Company Focus

7 December 2007 | 17 pages

Aban Offshore (ABAN.BO)

Target price change ☑
Estimate change ☑

Buy: Still Some Steam Left

- **Raising target** — We are increasing our target price to Rs5,895 from Rs3,830 as we switch to a DCF-based valuation approach. DCF, in our view, best captures the true earnings potential of Aban's assets through the whole cycle, i.e. allowing for the strong nearer-term cash flows to be tempered to factor in lower, mid-cycle earnings beyond FY10E, when Aban's earnings will peak.
- **Increasing FY08-09E earnings by 1-12%** — We have increased our FY08E-09E earnings to factor in new contract wins as well as higher than earlier anticipated rates for some of the contracts coming up for re-pricing. We are adjusting our earnings for FY10E by 3%, from when we factor in a decline in day rates tending towards mid-cycle levels.
- **Catalysts and risks** — Catalysts: (1) upcoming listing of the Singapore subsidiary; (2) repricing of assets (drillship Frontier Ice, semi-sub Bulford Dolphin, jackup Deep Driller; (3) asset acquisitions. Risks: (1) slowdown in offshore services growth, (2) downturn in jackup day rates, (3) delivery delays.
- **Maintain Buy (1M)** — The outlook for the sector remains solid, with continued strength in fundamentals. Not only are rig utilisation and day rates healthy, but also the current jackups and semisubs on order account for only 19% and 27% of the global fleet – levels we find manageable considering the more advanced drilling requirements of operators and the ageing global fleet. With the stock having declined ~13% from its recent highs, we maintain our rating.

Buy/Medium Risk	**1M**
Price (07 Dec 07)	Rs4,852.00
Target price	Rs5,895.00
from Rs3,830.00	
Expected share price return	21.5%
Expected dividend yield	0.1%
Expected total return	**21.6%**
Market Cap	Rs182,621M
	US$4,633M

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

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	nm	63.8	28.6	0.1
2007A	-502	-13.04	-170.3	nm	79.7	-19.9	0.1
2008E	4,241	110.11	944.3	44.1	28.6	99.5	0.1
2009E	14,855	385.68	250.3	12.6	6.9	92.6	0.2
2010E	20,024	519.88	34.8	9.3	3.9	56.2	0.2

Source: Powered by dataCentral

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

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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)	nm	nm	44.1	12.6	9.3
EV/EBITDA adjusted (x)	68.4	67.9	17.7	9.1	7.4
P/BV (x)	63.8	79.7	28.6	6.9	3.9
Dividend yield (%)	0.1	0.1	0.1	0.2	0.2
Per Share Data (Rs)					
EPS adjusted	18.56	-13.04	110.11	385.68	519.88
EPS reported	18.56	-13.04	110.11	385.68	519.88
BVPS	76.10	60.86	169.82	699.11	1,229.49
DPS	2.60	3.00	5.00	8.00	10.00
Profit & Loss (RsM)					
Net sales	4,902	7,187	24,149	45,121	52,041
Operating expenses	-3,112	-4,978	-10,093	-16,832	-19,445
EBIT	**1,790**	**2,209**	**14,056**	**28,289**	**32,596**
Net interest expense	-436	-2,686	-7,723	-7,773	-6,202
Non-operating/exceptionals	148	881	420	296	386
Pre-tax profit	**1,501**	**403**	**6,753**	**20,812**	**26,780**
Tax	-678	-747	-2,208	-4,488	-4,635
Extraord./Min.Int./Pref.div.	-108	-159	-305	-1,469	-2,120
Reported net income	**715**	**-502**	**4,241**	**14,855**	**20,024**
Adjusted earnings	715	-502	4,241	14,855	20,024
Adjusted EBITDA	2,804	3,474	16,063	31,383	36,127
Growth Rates (%)					
Sales	69.3	46.6	236.0	86.8	15.3
EBIT adjusted	85.6	23.4	536.4	101.3	15.2
EBITDA adjusted	86.7	23.9	362.4	95.4	15.1
EPS adjusted	32.4	-170.3	944.3	250.3	34.8
Cash Flow (RsM)					
Operating cash flow	**2,295**	**2,270**	**1,975**	**18,191**	**26,843**
Depreciation/amortization	1,014	1,266	2,007	3,095	3,531
Net working capital	458	1,348	-4,577	-1,227	1,167
Investing cash flow	**-8,341**	**-35,383**	**-24,035**	**-5,731**	**-1,960**
Capital expenditure	-8,341	-35,383	-24,035	-5,731	-1,960
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**3,894**	**97,302**	**7,183**	**-14,527**	**-25,692**
Borrowings	3,919	97,427	7,310	-14,270	-25,350
Dividends paid	-109	-130	-216	-346	-432
Change in cash	**-2,153**	**64,189**	**-14,876**	**-2,067**	**-810**
Balance Sheet (RsM)					
Total assets	**17,163**	**121,520**	**131,208**	**143,188**	**139,647**
Cash & cash equivalent	135	13,264	3,540	8,315	7,135
Accounts receivable	699	2,033	4,280	6,522	6,820
Net fixed assets	15,466	49,647	71,738	74,437	72,929
Total liabilities	**14,359**	**119,272**	**124,935**	**115,134**	**90,185**
Accounts payable	771	4,539	3,242	5,379	4,692
Total Debt	12,598	111,585	118,895	104,625	79,275
Shareholders' funds	**2,804**	**2,248**	**6,273**	**28,054**	**49,462**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	57.2	48.3	66.5	69.6	69.4
ROE adjusted	28.6	-19.9	99.5	92.6	56.2
ROIC adjusted	9.0	2.6	11.0	19.7	22.9
Net debt to equity	444.4	nm	nm	343.3	145.8
Total debt to capital	81.8	98.0	95.0	78.9	61.6

