

15 January 2008

**Buy**

Price	Target Price
<b>Rs5,018</b>	<b>Rs6,065</b>

<b>Sensex</b>	<b>20,728</b>
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**Price Performance**

(%)	1M	3M	6M	12M
Absolute	1	25	66	189
Rel. to Sensex	(3)	11	22	96

Source: Capitaline

**Stock Details**

Sector	Oil Field Services
Reuters	ABAN.BO
Bloomberg	ABAN @IN
Equity Capital (Rs mn)	75
Face Value (Rs)	2
52 Week H/L	5,555/1,528
Market Cap (Rs bn)	189.2
Daily Avg Vol. (No of shares)	144957
Daily Avg Turnover (US\$mn)	17.3

**Shareholding Pattern (%)**

(30 Sep.'07)	
Promoters	62.4
FII/NRI	16.0
Institutions	3.9
Private Corp.	3.1
Public	14.7

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**Aban Offshore****Upgrading Earnings and Price Target**Result  
Update

Aban Offshore Q3FY2008 standalone net profit at Rs478 millions is ahead of expectations primarily because of lower insurance cost and higher other income. With two of its assets operating at re-priced contract day rate (Aban II and FPU Tahara) Aban has reported a smart 34.0% growth in its topline (Rs1691 million) despite of rupee appreciation against USD. Operating profit for the quarter grew handsomely by 32.2% to Rs914 million, primarily because of 43.6% decline in insurance cost. With the boost from the other income (up 343% yoy Aban's Q3FY2008 pre-exceptional net profit increased by a staggering 130% to Rs478 million. Aban last 6 contracts has been concluded at better than expected day rates (7.5% higher than expected) and also it has recently added a semisubmersible Bullford dolphin to its fleet. Factoring these two events we are upgrading our earnings estimates for Aban by 25% for FY2009 and 22% for FY2010. Our EPS estimates now stand at Rs406 for FY2009 and Rs551 for FY2010. Aban is currently trading at 12.5 X its FY2009 earnings and 9.2X its FY2010 earnings. With the global offshore rig market continuing to witness rig shortage on account of long gestation period for new assets, the day rates for rigs in the medium term to long term would witness further upside. Hence Aban that still has 1 contract to be re-negotiate in the standalone entity and 4 fresh contracts for its new generation premium Jack ups rigs, is in a sweet spot. We believe that offshore oilfield service's industry fundamentals remain compelling and Aban is the best play to drive the strong demand for offshore rigs and continued uptrend in day rates. We maintain our Buy recommendation on the stock with a revised price target of Rs6065, which is a 20% upside from current levels.

**Results Highlights**

- Aban Offshore Q3FY2008 standalone net profit at Rs478 millions is ahead of expectations primarily because of lower insurance cost and higher other income.
- With two of its assets operating at re-priced contract day rate (Aban II and FPU Tahara) Aban has reported a smart 34.0% growth in its topline (Rs1691 million) despite of rupee appreciation against USD. While Aban II was re-contracted with ONGC at a rate of USD 85000 (2.9x earlier day rate) while the FPU Tahara was re-contracted with Hardy Oil at a day rate of USD 87500 (3.5x earlier day rate). The topline growth could have been higher but for a 12 day revenue loss for Aban IV.
- Operating profit for the quarter grew handsomely by 32.2% to Rs914 million, primarily driven by higher day rates for Aban II and FPU Tahara and 43.6% decline in insurance cost.
- On the cost front, the employee cost increased by 43.7% following acute shortage of rig engineers and toolpushers. Also following 3.5X jump in day rate of FPU Tahara, the rentals on machinery predominantly used for this rig increased by 209% to Rs124.8 million. Insurance cost declined by 43.6% on account of sharp fall in insurance cost for Aban fleet.
- Other income for the quarter grew by 343% on account of some treasury gains (Rs30 million) and some gains on forex (Rs100 million). The other income also includes Rs120 million of interest received on loans to Singapore subsidiary.
- With the boost from the other income and marginal increase in depreciation, Aban's Q3FY2008 net profit increased by a staggering 130% to Rs478 million.

