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Aban Offshore | **Annual Report Analysis** | November 8, 2008

Edelrank
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EdelRank: Annual report ranking for best accounting and disclosure practices (on a scale of 1-10 from best to worst. Refer Annexure-A for details

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Market Data

52-week range (INR):	3,356 / 517
Share in issue (mn):	154.7
M cap (INR bn/USD mn):	118 / 2,502
Avg. Daily vol. BSE ('000):	916.7

Share Holding Pattern (%)

Promoters	:	58.6
MFs, FIs & Banks	:	4.4
FIIs	:	21.7
Others	:	15.3

Subsidiary losses subdued consolidated profits

- Aban Offshore's (Aban) standalone PAT was at INR 1.6 bn vis-à-vis INR 1.2 bn for consolidated entity. High financing expenses and losses in a few subsidiaries subdued profits.
- Losses reported in a few subsidiaries were significantly higher than their respective revenues (please refer subsidiary analysis section for details).

High leverage: Future incremental cash flows will be key to deleveraging BS

- The debt-equity (DE) ratio as at end-FY08 was 16x; however, on considering non-convertible redeemable preference shares as debt, D/E would stood at 26.3x. D/E for the standalone entity as at the end of FY08 was at 1.4x and on considering non-convertible redeemable preference share as debt , D/E was at 2.5x. Preference shares are redeemable at par during 2011 & 2012
- Loan book has increased from INR 11 bn in FY06 to INR 130 bn in FY08, primarily due to the USD 2.2 bn Sinvest acquisition.
- Loan repayable in FY09 is INR 17.02 bn, which is ~8 times net cash from FY08 operations. However, with delivery and full-year contributions of many new-build rigs, future cash flows may be significantly higher, facilitating debt repayment. Also, the company had significant cash and cash equivalents of INR 8.4 bn.

Profitability analysis

- ROAE (adjusted), at 24.5%, and return on net operating assets (RNOA), at 4.6%, were subdued due to high proportion of CWIP (at 36.6% of average net operating assets), indicating significant accretion from capital base expansion, going forward. RNOA excluding CWIP was at 6.3% (refer ROE analyser for details).
- High foreign currency-denominated loans helped keep average effective borrowing cost low to 6.3%.
- Aban has high unhedged foreign exchange payable exposure of INR 14.0 bn (including INR 13.2 bn of foreign currency denominated loans).
- During the year, the company booked foreign currency exchange losses of INR 1.94 bn, primarily on account of subsidiaries.
- CWIP surged from INR 22.4 bn in FY07 to INR 42.7 bn in FY08, but gross block increased by INR 11.3 bn, indicating that large capacity implementation is under way. Fixed assets (excl. CWIP and goodwill) turnover of merely 0.7 has dampened profitability.
- Goodwill, at INR 44.2 bn, comprised 30.1% of total assets and 545.5% of net worth (including preference share capital).

Note : All numbers are on consolidated basis, except if stated otherwise

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Subsidary analysis **(INR mn)**

Subsidary	Share capital	Reserves & surplus	Net worth	Total assets	Total liabilities	Turnover	Profit / (Loss) after tax
Sinvest AS, Norway	2,165.4	(1,863.1)	302.3	10,459.2	10,156.9	-	(2,545.5)
Aban Singapore	6,619.8	(2,841.5)	3,778.3	49,929.5	46,151.1	629.5	(1,945.7)
Aban international Norway AS	375.8	863.6	1,239.3	32,388.1	31,148.8	12.0	(1,882.4)
Beta Drilling	1,223.7	(722.8)	500.9	3,240.3	2,739.4	896.9	(725.6)
Aban Holdings	7,372.4	(997.1)	6,375.3	14,772.1	8,396.8	6.2	(220.1)
Aban International Norway AS	2,006.0	(15.9)	1,990.1	11,512.8	9,522.6	0.4	(14.4)
Deep Drilling 6	2,058.6	(37.9)	2,020.7	4,301.5	2,280.8	-	(10.1)
Deep Drilling 7	2,253.8	(10.5)	2,243.4	4,731.9	2,488.6	-	(10.1)
Deep Drilling 8	1,125.6	(10.3)	1,115.3	3,354.6	2,239.3	-	(10.1)
Aban 8	1,525.5	(6.9)	1,518.6	6,532.7	5,014.1	-	(6.3)
Sinvest(Cyprus)	0.1	(1.7)	(1.5)	-	1.5	-	(1.7)
Aban Pearl	2,166.5	(1.4)	2,165.1	9,251.7	7,086.7	-	(1.4)
Aban Energies	2.0	(10.9)	(8.9)	6.6	15.5	13.5	(0.3)
Venture Drilling	0.0	(0.8)	(0.8)	0.0	0.8	-	(0.2)
DDI Holding AS	17,048.7	(3,224.9)	13,823.8	42,034.6	27,850.8	221.3	-
Deep Drilling Invest	25,790.8	(233.7)	25,557.1	32,213.1	6,656.1	67.7	-
Deep Drilling 4	1,513.9	263.7	1,777.7	9,441.1	7,663.5	1,211.7	294.9
Deep Drilling 5	2,734.0	828.0	3,562.1	6,382.0	2,819.9	1,624.2	871.7
Aban 7	842.5	1,291.5	2,134.0	4,551.8	2,417.8	1,817.9	1,002.8
Deep Drilling 1	5,433.8	1,931.2	7,365.0	7,769.3	404.3	2,603.3	1,379.6
Deep Drilling 2	5,847.9	2,462.3	8,310.2	8,640.6	330.4	2,613.6	1,422.7
Deep Drilling 3	5,213.7	1,990.5	7,204.2	7,480.4	276.2	3,128.2	2,041.0