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Switching to DCF valuation

We have increased our target price on Aban to Rs5,895 from Rs3,830 (based on 8x fully evolved consolidated earnings) as we switch to a DCF-based valuation methodology. The key driver for the change in our valuation methodology is that an absolute valuation better captures the future cash flows that would be generated once Aban's entire fleet of rigs and drillships is deployed and is running at full utilization, which is expected to occur in FY10, while at the same time allowing us to temper the strength in cash flows by assuming conservative terminal cash flows (beyond FY12). We realize peak earnings (in FY10E) and subsequent decline to mid-cycle levels are difficult to capture through a valuation methodology based entirely on traditional near-term forward multiples, hence our switch to DCF.

In our DCF valuation, we are assuming a terminal post-tax ROIC of 16% (12% if normalized for Aban's low tax rate) based on a 5-year payback period on the replacement cost of assets. This factors in a decline in day rates, expected to commence after 2-3 years, resulting in an EBIT decline of 28% from peak levels i.e. FY10E.

The key assumptions inherent in our DCF valuation are as follows:

- Explicit forecasts till FY12E incorporating the current contracts that Aban has already entered into and the contracts that are likely to be signed over the next few months based on the visibility in day rates. The latter include contracts for:

1. Drillship Frontier Ice, semi-sub Bulford Dolphin, and jackup Deep Driller 2 (likely to be signed over the next couple of months)
2. Jackup Aban VII (contract to end by end-FY08E)
3. Newbuild jackup Aban VIII (delivery expected in 1QCY08)
4. Newbuilds Deep Drillers 6, 7, and 8 (deliveries expected in 2HFY09)

- Steady state earnings assumed beyond FY12 such that the average payback period based on the replacement cost of assets is 5 years. This is a fairly conservative assumption, in our view, resulting in terminal EBIT being 28% lower than peak (FY10) EBIT, and considering the good track record of Aban's acquisitions (payback periods in the past have been 3-4 years). A payback period of 5 years translates into a post-tax ROIC of 16%, a fair assumption in our opinion (peak ROIC is 23% in FY10E).
- Decline in day rates over FY10-12E of 5-15% to factor in mid-cycle earnings. The result is a corresponding decline of 24% in earnings (EBIT) over FY10-12E (further 6% decline in the terminal year). Figure 1 below gives the key assumptions for our forecasts. As can be seen, the weighted average day rate per asset works out to US$158K in the terminal year, a decline of 13% from the peak of US$182K in FY10E.

Figure 1. Aban – Key Assumptions

	FY08E	FY09E	FY10E	FY11E	FY12E	Terminal
No. of assets operational	16	20	21	21	21	21
- Aban	9	10	10	10	10	10
- Sinvest[1]	7	10	11	11	11	11
Avg. capacity utilization	78%	90%	99%	95%	99%	99%
Weighted avg. day rate per asset ('000 US$/day)	108	165	182	167	159	158
Capex (US$m)	760	198	50	52	52	45

Source: Citi Investment Research estimates. [1]Including semi-sub Bulford Dolphin

- Earnings to peak in FY10E when all assets are fully deployed and have been tied into contracts, with the outlook for the global day rate environment expected to remain strong for the next 12-18 months
- Terminal growth rate of 3%, in line with global GDP growth.
- WACC of 9.2% based on a cost of debt of 9.0%, cost of equity of 12.5%, target debt/equity of 1.0x, and beta of 0.75

Figure 2. Aban – DCF Valuation

	FY08E	FY09E	FY10E	FY11E	FY12E	Terminal
EBIT	14,119	28,352	32,659	28,006	24,754	23,374
Less: Tax	(2,208)	(4,488)	(4,635)	(4,255)	(3,984)	(3,762)
Add: Depreciation	1,944	3,032	3,468	3,625	3,705	3,705
Add: Decrease in net WC	(5,153)	(2,444)	(137)	354	172	172
Less: Capex	(24,035)	(5,731)	(1,960)	(2,038)	(2,038)	(1,688)
Free Cash Flow to Firm	(15,332)	18,720	29,394	25,692	22,609	21,802
NPV of cash flows		18,316	26,330	21,068	16,969	
Terminal Value						240,310
Total Firm value	322,993					
Less: Net Debt	95,937					
Total Equity value	227,056					
Value per share (Rs)	**5,895**					