## Result Table

Rs millions	Q32008	Q32007	YoY(%)	9M2008	9M2007	YoY(%)
Net sales	1690.7	1261.4	34.0%	4619.8	3787.94	22.0%
Consumption of Stores	161.1	146.4	10.0%	515.3	421.4	22.3%
Staff cost	106.2	73.9	43.7%	352.61	240.1	46.9%
Rental charges to machinery	124.8	40.4	208.9%	262.4	124.6	110.6%
Repairs to machinery	55.5	27.2	104.0%	126.1	137.8	-8.5%
Insurance	46	81.5	-43.6%	162.88	244	-33.2%
other expenditure	283.6	201	41.1%	765.6	620.4	23.4%
Total Expenditure	777.2	570.4	36.3%	2184.89	1788.3	22.2%
EBIDTA	913.5	691	32.2%	2434.91	1999.64	21.8%
Other Income	248.4	56.1	342.8%	622.61	153.2	306.4%
Interest	156.5	96.2	62.7%	422.97	324.8	30.2%
Depreciation	242.9	241.1	0.7%	715	744.5	-4.0%
PBT before amortisation	762.5	409.8	86.1%	1919.55	1083.54	77.2%
Goodwill amortised	15.7	15.7		47.1	47.4	
PBT	746.8	394.1	89.5%	1872.45	1036.14	80.7%
Tax	268.7	186	44.5%	638.35	505	26.4%
PAT	478.1	208.1	129.7%	1234.1	531.14	132.3%
OPMs	52.7%	52.8%		54.0%	54.8%	
PBT(%)	41.6%	28.6%		45.1%	32.5%	
PAT	26.7%	14.0%		28.3%	16.5%	
Tax rate	33.3%	46.6%		35.2%	45.4%	

## Developments in Q3FY2008

## Aban VI bags USD95 million contracts

During the quarter Aban bagged contract for extended deployment of its Jack up rig Aban VI in direct continuation of its current contract. The term of the contract is 6 years from the end date of current contract. The rig is currently working with Oriental Oil Co Dubai at a day rate of USD 39000. The day rate for the initial 3 year period of the contract is EURO 62450 (approximately USD 88500). At a day rate of USD 88500 the total value of the contract works out to USD 95 million for the initial period of 3 years.

## Aban acquires Bulford Dolphin

Continuing its ferocious acquisition spree, and its intent to increase its deepwater drilling capability, Aban Offshore during Q3FY2008 acquired semi – submersible rig “Bulford Dolphin”. Aban would pay a consideration of USD 211 million for the rig and the rig is expected to go on contract during end Q4FY2008. Bulford Dolphin is a 2<sup>nd</sup> generation Semi-submersible with rated water depth of 1250 ft and drilling depth of 25000 ft. With the acquisition Aban has clearly shown its appetite for inorganic growth and its intent to be among the top drilling entities in the world. Bulford is likely to get a day rate of USD250000 and opex of USD70000. Hence, the pay back period for Bulford works out to a very lucrative 4.5 years.

## Upgrading earnings

Aban’s last 6 contracts (see exhibit below) has been concluded at higher than expected day rate (7.5% higher than expected). Further we had not factored in earnings estimates of recently added semisubmersible Bullford Dolphin. Factoring these two events we are upgrading our earnings estimates for Aban by 25% for FY2009 and 22% for FY2010. Our EPS estimates now stand at Rs406 for FY2009 and Rs551 for FY2010.