Source: Company annual report, Edelweiss research

Income statement **(INR mn)**

Particulars	Consolidated	Standalone
Operating revenue	20,828	7,176
Net operating income (Before tax)	5,326	1,955
Financing expenses	6,658	692
PAT	1,230	1,591
Preferred dividend (Including tax)	305	305
PAT for common equity	925	1,286
EBIT margins (%)	25.6	27.2
PAT margin (%)	4.4	17.9

Source: Company annual report, Edelweiss research

- Higher financing expenses in subsidiaries led to lower consolidated PAT margins. Net losses on consolidation of subsidiary companies were INR 360 mn. Out of the 22 subsidiaries, 14 incurred losses in FY08. This could be because of higher interest expenses and its newly delivered Singapore subsidiary rigs not having completed one full year of operations.
- Investments in subsidiaries, including loans extended, were at INR 15.7 bn. Corporate guarantees issued on behalf of subsidiaries were at INR 19.9 bn.

Accounting policy and financial highlights

- The impact of compliance with more logical global accounting practices will result in reduction of PAT (before exceptional items) by 32%, basic EPS by 1%, and net worth by 27%. ICAI has issued a white paper on convergence of IGAAP with IFRS and has indicated full adoption of IFRS from the financial year commencing April 1, 2011.
- The company has not recognised deferred tax asset on losses incurred by subsidiaries, consequently the effective tax rate for FY08 stands at 78.7% (FY07 182.9%).
- Revenue increased 164% in FY08 to INR 21.3 bn (INR 8.07 bn in FY07). However, profit after tax for FY08 increased to INR 1.2 bn from loss of INR 140 mn in FY07.

Profitability analysis (ROE analyser)

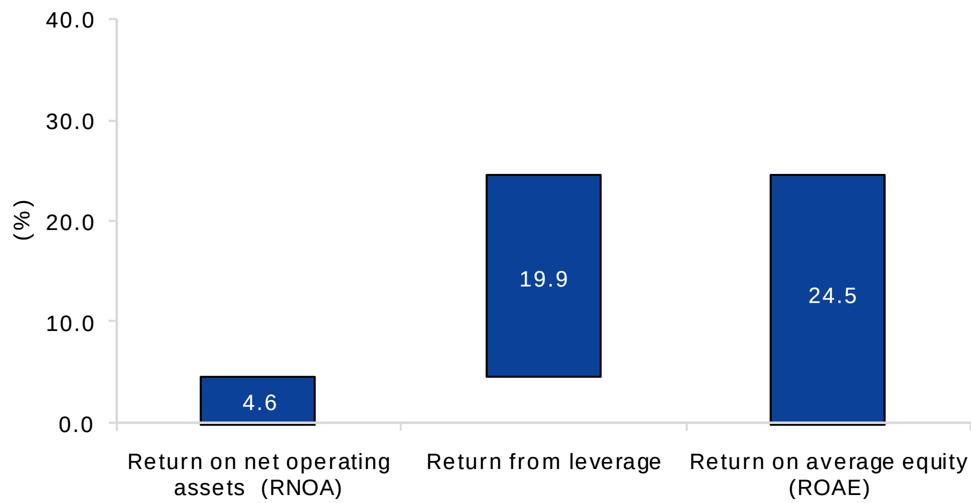
ROE analyser analyses profitability on the scale of operating efficiency and capital allocation efficiency (detailed concept explained in Annexure B). We have analysed Aban's profitability for FY06, FY07, and FY08; the results and key findings are given below:

ROE Analyser

	FY06	FY07	FY08
A. Return on net operating assets (RNOA) (OPATO x NOPAT margin) (%)	**8.9**	**2.7**	**4.6**
OPATO (Operating asset turnover) (x)	0.4	0.1	0.2
NOPAT (Net operating profit after tax) margin (%)	21.5	19.5	25.6
B. Return from leverage (FLEV x spread) (%)	**19.1**	**(14.0)**	**19.9**
FLEV (Financial leverage) (x)	3.6	21.1	29.8
NBC (Net borrowing cost) (%)	3.6	3.3	3.9
Net financial spread (RNOA -NBC) (%)	5.3	(0.7)	0.7
ROAE derived (A+B) (%)	**28.0**	**(11.3)**	**24.5**

Source: Company annual report, Edelweiss research

ROE Tree



Source: Company annual report, Edelweiss research

Low RNOA due to high CWIP and forex loss; high leverage significantly boosted ROAE

RNOA subdued due to high forex loss and CWIP.

- RNOA excluding CWIP was at 6.3% as Operating asset turnover excluding CWIP was at 0.25.
- Forex loss of INR 1.94 bn subdued operating profits; RNOA excluding forex loss and CWIP was at 8.7%.

High returns from leverages on account of :

- Low borrowing cost, primarily because of forex loans
- High financial leverage, at 29.8(x)

Cash flow analysis (refer Annexure-B for details) **(INR bn)**

		FY08
Net cash from operating activities (1)		**(26.1)**
NOPAT (net operating profit after tax) #	5.3	
Increase in net operating assets (NOA) #	(31.4)	
Net cash from financing activities (2)		**23.8**
Adjusted net financing income #	(4.4)	
Increase in net financial assets #	28.2	
Net cash flow from share holders (3)		**2.3**

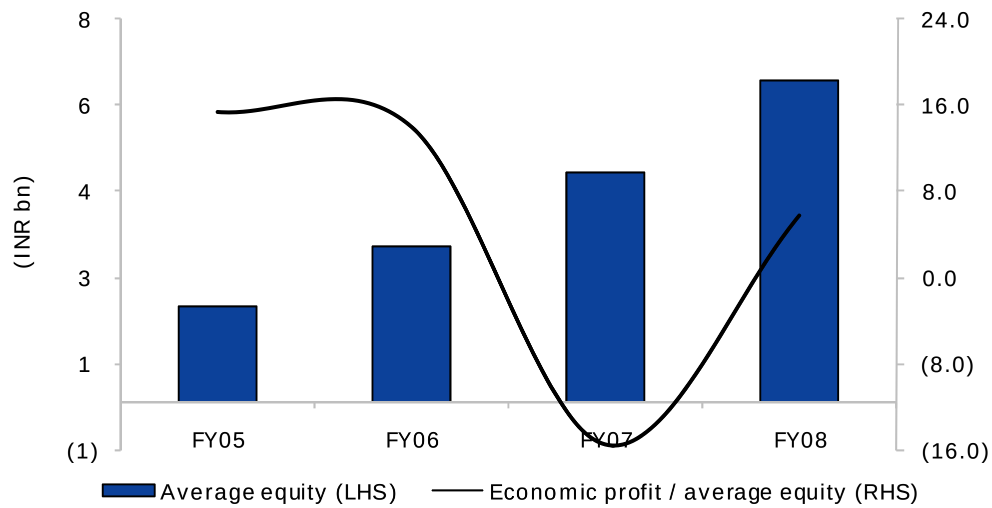
Source: Company annual report, Edelweiss research

Note: # Adjusted for direct debit into reserves

1. Cash from operating activities: Cash generated from operations less cash deployed into net operating assets (includes operating cash).
2. Cash from financing activities: Sum of net cash from debt financing and non-strategic investments (includes surplus cash).
3. Cash from equity financing: Represents net inflow of cash from shareholders due to issue of shares on conversion of FCCB.

High contribution from leverage and increase in operations has led to higher ROE and economic profits