Source: Citi Investment Research estimates

On our price target, Aban would trade at a P/E of 11.3x and EV/EBITDA of 8.6x FY10E, slightly above our target multiple range for global peers. We believe this is justified given the strong, better-than-anticipated day rates that Aban has managed to get for all of its recent asset placements, as well as the longer-term nature of some of these contracts. For instance, Transocean received 3-year extensions with ONGC for 2 of its rigs at day rates of US$145K each. In contrast, Aban 3 jackups (Aban III, IV, V) were contracted at a much higher rate of US$157K for a similar duration. Also, though day rates have displayed cyclicality in the past, market fundamentals indicate sustained strength in the current cycle for a longer duration (refer to the section titled 'Industry Outlook: Rig Utilisation High and Day Rates Firm').

Adjusting earnings estimates

We are raising our FY08-09E earnings by 12% and 1% respectively and lowering our FY10E earnings by 3% as we incorporate modest changes to our day rate assumptions.

Figure 3. Aban – Earnings Revisions

Year to	Net Profit (Rs Mils.)		Diluted EPS (Rs)			Div. Per Share (Rs)	
31-Mar	Old	New	Old	New	% Chg	Old	New
2008E	3,770	4,241	97.88	110.11	12.5%	5.0	5.0
2009E	14,685	14,855	381.26	385.68	1.2%	8.0	8.0
2010E	20,680	20,024	536.90	519.88	-3.2%	10.0	10.0

Source: Citi Investment Research estimates

The key changes are as follows:

- Aban VI repricing at US$87K/day for a period of 6 years (vs. our assumption of US$60K/day)
- Extension of the current contract for Aban VII till end-FY08E at the contracted day rate of US$170K. Hence, the decline in the rate for the subsequent contract (US$150K) that we assume does not impact FY08E earnings.
- Higher than earlier assumed day rate of US$140K (vs. US$100K) for Drillship Frontier Ice
- Day rate forecasts for most of Sinvest's premium jackup rigs in the US$180-200K range (vs. US$200-220K earlier).

Our day rate assumptions for Aban's assets are shown in Figure 4 below.

Figure 4. Day Rate Assumptions for Aban's Assets (US$'000)

Asset	Contract validity	Client	Location	FY08E	FY09E	FY10E	FY11E	FY12E
Jack-up – Aban II	May-10	ONGC	East Coast	$85.0	$85.0	$85.0	$75.0	$75.0
Jack-up – Aban III	Jan-11	ONGC	Mumbai High	$72.8	$156.6	$156.6	$156.6	$145.0
Jack-up – Aban IV	Nov-10	ONGC	Mumbai High	$88.6	$156.6	$156.6	$156.6	$145.0
Jack-up – Aban V	Jan-11	ONGC	Mumbai High	$71.9	$156.6	$156.6	$156.6	$145.0
Jack-up – Aban VI	Oct-13	Oriental Oil	Dubai	$63.7	$87.4	$87.4	$87.4	$87.4
FPU – TAHARA	Jul-09	Hardy Oil	East Coast	$71.4	$87.5	$84.4	$75.0	$75.0
DRILL SHIP – FRONTIER ICE	Mar-08	ONGC	Mumbai High	$108.3	$140.0	$140.0	$130.0	$130.0
Jack-up – Aban VII (ROWAN TEXAS)	Mar-08	OVL	Qatar	$168.3	$150.0	$150.0	$140.0	$140.0
DRILL SHIP – Aban Abraham	Jun-09	Kosmos Energy	West Africa	$325.0	$388.8	$410.0	$350.0	$350.0
Jack-up – Aban VIII	Q108*	--	--	-	$190.0	$190.0	$175.0	$175.0
Jack-up – Deep Driller 1	May-09	GSPC	India	$191.8	$190.0	$190.0	$190.0	$180.0
Jack-up – Deep Driller 2	To be repriced in the next few months			$195.0	$190.0	$190.0	$190.0	$180.0
Jack-up – Deep Driller 3	May-08	Petronas	Malaysia	$197.5	$220.0	$220.0	$220.0	$200.0
Jack-up – Deep Driller 4	Dec-08	NA	South Asia	$220.0	$220.0	$200.0	$200.0	$185.0
Jack-up – Deep Driller 5	Mar-08	Cairn	Bangladesh	$200.0	$200.0	$190.0	$190.0	$180.0
Jack-up – Deep Driller 6	Q308*	--	--	-	$180.0	$180.0	$180.0	$175.0
Jack-up – Deep Driller 7	Q308*	--	--	-	$190.0	$190.0	$190.0	$180.0
Jack-up – Deep Driller 8	Q109*	--	--	-	-	$185.0	$185.0	$175.0
Bulford Dolphin	To be contracted in the next few months			$275.0	$275.0	$275.0	$250.0	$250.0
Jack-up – Murmanskya"	Mar-08	ROC OIL	China	$215.0	$200.0	$200.0	$200.0	-
Drillship "Deep Venture" (50% stake)	Nov-08	Exxon Mobil	West Africa	$410.0	$410.0	$410.0	$350.0	$350.0