**Contracted day rates higher than expected day rate**

Rigs	Expected Day rate	Actual Day rate	Change
Aban III	150000	156600	4.4%
Aban IV	150000	156600	4.4%
Aban V	150000	156600	4.4%
FPU Tahara	60000	87500	45.8%
DD4	200000	220000	10.0%
DD5	200000	201500	0.8%
<b>Average</b>	<b>151667</b>	<b>163133</b>	<b>7.6%</b>

**Upgrading earnings by 25% for FY2009 and 22% for FY2010**

	Earlier		Revised		Change	
	FY2009E	FY2010E	FY2009E	FY2010E	FY2009E	FY2010E
Rs million						
Revenues	37397.1	46418.5	45593.4	54175.8	22%	17%
EBIDTA	28807.6	34886.8	33869.1	39740.5	18%	14%
EBIDTA (%)	77.0%	75.2%	74.3%	73.4%		
Net Profit	13550.8	18863.2	16902.2	23139.6	25%	22%
EPS	323.9	450.9	406.0	551.4	25%	22%

**Upgrading Price target to Rs6065 - upside of 20%**

On the back of its recently concluded contracts and that too with long term duration of 2-3 year, Aban's earnings visibility has extent beyond FY2009. Also with the acquisition of Bullford Dolphin Aban has clearly shown its appetite for inorganic growth and its intent to be among the top drilling entities in the world. Hence on account of earnings upgrade and strong earnings growth visibility we are upgrading our price target on Aban to Rs6065 which is a 20% upside from current levels. Since we have based our new target of Aban on FY2010E earnings, it is a 15 month price target. Our price target is based on average of Aban's FY2010 target PE of 11X, FY2010 target EV/EBIDTA of 7X and a two stage DCF with WACC of 11.33% and terminal growth of 3%.

**Aban's price target Rs6065**

Valuation Measure	Multiple	Rs per share
DCF	WACC 11.33%, TG- 3%	6186
FY2010 PER	11X	6060
FY2010 EV/EBIDTA	7X	5950
Average		6065
CMP		5069
Upside		20%

**DCF Projections**

Period	FY08E	FY09E	FY10E	FY11E	FY12E
<b>Y/E March (Rs mn)</b>					
PAT (after pref dividend)	4549.2	15585.0	21167.3	19913.2	13939.2
Depreciation	3766.0	5342.0	6142.0	6142.0	6142.0
Interest(1-T)	6320.7	6017.0	4842.5	3472.2	2604.2
Capex	7365.9	12750.0	0.0	0.0	0.0
Net change in Working Capital	(3924.7)	(269.0)	(117.6)	31.2	31.2
<b>FCFF</b>	<b>18077.1</b>	<b>39425.0</b>	<b>32034.2</b>	<b>29558.5</b>	<b>22716.5</b>
Discount Rate	1.00	0.90	0.81	0.72	0.65
<b>PV of Free Cash Flow</b>	<b>18077.1</b>	<b>35411.6</b>	<b>25844.2</b>	<b>21419.4</b>	<b>14785.7</b>
Cumulative Cash Flow	18077.1	53488.8	79333.0	100752.4	115538.1

**Assumption for DCF**

<b>Assumed Terminal Year (N)</b>	<b>FY2012</b>	<b>Per share value</b>
Cash Flow at N+1	23398.0	
Growth Rate (Post 2013)	3.0%	
WACC (%)	11.33%	
Terminal Value (N+1)	280776.4	
Discounted Terminal Value	182751.0	4761
Present Value of Firm till Terminal Year	115538.1	3010
Total Discounted Value of Firm	298289.1	7771
Less: Current Debt of the Firm	60840.0	1585
Present Value of Equity	237449.1	6186
No. of Equity Shares (cr)	38.4	
Fair Value (Rs/share)	6186	
WACC Calculation		
Risk Free rate	8.5%	
Market Risk Premium	5.5%	
Mid cap Risk Premium	2.0%	
Adjusted Beta	1.00	
Cost of Equity	16.0%	
Cost of Debt	9.00%	
Target Debt Equity	2:1	
WACC	11.33%	

**PV of explicit period cash flow for Aban is Rs3010 ~ 60% of CMP**

While arriving at a DCF value for Aban we have adopted a two stage DCF approach with explicit period of 5 year (FY2008-12). For the first three year of the explicit period i.e. for FY2008-10, we already have our estimates for Aban which are based on the long term contracts it has tied up for its fleet. For the balance two years of the explicit period i.e. FY2011-12 we conservatively estimate a drop of 34% in Aban's earnings, on the back of possible softening in Jack up day rates. The discounted value (WACC of 11.33%) of the cash flow of this explicit period comes to Rs3010 per share of ABAN (see Assumption for DCF). This Rs3010 is approximately 60% of the CMP. The average life of Aban's asset is approximately 13 years, which is approximately 40% of the economic life of a rig (which is 30 years). This essentially means that for the balance 60% of the life of asset the market is just paying 40% of the value, which we believe is very pessimistic.

