

Equities

14 February 2011 | 7 pages

Aban Offshore (ABAN.BO)

Alert: 3Q Disappoints On Lower Revenues; Contract Renewals Coming Up

3Q below expectations — 3Q PAT of Rs620m came in below expectations, down 31% yoy and 18% qoq. The main disappointment came at the revenue line (-6% qoq), which exacerbated the impact on the bottom line due to the company's high leverage. Reported profits were also impacted by another Rs135m write-off on account of Petrojack (cumulative write-off of Rs1.62bn so far, with another cRs150m remaining on the books).

EBITDA margins remain robust, but revenues disappoint — EBITDA margins remained robust at 66.4%, largely in line with 2Q levels of 67.2% and up from the 53-64% levels seen in the previous two years. Revenues, however, disappointed significantly (-6% qoq and 10% below estimates), largely on account of: (i) delays in commencement of contracts for Aban II and Aban VII (commenced in mid-Jan) as well as Aban Abraham (now likely to commence by end-Mar), (ii) end of the Aban IV contract in Dec (lying idle currently), and (iii) one-off mobilisation fees of cUS\$12m for rigs Aban II, Aban VII, and DD 8 that it earned in 2Q which were discontinued in 3Q.

4Q to be better, but no contribution from Aban Abraham yet — 4Q should see a sequential pick-up in profits due to commencement of contributions from Aban II and Aban VII, as well as full contribution from DD 1 (commenced in mid-Nov), though this will be partly offset by nil contribution from Aban IV. Delay in commencement of Aban Abraham has been another disappointment and contribution from the rig is now likely to commence only from 1QFY12E.

Cash flow situation improving gradually, but timing of upcoming contract renewals critical — Contracts for four of Aban's rigs are ending in the next four months – Aban III and V end in Apr/May and Aban II and VII end in June. Combined with the two idle rigs – Aban IV and drillship Deep Venture (latter is currently under arbitration) – Aban has a busy contract renewal season coming up. Aban generated operating cash flow of ~US\$95m in 9MFY11 (~US\$120m in full year FY11E). This could increase to over US\$200m in FY12E on our estimates, which would help the company deleverage its balance sheet by an equivalent amount. This would, however, be contingent on timely contract renewals and contract commencements (i.e., reducing rig downtime), where there has been slippage in the past.

■ Company Update

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Figure 1. Aban Offshore – 3QFY11 Results (Rupees in Millions)

Year to 31-Mar	Q3FY10	Q2FY11	Q3FY11	%yoy	Comments
Net Sales	8,413	8,281	7,780	-8%	2Q included mob. revenues of cUS\$12m for Aban II, Aban VII, DD8; Aban IV ended in early-Dec; Aban Abraham delayed to end-Mar
Consumption - stores & spares	387	276	319	-18%	
Staff Cost	737	870	850	15%	
Rental charges for machinery	18	121	158	788%	
Repairs and maintenance	105	171	100	-5%	
Insurance	240	142	133	-45%	
Other expenditure	1,733	1,137	1,055	-39%	
Total expenditure	3,220	2,718	2,614	-19%	
EBITDA	5,193	5,563	5,166	-1%	
<i>EBITDA margin</i>	<i>61.7%</i>	<i>67.2%</i>	<i>66.4%</i>		Operating margins remained robust
Interest	2,599	2,405	2,329	-10%	
Depreciation	1,352	1,230	1,186	-12%	
Other income	39	24	94	140%	
Exceptional items		(139)	(135)		Continued write-off on Petrojack (Rs1.62bn so far)
Profit before tax	1,281	1,812	1,610	26%	
Current tax	727	795	588	-19%	
Deferred tax	(17)	(38)	(30)	79%	
<i>Tax rate</i>	<i>55.5%</i>	<i>41.8%</i>	<i>34.6%</i>		
Net income	570	1,054	1,053	85%	
Add: Share of profit in JV	324	(302)	(433)	-234%	Continued expenses on Deep Venture (50% stake) which is idle and arbitration is ongoing
Reported net profit	894	752	620	-31%	

Source: Citi Investment Research and Analysis

Aban Offshore (ABAN.BO; Rs553.25; 1H)

Aban Offshore

Valuation

Our target price for Aban of Rs1,122 is based on our DCF for Mar-11E. Our DCF is based on two years of explicit cash flow forecasts and the following key assumptions: day rates based on actuals for the contracted rigs; steady state earnings assumed beyond FY13E based on a payback period of 5½ years; terminal EBIT 15% lower than peak (FY11E) EBIT; terminal post-tax ROIC of 9%; WACC of 11.0% (risk-free of 7.5%, risk premium of 6.0%, beta of 1.4, cost of equity of 15.9%, cost of debt of 8.0%, target D/E of 1.0x); and terminal growth rate of 3%. DCF, in our view, best captures the true earnings potential of Aban's assets through the whole cycle, i.e., allowing the strong nearer-term cash flows to be tempered to factor in lower, mid-cycle earnings beyond FY11-12E.

Risks

We rate Aban High Risk in line with our quantitative risk rating system. Key downside risks that could impede the stock from reaching our target price are: failure to refinance/restructure debt; equity raising; decline in crude prices; failure to renew contracts for rigs; deterioration in global economy; and currency fluctuations.

Appendix A-1

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Aban Offshore (ABAN.BO)

Ratings and Target Price History Fundamental Research

Analyst: Saurabh Handa



Chart current as of 12 February 2011

	Date	Rating	Target Price	Closing Price
1	21-Apr-08	1M	*4,810.00	3,624.30
2	22-Jul-08	*1H	*3,600.00	2,568.40
3	30-Oct-08	*1S	*1,200.00	702.80

	Date	Rating	Target Price	Closing Price
4	1-Feb-09	*3S	*520.00	484.20
5	25-Aug-09	*1M	*1,550.00	1,210.45
6	7-Jan-10	1M	*1,650.00	1,443.90

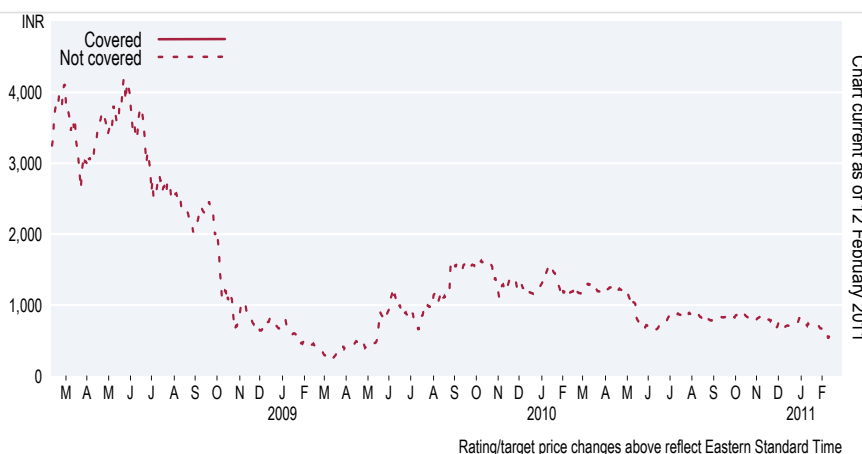
	Date	Rating	Target Price	Closing Price
7	28-Jan-10	1M	*1,446.00	1,129.95
8	25-May-10	*1H	*1,104.00	688.30
9	9-Nov-10	1H	*1,122.00	848.05

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Aban Offshore (ABAN.BO)
Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Saurabh Handa



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