Source: Company reports and Citi Investment Research. *Delivery dates for assets under construction/purchased

Possible valuations for Aban Singapore support our fair value

Recent media reports (*Indian Express*) suggest that Aban could raise anywhere between US$450m-500m by divesting a 10-15% stake in Aban Singapore. Including the 10.4% dilution following conversion of bonds held by outside stakeholders in Aban Singapore, this would result in Aban Offshore's holding coming down to ~75-80%. Figure 5 below shows the sensitivity of value accretion to Aban Offshore to the possible valuations that Aban Singapore may achieve on listing.

Figure 5. Aban Singapore – Valuation Scenarios

US$m	Scenario I	Scenario II	Scenario III
Money raised through listing of Aban Singapore	500	500	500
Stake dilution	15%	12%	10%
Implied market value of Aban Singapore – (1)	3,333	4,167	5,000
FY09E net debt of Aban Singapore – (2)	2,371	2,371	2,371
Implied EV of Aban Singapore – (3)=(1)+(2)	5,704	6,537	7,371
FY10E EBITDA of Aban Singapore (4)	716	716	716
Implied EV/EBITDA (FY10E) of Aban Singapore – (3)/(4)	8.0	9.1	10.3
Implied PE (FY10E) of Aban Singapore	7.6	9.5	11.4
FY10E EBITDA of Aban India	210		
EV/EBITDA	7.5		
EV of Aban India – (5)	1,574	1,574	1,574
Post-stake sale and dilution			
Aban's interest in Aban Singapore* – (6)	74.6%	77.6%	79.6%
EV of Aban consol – (7) = (5)+(3)*(6)	5,831	6,649	7,443
FY09E net debt of Aban consol – (8)	1,850	1,850	1,850
Implied mkt. cap of Aban consol – (7)-(8)	3,981	4,799	5,593
Implied price (Rs/share)	4,159	5,013	5,843
Aban's current market cap	4,664	4,664	4,664
Upside from current market cap	**-15%**	**3%**	**20%**

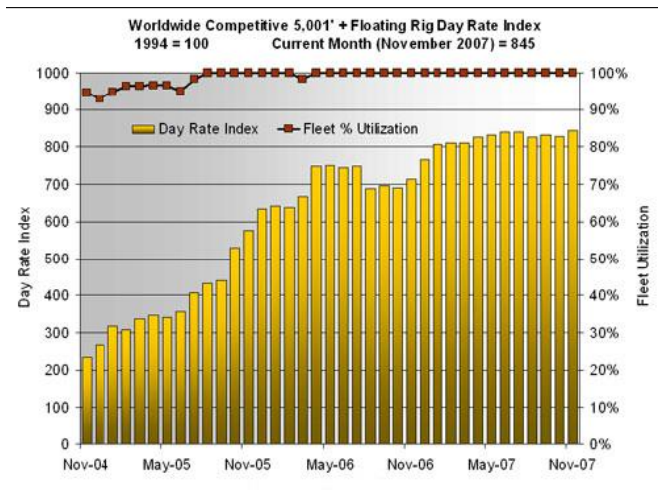
Source: Citi Investment Research estimates. *Including 10.4% additional dilution following conversion of bonds.

Industry Outlook: Rig Utilisation High and Day Rates Firm

The following is extracted from "Singapore Conglomerates: 2008 Outlook: Still Robust but Risk Appetite Scaled Back" dated 4 Dec 2007

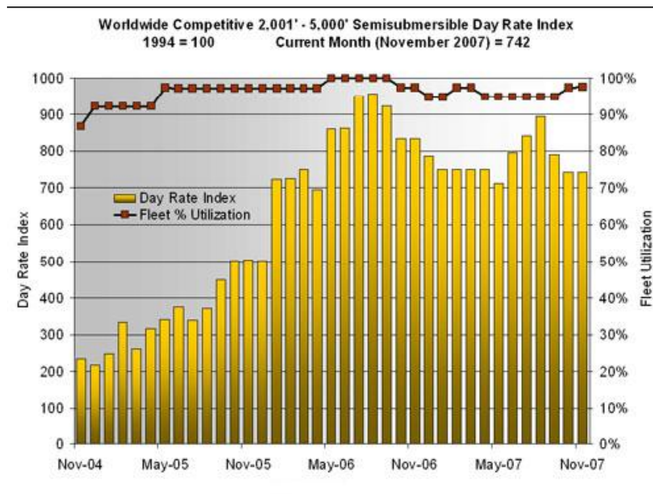
According to ODS-Petrodata's Offshore Rig Day Rate Index, deepwater drilling rig day rates are at record highs across rig types and geographical locations, except Gulf of Mexico day rates which continue to weaken. Fleet utilisation is at or close to 100% except for the Gulf of Mexico.