**Current price implies terminal growth rate of 0.5% for Aban**

Alternatively the current price for Aban, implies terminal growth rate of 0.5%. However if we look at jack up day rates for last 11 year (1996-2007), the same has grown at a CAGR of 14.1%. Even if we consider the long term period of 1984-2007, the jack up day rates increased at a CAGR of 9%. Based on this data we believe that there is substantial head room for upgrade of terminal growth rates for offshore driller globally and Aban in particular. We believe that the pessimism on the offshore drillers in general and Aban in particular is unjustified and we believe that the market is getting overly worried about the near term increase in jack up supply. We believe that with crude price close to USD 90 per barrel and depleting global oil reserves, the demand for offshore rigs would remain strong and would absorb the supply. However we do not rule out some bunching up of Jack up supply which could put some pressures on Jack up day rates in short term.

**Outlook positive - maintain BUY**

Aban is currently trading at 12.5 X its FY2009 earnings and 9.2X its FY2010 earnings. On price to cash flow basis the stock is trading at 8.9X for FY2009 and 6.7X for FY2010. With the global offshore rig market continuing to witness rig shortage on account of long gestation period for new assets, the day rates for rigs in the medium term to long term would witness further upside. Hence Aban that still has 1 contract to be re-negotiate in the standalone entity and 4 fresh contracts for its new generation premium Jack ups rigs, is in a sweet spot. We believe that offshore oilfield service's industry fundamentals remain compelling and Aban is the best play to drive the strong demand for offshore rigs and continued uptrend in day rates. We maintain our Buy recommendation on the stock with a revised price target of Rs6065 which is a 20% upside from current levels.

**Further trigger for Aban stock lined up****Listing of Aban Singapore to unlock value**

According to media reports Aban Singapore, a wholly-owned subsidiary of Aban Offshore, has appointed UBS and Merrill Lynch as lead managers for its proposed USD 500 million IPO. ASPL is to offload around 13-15% for USD500 million, and the IPO is slated for March 2008. The Singapore IPO is aimed at retiring its debt, which is around USD2.2 billion. The IPO if successful would value the subsidiary at a whopping USD 3.85 billion, much higher than our expectation of USD 3 billion. We believe that the chance of the IPO getting successful is very high as the Singapore entity is expected to achieve an EBIDTA of USD 550 million in FY2009 and USD722 in FY2010, valuing the firm at close to 7 X FY2009 EBIDTA and 5.3X FY2010 EBIDTA.

**Drillship frontier ice due for re-pricing in Feb 2008**

Of the 7 Drilling assets that are owned by Aban in the standalone entity, Aban has re-priced 6 assets, with the new day rate being approximately 2.5X of earlier contracted day rates. The last of the asset to be re-priced is drillship Frontier Ice which is currently working with ONGC at a day rate of USD 43000. The Drillship is expected to get a day rate of USD125000.

**4 Jack up rigs still to bag contracts**

Apart from the above-mentioned re-pricing of the drill ship Aban still has an arsenal of 4 new premium class Jack rigs to be delivered over next 16-18 months and the same rigs are yet to bag contracts. Two out of these four rigs are 375 ft water depth rigs and two are of 350 ft water depth rigs. Recently Aban had bagged contract for Deep Driller 4 (375ft rig) at a day rate of USD 220000 and Deep Driller 5 (350ft) at a day rate of USD 205000. We expect rest of the rigs also to get day rate in the range of USD 200000-220000.

**Bullford Dolphin to be contracted**

Aban's recent acquisition Bullford Dolphin is expected to bag contract during the quarter. We expect a day rate of USD 250000 at which it will have a pay back of 4.5 years.