Economic profits



Source: Company annual report, Edelweiss research

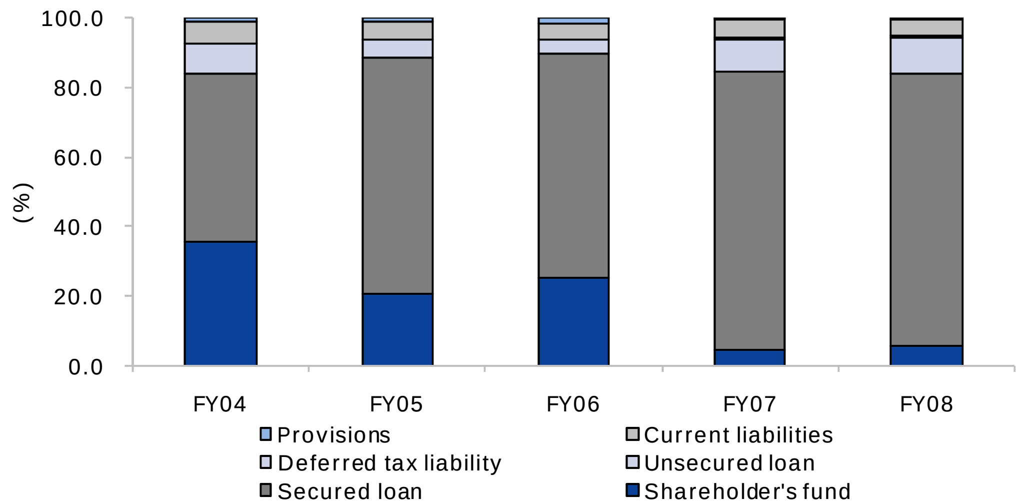
Highly levered balance sheet; future operating cash flows are key to de-lever the BS

Large CWIP and goodwill on consolidation constitutes 59% of total assets

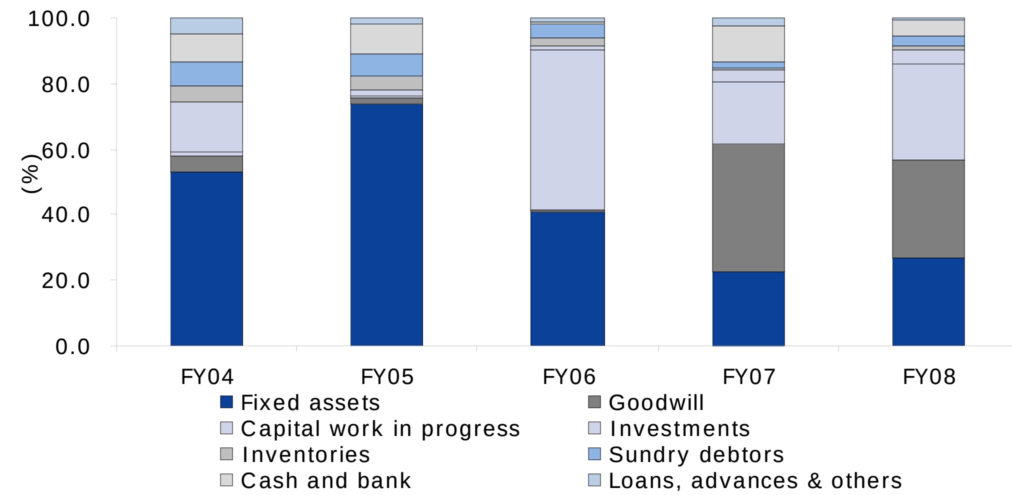
High effective tax rate on account of non creation of deferred tax asset on losses made by subsidiaries

