising from 46 jackups to 86 currently. The Middle East seems a likely destination for many of the newbuild jackups under construction, in our view, due to its relative proximity to Asia-Pacific shipyards and operators' demonstrated preference for premium equipment.

Although difficult, if not impossible, to quantify, we believe nationalization of oil and gas reserves will also drive an increase in offshore rig counts as major oil companies seek ways to offset lost production. Conoco, ExxonMobil, and Petro-Canada announced in late June that they would leave Venezuela after refusing to accept that government's terms for transferring majority ownership of oil projects to the state. Russia is also making moves to exert greater control of its oil and gas reserves, as evidenced by the recent decision by BP to sell its stake in the Kovykta gas field to state-controlled Gazprom for $700-$900 million, a price widely reported to be well below the field's true value.

Faced with fewer investment opportunities (primarily on land), we believe major oil companies may ramp up their offshore drilling programs in regions with well-established infrastructures and stable political environments, such as the U.S. Gulf of Mexico and the North Sea, and also increase their drilling activity in more lightly explored areas, such as offshore West Africa, that hold the potential for sizable discoveries.

Implications from Merger of Transocean and GlobalSantaFe

Transocean Inc. (RIG) and GlobalSantaFe Corp (GSF) have recently agreed to a merger of equals (no premium). According to our US analyst, industry consolidation could potentially have the biggest positive impact in the jackup market because concentrated ownership can eliminate, or at least moderate the negative impact of a market transitioning from a condition of capacity constraint to oversupply, which is a possibility in the jackup market due to newbuilds without contracts.

The following is taken from "Transocean Inc: RIG and GSF to Combine in Merger of Equals", dated 23 July 2007, by our US analyst, Geoff Kieburtz.

Following the merger, Transocean will own a fleet of 146 rigs, comprised of 72 floaters (including five under construction), 68 jackups, and six other rigs. The next-largest deepwater fleet is owned by Diamond Offshore, with 31 floaters, while the second largest jackup fleet belongs to ENSCO International, with 44 rigs. The combined company will have a major presence in every jackup market in the world, with the exception of the weak Gulf of Mexico jackup market, where it will have just three rigs.

The merger will allow Transocean to maintain its presence in the jackup market. Transocean's stand-alone fleet of 25 rigs is far smaller than competitors such as ENSCO International, Noble Corporation, and GlobalSantaFe, and it was unlikely to grow significantly because Transocean eschews building rigs on speculation, which is how the majority of jackups are built today. Absent this merger we believe it is likely that Transocean would have eventually exited the jackup market altogether. Transocean also gains exposure to new shallow water markets, such as the North Sea and the Middle East. In particular, Saudi Aramco (private), the world's largest oil producer, will now become a major jackup customer.

GlobalSantaFe benefits from a significantly greater presence in the deepwater drilling market. GlobalSantaFe could have attempted to build a greater deepwater presence on its own by buying newbuilds under construction by speculators but would be taking on considerably more risk in terms of project management and contracting. GlobalSantaFe's turnkey drilling subsidiary, ADTI, will also benefit from much greater exposure to national oil companies.

Two regions where the combined company would have a significant market presence would be West Africa, with a fleet of 13 jackups out of a total of 26 jackups in the region, and the North Sea, with a combined fleet of 18 semis representing 45% of total capacity in the region.

The merger could potentially have the greatest positive impact in the jackup market because of the risk that newbuilds entering the market could oversupply the market

In our view, the benefits of concentrated ownership are possible to exploit at inflections points in the cycle. Assuming continued capacity constraints, concentrated asset ownership does not seem to convey a significant benefit. In a market that is transitioning from oversupply to capacity constrained, concentrated ownership would likely speed along the process, in our view. Going from a condition of capacity constraints to oversupply, concentrated asset ownership can eliminate, or at least, moderate the negative impact. As a result, we believe the merger could potentially have the greatest positive impact in the jackup market because of the risk that newbuilds entering the market could oversupply the market.

While each company separately could have done a leveraged recapitalization, by merging they are concentrating the ownership of rigs in fewer hands, which we believe has positive implications for Transocean and the entire offshore drilling industry in terms of bargaining power with suppliers and negotiating leverage with oil and gas companies.

Finally, we believe the announcement increases the likelihood of additional mergers. Size is an attribute in the offshore drilling sector, in our view, and despite recent commentary from Noble's CEO, Mark Jackson, that consolidation was unlikely and unnecessary, we believe smaller competitors like Noble, Diamond Offshore, ENSCO International, and Pride International may now feel pressure to combine to compete on a global scale against Transocean. At the very least we believe it is likely investors will exert greater pressure on these companies to realize greater value from their backlogs.

Aban Offshore

Company description

Aban Offshore, the flagship company of the Aban group, was established in 1986 as an Indo-US joint venture in offshore drilling. The company was set up as Aban Lloyd Chiles Offshore by M.A. Abraham in collaboration with Chiles Offshore Inc (a drilling company based in the US which has now merged with ENSCO). Aban Offshore is the largest offshore oilfield service provider in the private sector in India. With the acquisition of the Norwegian company Sinvest in 2007, the consolidated entity has 19 offshore drilling assets (including two bare boat charters) and one FPU. While Aban's primary area of operation is the drilling and oilfield services sector, it is also engaged in power generation through renewable energy (windmills).