Figure 6. Floating Rigs (Depths > 5,000ft) – Day Rates and Utilisation



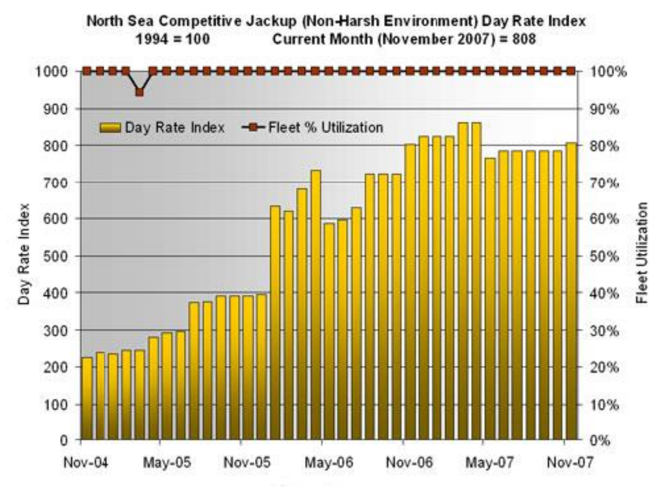
Source: ODS-Petrodata

Figure 7. Floating Rigs (Depths 2001-5,000ft) – Day Rates and Utilisation



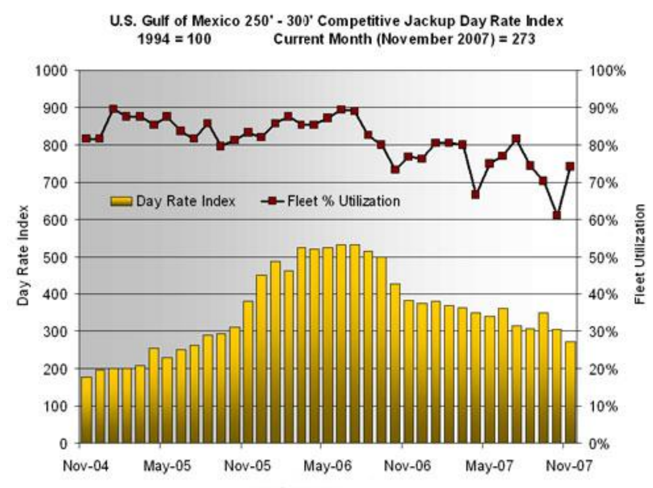
Source: ODS-Petrodata

Figure 8. North Sea Competitive Jackups – Day Rates and Utilisation



Source: ODS-Petrodata

Figure 9. U.S. Gulf of Mexico Competitive Jackups - Day Rates and Utilisation



Source: ODS-Petrodata

The following are extracted from "Avoiding a Rush to Judgment: Fears of a Collapse in International Jackup Rates Are Premature" dated 17 Sep 2007; "Offshore Drilling 3Q07 Preview: Divergence Continues" dated 14 Oct 2007; and "Diamond Offshore Drilling Inc (DO): Sharing the Wealth" dated 25 Oct 2007 by our US Oilfield Equipment & Services analyst Geoff Kieburtz.

Our optimistic outlook is further buoyed by recent contracts received by several speculative jackups prior to exiting the shipyard. Petrobras recently agreed to a two-year contract for jackup Offshore Defender that begins in first quarter 2008 at a day rate of $185,000. Premier has contracted jackup WilBoss for six months in second quarter 2008 at a $220,000 day rate. Day rates are likely to

remain at current levels rather than decline precipitously over the next several quarters as additional capacity is absorbed.

Delivered rigs have been receiving contracts at market rates. ODS-Petrodata shows that 18 jackups have been delivered between Sep 06 to Sep 07. Three are owner-operated, i.e. non-competitive. All of the remaining 15 rigs are contracted. Of these 15, 12 can be classified as speculative (no contract prior to beginning construction). The day rates for the 12 speculative rigs range from a low of US$165,000 to a high of $255,000, which is within the range of day rates received by existing rigs over the past year.