Balance sheet and income statement analysis

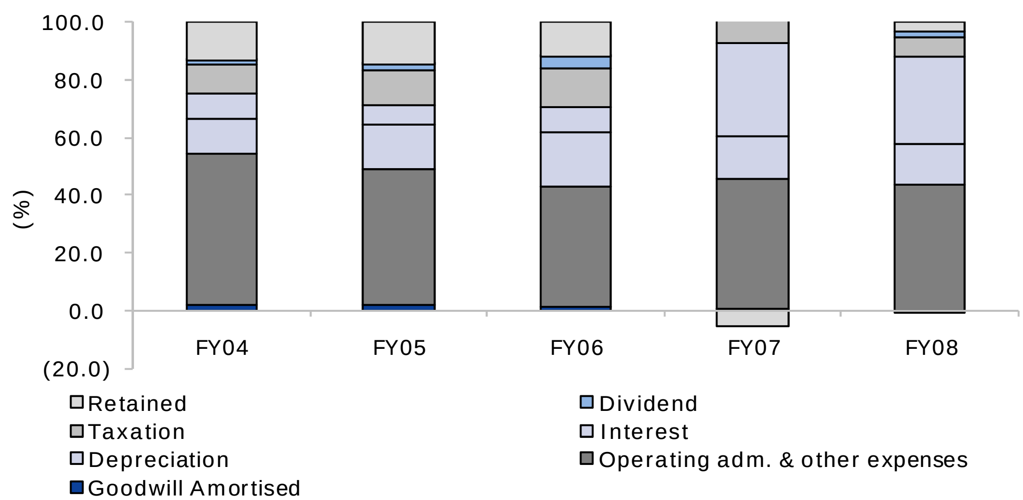
Sources of funds



Application of funds



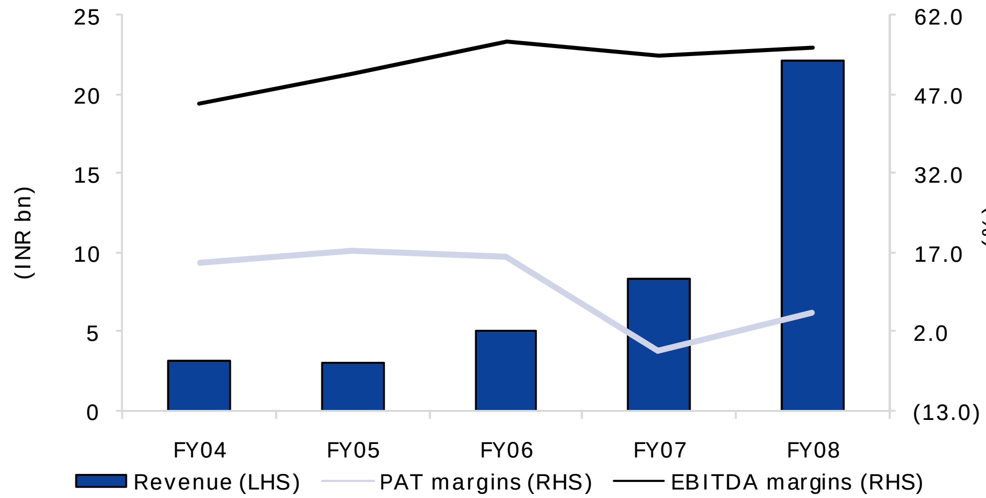
Utilisation of income



Source: Company annual report, Edelweiss research

Revenue increased considerably, but PAT margins still under stress due to high interest cost and foreign exchange fluctuation losses