## Income Statement

Y/E, Dec (Rs. m)	FY07	FY08E	FY09E	FY10E
<b>Net Sales</b>	<b>7186.7</b>	<b>25957.2</b>	<b>45593.4</b>	<b>54175.8</b>
Growth (%)		261.2	75.6	18.8
<b>Total Expenditure</b>	<b>3673.5</b>	<b>7940.4</b>	<b>11724.4</b>	<b>14435.3</b>
Growth (%)		116.2	47.7	23.1
Fuel, Oil & Water	151.8	389.4	455.9	541.8
% of sales	2.1	1.5	1.0	1.0
Repairs & Maint	961.1	2855.3	4103.4	5417.6
% of sales	13.4	11.0	9.0	10.0
Other Fleet Oper Exps	623.0	1817.0	2735.6	3250.5
% of sales	8.7	7.0	6.0	6.0
Admin & Other Exps	1421.6	1191.5	1693.8	1974.8
% of sales	19.8	4.6	3.7	3.6
<b>EBIDTA</b>	<b>3513.2</b>	<b>18016.8</b>	<b>33869.1</b>	<b>39740.5</b>
Growth (%)		412.8	88.0	17.3
<b>EBIDTA %</b>	<b>48.9</b>	<b>69.4</b>	<b>74.3</b>	<b>73.4</b>
Other income	880.9	1300.0	1300.0	1300.0
Interest	2788.5	8427.6	8022.6	6456.6
Depreciation	1202.6	3766.0	5342.0	6142.0
<b>EBT</b>	<b>403.0</b>	<b>7123.2</b>	<b>21804.5</b>	<b>28441.9</b>
Tax	746.6	1979.3	4902.3	5302.3
<b>EAT</b>	<b>-343.6</b>	<b>5143.9</b>	<b>16902.2</b>	<b>23139.6</b>
Growth (%)		-1597.0	228.6	36.9
EAT (%)	-4.8	19.8	37.1	42.7
E/O items	0.0	0.0	0.0	0.0
<b>Adjusted PAT</b>	<b>-343.6</b>	<b>5143.9</b>	<b>16902.2</b>	<b>23139.6</b>

## Balance Sheet

Y/E, Dec (Rs. m)	FY07E	FY08E	FY09E	FY10E
Equity share capital	73.7	76.8	76.8	76.8
Preference Capital	3060.0	3060.0	3060.0	3060.0
Reserves & surplus	6459.3	10928.7	26436.9	47527.4
<b>Networth</b>	<b>9593.0</b>	<b>14065.4</b>	<b>29573.7</b>	<b>50664.2</b>
<b>Loan Funds</b>	<b>104240.4</b>	<b>95640.0</b>	<b>82640.0</b>	<b>60840.0</b>
<b>Minority Share</b>		<b>334.5</b>	<b>1391.6</b>	<b>3103.9</b>
<b>Total Liabilities</b>	<b>113833.4</b>	<b>110040.0</b>	<b>113605.3</b>	<b>114608.0</b>
Gross Block	80994.3	106554.3	123554.3	123554.3
Less: Depreciation	5790.9	9556.9	14898.9	21040.9
<b>Net block</b>	<b>75203.4</b>	<b>96997.4</b>	<b>108655.4</b>	<b>102513.4</b>
<b>Ships under construction</b>	<b>22444.1</b>	<b>4250.0</b>	<b>0.0</b>	<b>0.0</b>
<b>Investment</b>	<b>4682.5</b>	<b>4682.5</b>	<b>2341.3</b>	<b>2341.3</b>
<b>Current Assets</b>	<b>19190.1</b>	<b>11928.2</b>	<b>15537.5</b>	<b>24916.0</b>
Inventories	1022.3	2844.6	4996.5	5937.1
Sundry debtors	2033.1	4266.9	7494.8	8905.6
Cash & bank balance	13264.0	1945.9	175.5	7202.7
Loans & advances	2870.7	2870.7	2870.7	2870.7
<b>Current Liab &amp; Prov</b>	<b>6949.1</b>	<b>7080.6</b>	<b>12191.4</b>	<b>14425.1</b>
Current liabilities	6624.5	6756.0	11866.8	14100.5
Provisions	324.6	324.6	324.6	324.6
<b>Net current assets</b>	<b>12241.0</b>	<b>4847.6</b>	<b>3346.1</b>	<b>10490.9</b>
<b>Net deferred tax</b>	<b>-737.5</b>	<b>-737.5</b>	<b>-737.5</b>	<b>-737.5</b>
<b>Total Assets</b>	<b>113833.5</b>	<b>110040.0</b>	<b>113605.3</b>	<b>114608.0</b>