Diamond sees the potential for another step-up in day rates. Diamond's outlook for day rates is perhaps more bullish than ours for we continue to assume that today's leading edge day rates will still be the leading edge in the 2008-2010 time frame. As new builds consistently receive commitments at day rates well in excess of $500,000, the gap between these rigs and the existing worldwide fleet will continue to tighten, in Diamond's view, as it has done over the past several quarters. Midwater day rates should continue to benefit from tightness in the deepwater market and growing activity in international markets in water depths of 2,000'-3,000' that remain largely unexplored.

New Builds are Manageable

The current jackup and semisub rigs on order only account for 19% and 27% of the global fleet respectively – levels we find manageable considering the advanced drilling requirements of operators and the ageing global fleet.

Figure 10. New Builds are Manageable

	Jackup		Semi-Sub	
Global Fleet	**413**	**100%**	**165**	**100%**
Delivery (of global fleet)				
2007	10	2%	2	1%
2008	29	7%	11	6%
2009	23	6%	21	13%
2010	13	3%	10	5%
2011	3	1%	1	1%
Under Construction (of global fleet)	**78**	**19%**	**45**	**27%**
Keppel Corp (of total under const.)	**29**	**37%**	**10**	**22%**
SembMarine (of total under const.)	**17**	**22%**	**8**	**18%**

Source: ODS-Petrodata, Rigzone, Citi Investment Research

Delays May Provide Support to Day Rates

Rig supply may expand more slowly than anticipated due to strains evident in the newbuild supply chain, which should provide support to day rates.

The following is extracted from "Noble Corp (NE): Eye on the Ball" dated 18 October 2007 by our US Oilfield Equipment & Services analyst Geoff Kieburtz.

Noble is experiencing shipyard delays, others may as well. Delivery dates for Noble's two jackups under construction, *Noble Hans Deul* and *Noble Scott Marks*, have been pushed back by five months and three months, respectively.

Noble has a reputation for delivering rigs on time and within budget, so the fact that it is experiencing delays suggests that other contractors may be as well, particularly speculative contractors with little rig construction experience.

In our recent tour of shipyards in Asia, we heard numerous comments about the strains evident in the newbuild supply chain. Several contractors are now adding a one- to three-month delay to the scheduled delivery dates for planning purposes. Noble's delays were apparently caused by defective workmanship on the fabrication of legs completed in the U.S. We heard similar problems have been experienced on other contractors' projects in Singapore.

As a result, rig supply will likely expand more slowly than anticipated, which should provide support to day rates. If jackup delivery delays average three months per rig, the number of jackups scheduled for delivery over the next 12 months falls to 24 from 32. Considering only jackups without contracts, the number of deliveries falls to 15 from 21.

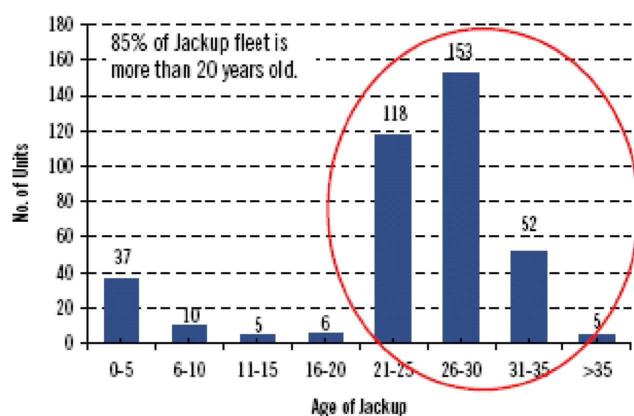
Ageing Global Fleet and Safety Risk

The global rig fleet (jackups and semisubs) continues to age with 83% of the total above 20 yrs old. We believe part of the fleet will be replaced and recent news on the dangers of these old assets may prompt further investments to replace the existing fleet.

In a recent Upstream article, the UK government has claimed that UK's offshore oil and gas infrastructure is old, decaying and neglected by an industry that does not understand the potential dangers. Most of the UK's North Sea oil and gas assets are near or beyond the end of their intended design life and not getting the attention they need to keep operating safely in their twilight years, according to the Health & Safety Executive (HSE). "There is a poor understanding across the industry of potential impact of degraded, non safety-critical plant and utility systems on safety-critical elements in the event of a major accident," the HSE said after inspecting nearly 100 offshore installations - about 40% of the total.

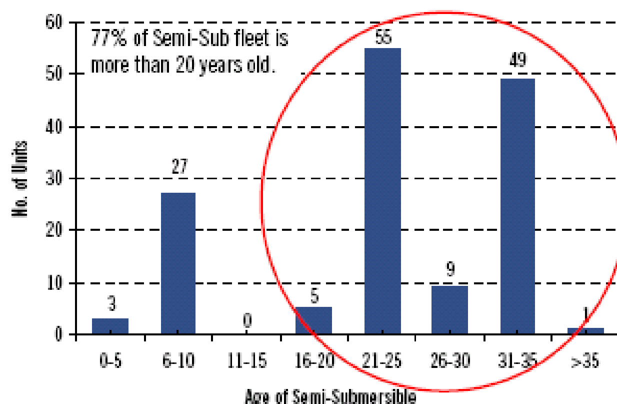
According to the same article, more than half of the offshore assets studied in the three-year investigation - including fixed manned and unattended platforms, floating production, storage and offloading vessels and mobile drilling rigs - were found to be in a poor condition. The HSE warned that the poor state of equipment was harming morale in an offshore energy sector already struggling to attract enough skilled labour and called on companies to cooperate more effectively.