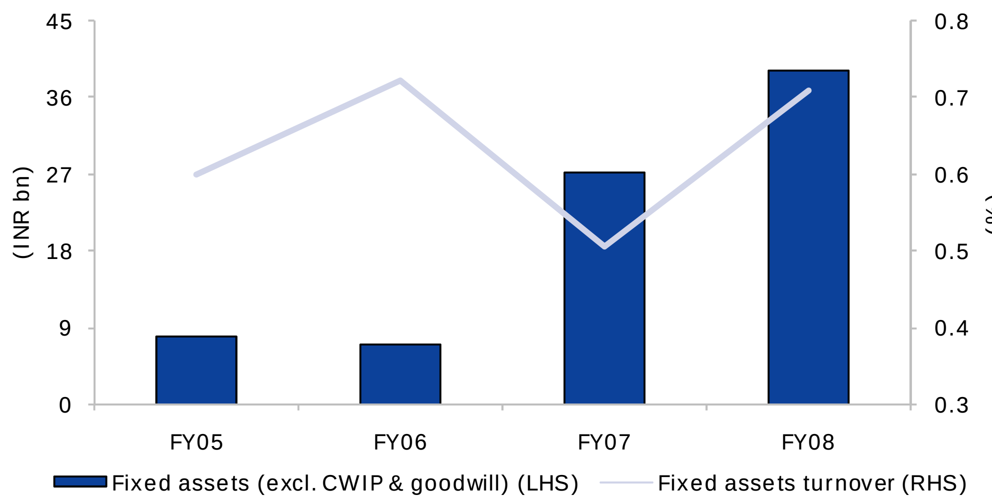
Profit margins analysis



Source: Company annual report, Edelweiss research

Fixed assets turnover is low on account of large capex during the past two years

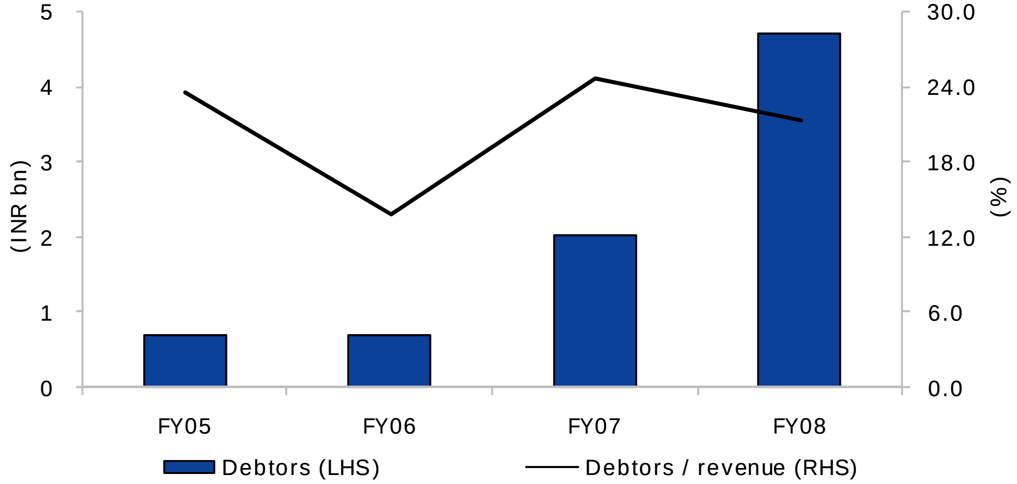
Fixed assets turnover analysis



Source: Company annual report, Edelweiss research

Debtors, as a percentage of revenue, increased from 14% in FY06 to 21% in FY08

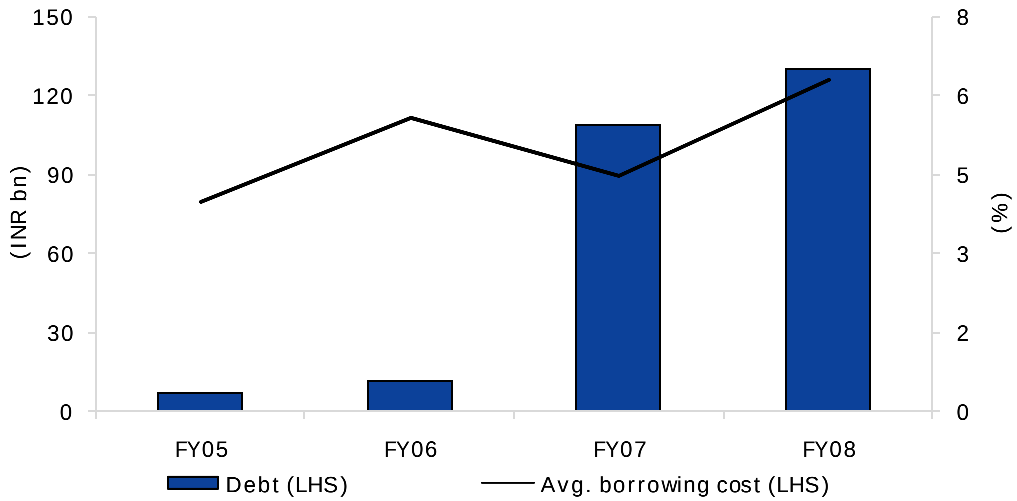
Debtors analysis



Source: Company annual report, Edelweiss research

Borrowings have increased particularly in the past two years, but high proportion of foreign currency loans keeps borrowing cost low.