Investment thesis

Our target price of Rs3530 is based on 8x fully evolved earnings, in line with average target P/E multiples for its global peer group. We believe that Aban should trade in line with its peers – despite the company being smaller in size – as it has a good track record in the offshore space and the new contract wins at robust rates provide visibility to the company’s volume-led earnings growth prospects. Consolidated with Sinvest, Aban is a material play on the global offshore services industry with a pipeline of seven assets (one refurbished drillship, five new jackups, and one refurbished jack-up) which will come on stream over CY07-09 (adding to an existing fleet of 13 offshore assets). This well-timed fleet expansion should help Aban capitalize on the strong cyclical uptrend in the offshore drilling industry. Strong operational cashflows should help Aban service and pay-down part of its large debt over the next three years. Potential listing of the Singapore subsidiary could provide an additional trigger for the stock in the medium term.

Valuation

Our target price for Aban of Rs3,530 (Rs2,850 earlier) is based on 8x fully evolved consolidated earnings, which we expect to be achieved by FY10E, which is then discounted back by one year. The target multiple is at the lower end of global peers comparisons (see Figure 7 below). We believe that Aban should trade in line with these companies, despite being smaller in size, as it has a long and good track record in the offshore space and of managing new acquisitions and deploying them. As a cross-check, on our target price, the stock would trade at a price/cash earnings of 6.8x FY10E, discounted back by one year, in line with the target multiples of global peers. Our target price also imputes a multiple of 10.0x FY09E earnings, which is also in line with global peer comparisons.

Figure 7. Valuation Comparisons

Company Name	RIC Code	Rating	Mkt cap (US$m)	Imputed Target P/E CY09/FY10E	Imputed Target P/CE CY09/FY10E
Ensco International Inc	ESV.N	1H	8,611	9.4	8.0
Nabors Industries Ltd	NBR.N	1H	8,452	8.0	5.4
Pride International Inc	PDE.N	1H	5,707	8.8	8.8
Hercules Offshore Inc	HERO.O	1H	2,510	8.3	5.7
Diamond Offshore Drilling Inc	DO.N	1H	13,390	9.3	9.3
GlobalSantaFe Corp	GSF.N	1H	15,496	9.5	8.2
Noble Corp	NE.N	1H	13,268	9.6	8.1
Transocean Inc	RIG.N	1H	30,065	10.3	9.1
China Oilfield Services	2883.HK	1L	5,226	18.8	11.9

Source: Citigroup Investment Research

Risks

We rate Aban Medium Risk, in line with our quantitative risk-rating system, which tracks 260-day historical share-price volatility. Key risks that could prevent the shares reaching our target price are: E&P activity decline; long-term day rates which vary with the demand-supply scenario in the rest of the world; delays in completing shipyard work could result in jack-ups going on day rates later than expected, which could result in lower-than-expected earnings; higher-than-anticipated shipyard costs; and currency fluctuations.

Appendix A-1

Analyst Certification

We, Saurabh Handa and Rahul Singh, research analysts and the authors of this report, hereby certify that all of the views expressed in this research report accurately reflect our personal views about any and all of the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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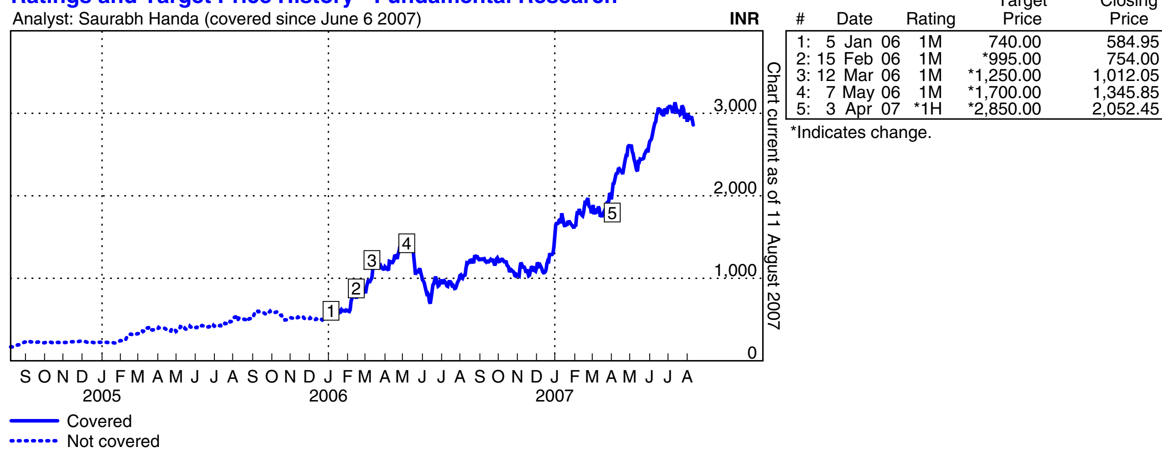
Aban Offshore (ABAN.BO)

Ratings and Target Price History - Fundamental Research



#	Date	Rating	Target Price	Closing Price
1:	5 Jan 06	1M	740.00	584.95
2:	15 Feb 06	1M	*995.00	754.00
3:	12 Mar 06	1M	*1,250.00	1,012.05
4:	7 May 06	1M	*1,700.00	1,345.85
5:	3 Apr 07	*1H	*2,850.00	2,052.45

*Indicates change.

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