Figure 11. Jackups – Age Profile



Source: ODS-Petrodata

Figure 12. Semi-Submersibles – Age Profile



Source: ODS-Petrodata

Jackup and Semisub Markets

The following are extracted from "Offshore Drilling 3Q07 Preview: Divergence Continues" dated 14 Oct 07; "Noble Corp (NE): Eye on the Ball" dated 18 Oct 07; "Diamond Offshore Drilling Inc (DO): Sharing the Wealth" dated 25 Oct 07; "Ensco International Inc (ESV): Engineering Growth" dated 25 Oct 07; "Hercules Offshore Inc (HERO): Emerging from the Gulf" dated 30 Oct 07; "Transocean Inc (RIG): Moving to the Next Level" dated 31 Oct 07; and "Pride International Inc (PDE): Unfamiliar Ground" dated 1 Nov 07 by our US Oilfield Equipment & Services analyst Geoff Kieburtz.

Jackup

Substantial unsatisfied international jackup demand exists. According to ODS-Petrodata (private), more than 180 jackups may be needed to fulfill drilling programs outside the U.S. Gulf of Mexico slated to begin over the next 12 months. This exceeds the approximately 135 international jackups expected to have availability during the same period. Even after including 16 jackups under construction that will be available through October 2008, demand is forecasted to outstrip supply by close to 30 units.

The concern among investors is on the supply side and the 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 330 and 320, respectively, resulting in utilization of 97%. Of the 80 jackups under construction, 60 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 410 and 340, with utilization of 83%. If we were to assume that half of the 60 jackups under construction without contracts remain idle after delivery, demand would be 370 rigs and utilization would be 90%.

All international jackup markets appear undersupplied. ENSCO believes that there is a need for five incremental jackups in Saudi Arabia by early 2008, and deficits exist in the Neutral Zone, U.A.E., Iran, India, Mediterranean, West Africa, the North Sea, and Mexico. Mexico is a new market for ENSCO, as the company will contract its first jackup with Pemex (private) under a 2.5-year commitment beginning in December 2007 at a day rate in the mid-$160,000s, or approximately twice the day rate it would likely earn in the fourth quarter if it were to remain in the U.S.

In particular, Noble highlighted incremental jackup needs in Mexico, West Africa, the Middle East, Southeast Asia, and Brazil. The North Sea is currently in balance but could be short capacity by mid-2008 as at least three rigs are expected to leave the region for work in other markets. This supply deficit is unlikely to be satisfied by units under construction without contracts because the vast majority of these rigs are not being outfitted for work in harsh environments. This is a positive for Noble as it has five jackups in the region that will be ending current commitments prior to the end of the third quarter.

The rise of indigenous drilling contractors in India is one area of concern as it appears they are willing to accept below-market rates as they build competency, which could pressure day rates for non-Indian contractors with a presence in the region. Noble's exposure to India is limited to two units, one of which is contracted through July 2009 and the other until January 2010.

Transocean is "pleasantly surprised" by the international jackup market but cautioned that visibility is limited to first half 2008. Demand is growing rapidly in the Middle East, where Saudi Aramco may need as many as 20 incremental jackups over the next few years, and India, supplemented by more gradual demand increases in more mature jackup markets. Transocean remains concerned about new building activity but has been so for the past two years, even as the market has remained robust. The jackup market is naturally shorter-term than the deepwater market so forward visibility is fairly limited. Nevertheless, as we have noted numerous times, it appears at this time as if there is sufficient incremental demand to absorb rigs under construction without resulting in a significant decline in day rates.

Semisub

The floating rig market remains the most attractive offshore drilling sector, in our view, and appears poised to remain so as demand is far outstripping supply even after accounting for new builds under construction. Essentially all currently active floaters are contracted and day rates remain at record levels. Notably, drillship Stena DrillMax III, which was built on speculation, recently received a five-year, $520,000 commitment for work beginning in July 2009.

GlobalSantaFe's recent announcement that it would undertake a $740 million drillship newbuild program, with delivery in third quarter 2010, without a contract in hand is the latest sign of market tightness. The company indicated that assuming no new discoveries there will be a 40-50 deepwater rig shortage in 2010. Pride International is also constructing two drillships on speculation, with deliveries scheduled in 2010. The decision to go forward with construction on speculation is a reflection of tight shipyard and vendor capacity, which has

resulted in construction options that move faster than customers' tender processes.