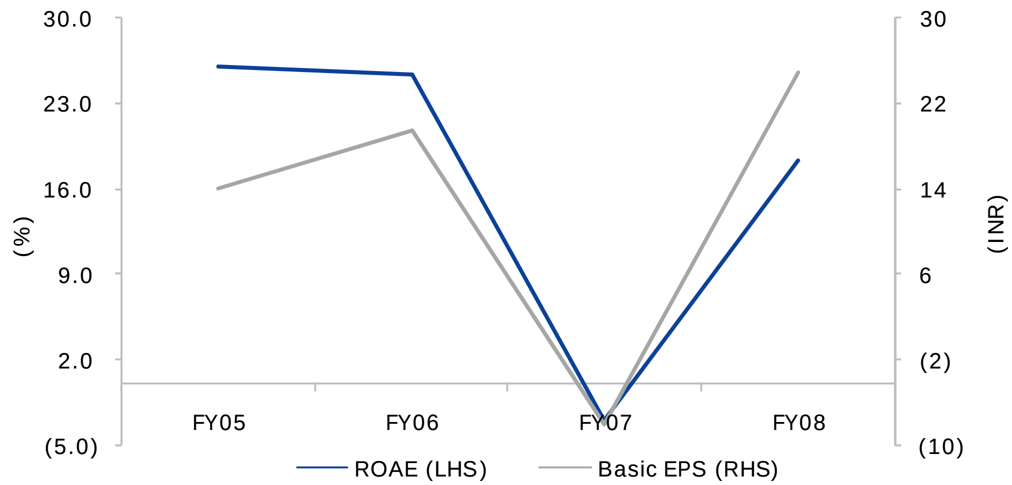
Borrowing cost analysis



Source: Company annual report, Edelweiss research

Increase in number of operational rigs led to increase in EPS and ROE

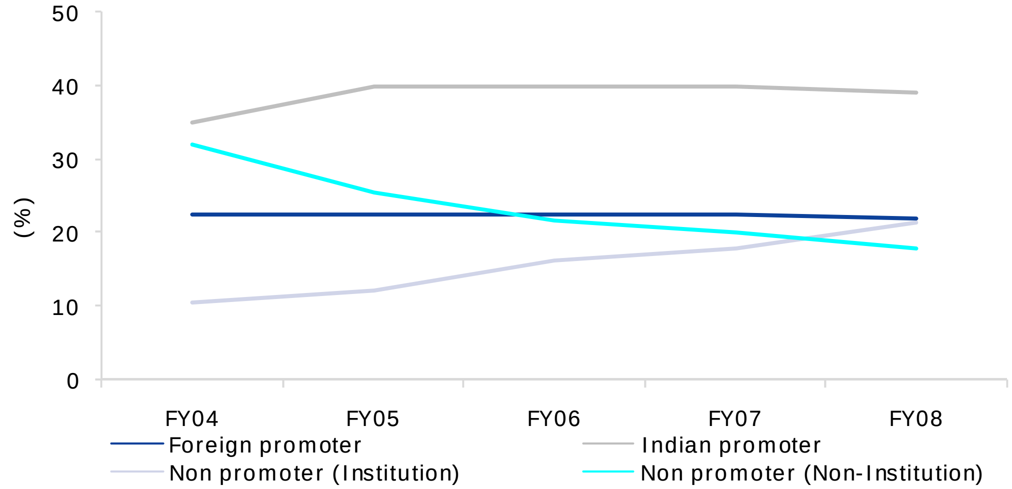
ROAE versus EPS



Source: Company annual report, Edelweiss research

Over the period, holding of institutional investors in the company has gone up

Shareholding pattern



Source: Company annual report, Edelweiss research

Accounting policy analysis

ICAI has issued a concept paper on convergence of accounting standards with IFRS and has indicated full adoption of IFRS from the financial year commencing April 1, 2011.

We have calculated the impact on reported financials of the company in light of more logical globally accepted practices (refer Annexure C for details).

Impact of adoption of more reasonable accounting **(INR mn except for caluation of EPS)**

Sl. No.	Particulars of the issue	Reason	Impact on PAT	Impact on net worth	Impact on basic EPS
1	Goodwill arising on amalgamation is amortised over a period of seven years	IFRS/ US GAAP more logical	62.9	62.9	1.7
2	Redeemable preference shares are treated as part of share capital. However, as per IFRS it should be treated as financial liability	IFRS/ AS 31 more logical	(304.7)	(3,060.0)	-
3	Issue expenses and redemption premium on FCCB debited to securities premium. Also, total borrowed amount disclosed as financial liability.	IFRS/ AS 30/31 more logical	(52.3)	818.9	(1.4)
	Total	**(A)**	(294.0)	(2,178.2)	0.3
	Reported consolidated PAT, net worth & basic EPS	**(B)**	1,229.9	8,119.0	24.9
	Revised consolidated PAT, net worth & basic EPS		935.8	5,940.9	25.1
	% Impact	**(A)/(B)**	**(24)**	**(27)**	**1.1**

Source: Company annual report, Edelweiss research

ANNEXURES

Annexure A: EdelRank

EdelRank is a framework that ranks companies objectively for compliance with accounting standards and disclosure requirements. The ranking is done based on percentage scoring achieved by the company for adhering to accounting standards and disclosure norms out of a predefined score card.

EdelRank scorecard

AS No.	Accounting standards	% Score obtained
AS-1	Disclosure of accounting policies	100.0
AS-2	Valuation of inventories	100.0
AS-3	Cash flow statements	100.0
AS-6	Depreciation accounting	100.0
AS-9	Revenue recognition (1)	0.0
AS-10	Accounting for fixed assets	100.0
AS-11	The effects of changes in foreign exchange rates	100.0
AS-13	Accounting for investments	100.0
AS-14	Accounting for amalgamations	100.0
AS-15	Employee benefits	100.0
AS-16	Borrowing costs	100.0
AS-17	Segment reporting	100.0
AS-18	Related party disclosures	100.0
AS-19	Leases	100.0
AS-20	Earnings per share	100.0
AS-21	Consolidated financial statements	100.0
AS-22	Accounting for taxes on income (2)	44.4
AS-23	Accounting for investments in associates in CFS	100.0
AS-27	Financial reporting of interests in joint ventures (3)	30.0
	Total	**85.8**

Source: Company annual report, Edelweiss research

1. Revenue recognition policy not disclosed.
2. The break-up of deferred tax assets and deferred tax liabilities into major components of the respective balances not disclosed
3. Company has not diclosed assets, liabilities, income & expenses, capital commitments & contingent liability in joint venture seperately.

Annexure B: ROE and cash flow analyser

ROE analyser analyses profitability on the scale of operating efficiency and capital allocation efficiency. While operating efficiency is a measure of how efficiently the company is making use of operating assets, capital efficiency is the measure of balance sheet efficiency.

The above analysis involves:

1. Dissection of profitability along two major drivers:

   a. Return from operating activities (RNOA).

   b. Return from financing activities (leveraging effect on ROE).