## Cash Flow

	FY07E	FY08E	FY09E	FY10E
<b>Net Profit after Tax</b>	<b>-343.6</b>	<b>5143.9</b>	<b>16902.2</b>	<b>23139.6</b>
<b>Add : Depreciation</b>	<b>1202.6</b>	<b>3766.0</b>	<b>5342.0</b>	<b>6142.0</b>
<b>Add : Misc exp w/off</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
changes in debtors	-1334.0	-2233.8	-3227.9	-1410.8
changes in inventories	-533.5	-1822.3	-2151.9	-940.5
changes in L & A	-2689.3	0.0	0.0	0.0
changes in creditors	5792.5	131.5	5110.8	2233.8
changes in provisions	0.0	0.0	0.0	0.0
<b>Net changes in WC</b>	<b>1235.7</b>	<b>-3924.7</b>	<b>-269.0</b>	<b>-117.6</b>
<b>Operational Cash Flows</b>	<b>2094.7</b>	<b>4985.2</b>	<b>21975.2</b>	<b>29164.1</b>
<b>Capital expenditure</b>	<b>-83651.6</b>	<b>-7365.9</b>	<b>-12750.0</b>	<b>0.0</b>
Investments	-4490.4	0.0	2341.3	0.0
<b>Investing Cash Flows</b>	<b>-88142.0</b>	<b>-7365.9</b>	<b>-10408.8</b>	<b>0.0</b>
<b>Borrowings</b>	<b>93142.4</b>	<b>-8600.4</b>	<b>-13000.0</b>	<b>-21800.0</b>
dividend paid	-184.5	-336.9	-336.9	-336.9
Issue of shares	6218.0	0.0	0.0	0.0
<b>Financing Cash Flows</b>	<b>99175.9</b>	<b>-8937.3</b>	<b>-13336.9</b>	<b>-22136.9</b>
changes in cash	13128.6	-11318.0	-1770.4	7027.2
Opening balance	135.4	13264.0	1946.0	175.6
<b>Closing balance</b>	<b>13264.0</b>	<b>1946.0</b>	<b>175.6</b>	<b>7202.8</b>

## Key ratios

	FY07	FY08E	FY09E	FY10E
EPS (Rs)	-12.3	118.5	406.0	551.4
CEPS (Rs)	66.3	353.5	649.3	771.0
Book Value Per Share (Rs)	175.3	284.7	688.7	1238.1
Dividend Per Share (Rs)	2.0	2.0	2.0	2.0
<b>Valuations Ratios (x)</b>				
PER	-491.4	51.1	14.9	11.0
P/CEPS	91.3	17.1	9.3	7.9
P/BV	34.6	21.3	8.8	4.9
EV/EBIDTA	88.1	17.9	9.2	7.1
EV/Sales	43.1	12.4	6.9	5.2
M-Cap/EBIDTA	63.6	12.9	6.9	5.9
M-Cap/sales	31.1	9.0	5.1	4.3
<b>Financial ratios</b>				
RoCE (%)	4.9%	13.9%	26.7%	30.6%
RoNW (%)	-5.3%	46.7%	63.7%	48.6%
Net debt/ Equity	13.2	8.1	3.0	1.1
Total Debt/Equity	16.0	8.7	3.1	1.3
Dividend yield (%)	0.0	0.0	0.0	0.0

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