Recent data points appear to support GlobalSantaFe's and Pride's view of a constrained floating rig market. Open demand for floaters in 2008 alone could be approximately 45 rig years, according to ODS-Petrodata, while availability is estimated to be just 25 years, assuming options to extend contracts are exercised. This supply/demand imbalance should ensure continued high rig utilization and robust day rates, in our view.

Pride is noting customer inquiries for long-term contracts beginning as far out as 2010. The company is currently in discussions with one operator for its 10,000' drillship *Pride Angola*, which ends its current contract in June 2008. Pride would not disclose day rate discussions but, as we have seen with other recent signings, operators appear willing to pay a significant premium to leading-edge term rates in order to secure near-term access. In our view, a day rate approaching $500,000 is not out of the question in light of the company's expectation that Pride South Pacific, a 6,500' water depth semi, will receive a day rate competitive with the $450,000 day rate recently secured by a competitor's similarly equipped rig.

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 purchase of the Norwegian company Sinvest and the recent acquisition of a semi-submersible rig, the consolidated entity has 21 offshore drilling assets (including 2 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 strategy

We rate Aban Buy/Medium Risk. Consolidated with Sinvest, Aban is a material play on the global offshore services industry with a pipeline of 5 assets (4 new jackups and 1 recently acquired semi-submersible rig), which come on stream over CY08-09 (adding to an existing fleet of 16 offshore assets). This well-timed fleet expansion will help Aban capitalize on the strong cyclical uptrend in the offshore drilling industry. Strong operational cashflows will help Aban service and pay-down part of its large debt over the next three years. We see repricing of assets, upcoming listing of the Singapore subsidiary, and growth in earnings as key share-price drivers.

Valuation

Our target price for Aban of Rs5,895 is based on our DCF fair value for Dec-08E. Our DCF is based on 5 years of explicit cash flow forecasts and the following key assumptions: decline in day rates over FY10-12E of 5-15% to factor in mid-cycle earnings; steady state earnings assumed beyond FY12 based on a payback period of 5 years; terminal EBIT being 28% lower than peak (FY10) EBIT; terminal post-tax ROIC of 16% (vs. peak ROIC of 23% in FY10E); WACC of 9.2% (risk free of 8%, risk premium of 6%, beta of 0.75x, target D/E of 1:1). On our target price, Aban would trade at ~11x FY10E earnings, by which time all the assets of the company, existing as well as in the pipeline, would contribute fully to earnings.

Risks

We rate Aban as 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 are: E&P activity decline; long-term day rates which vary with the demand-supply scenario in the rest of the world; delay 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

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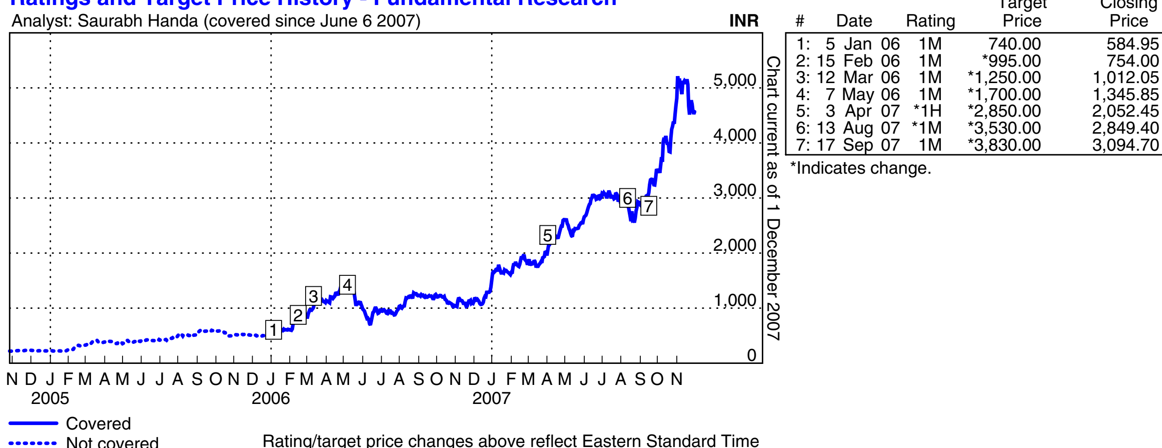

#	Date	Rating	Target Price	Closing Price
1:	5 Jan 06	1M	740.00	584.95
2:	15 Feb 06	1M	*995.00	754.00
3:	12 Mar 06	1M	*1,250.00	1,012.05
4:	7 May 06	1M	*1,700.00	1,345.85
5:	3 Apr 07	*1H	*2,850.00	2,052.45
6:	13 Aug 07	*1M	*3,530.00	2,849.40
7:	17 Sep 07	1M	*3,830.00	3,094.70

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