   ROE = Return from operating activities (RNOA) + Return from leverage

   Or

   ROE = Operating margin x Operating assets turnover + Leverage spread x Leverage multiplier

   Where:

   - RNOA = NOPAT/Average operating assets
   - Operating margin = NOPAT/Operating revenue
   - Operating assets turnover = Operating revenue/Average operating assets
   - Leverage spread = RNOA – Net borrowing cost
   - Leverage multiplier = Average net financial obligation/Average common shareholders' equity

2. Reformulation of balance sheet: We have regrouped assets and liabilities into operating and financing categories (against traditional current and non-current categorisation).

3. Reformulation of income statement: We have regrouped income and expenses into operating and financing activities.

Cash flow analyser:

Unlike traditional cash flow, reformulated cash flow (zero sum cash flow) clearly distinguishes cash generation/usage into three broad buckets:

1. Cash from operating activities: Cash generated from operations less cash deployed into net operating assets (includes operating cash).

2. Cash from financing activities: Sum of net cash from debt financing and financial assets (includes surplus cash).

3. Cash from equity financing: Sum of 1 and 2 represents net cash flow from/to shareholders (represents dividend/share buyback/share issuances).

Annexure C: Accounting policy analysis

ICAI has issued a concept paper on convergence of accounting standards with IFRS and has indicated full adoption of IFRS from the financial year commencing April 1, 2011. IASB and FASB are finalising a joint conceptual framework to make accounting more logical by adopting better practices from either IFRS or US GAAP.

We have recomputed the financials by:

(a) Applying more reasonable accounting treatment to transactions where no authoritative accounting standard is issued for that transaction.

(b) Applying the logical accounting standard in case a transaction is accounted by the company under any legal and regulatory requirement, and not as per existing accounting standards.

(c) Applying accounting principles prescribed by IFRS/US GAAP, where the accounting principles significantly differ from that of Indian Accounting Standards, and the treatment prescribed by IFRS/US GAAP is more logical. However, please note that these do not represent conversion of the financial statements in compliance with IFRS.

Amortisation of goodwill

- **Existing provision**

  AS -21 “Consolidated Financial statement” only defines the method of recognising goodwill on consolidation, it does not prescribe any further accounting treatment. However AS-14 “Accounting for Amalgamation” requires amortising the goodwill recognised for amalgamation over a period not extending five years.

- **Logical accounting treatment as prescribed by US GAAP**

  As per US GAAP, the goodwill recognised as a result of amalgamation should not be amortised rather it is tested for impairment.

Redeemable preference shares are treated as part of share capital and not liability

- **Existing provision**

  Schedule VI of the Companies Act, 1956, requires that all preference shares should be disclosed as a part of ‘share capital’. Hence, in compliance with Schedule VI, the company has classified redeemable preference shares as part of share capital. Also, dividend distributed on such preference shares is treated as a distribution to holders thereof, and disclosed as an appropriation of profit and not expense.

- **Logical treatment as per IFRS/AS-30/31**

  However, as per IFRS and New AS-31, the substance of a financial instrument, rather than its legal form, should govern its classification on the entity’s balance sheet. Accordingly, a preference share that provides for mandatory redemption by the issuer for a fixed or determinable amount at a fixed or determinable future date, or gives the holder the right to require the issuer to redeem the instrument at or after a particular date for a fixed or determinable amount, is a financial liability. Also, dividend distributed on such preference share should be treated as an expense.

Issue expenses and redemption premium on FCCB and split accounting

- **Existing provision**

  The transaction cost, directly attributable to the issue of bonds/notes, is charged to the security premium account (i.e., net worth) as defined in Section 78 of the Companies Act, 1956.

Premium payable on the redemption of bonds is treated differently by companies:

a. Some companies charge it proportionately over the maturity period of the bond to the securities premium account in absence of any specific guidelines and accounting standard.

b. Few companies charge redemption premium fully in the securities premium account in the year of issue.

c. Most companies give no treatment for redemption premium.

d. Very few companies charge redemption premium over the maturity period of the bond to P&L account.

- **Logical treatment as per IFRS/AS-30/31**

IFRS and new AS-30/31 require the issuer to show the liability component and equity component separately on the balance sheet (split accounting). The liability component is measured on the basis of the present value of future cash flows discounted at the market interest rate for similar instruments, but without the conversion option. The difference between proceeds of bonds issue and the fair value of liability is assigned to the equity component.

Redemption premium will be calculated on the liability portion and treated as an expense to be amortised over the life of the FCCB on YTM basis.

Transaction costs (e.g., issue expenses) are allocated to the liability and equity components in proportion to the allocation of total proceeds of bonds; the portion allocated to liability component will be amortised over the life of the FCCB on YTM basis.

NOTES:

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