Company In-Depth

4 April 2007 | 11 pages

Aban Offshore (ABAN.BO)

Buy: Digesting Sinvest; Increasing Target Price to Rs2850

Rating change ☑
Target price change ☑
Estimate change ☑

- Raising target price; maintain Buy — Raising target price for Aban to Rs2850 (from Rs1700 earlier) based on 8x FY09E consolidated EPS, in-line with target multiples for global peers. We reiterate Buy, but raise our risk rating on the stock to High (from Medium earlier) due to Aban's high financial leverage.
- Consolidating growth... — Aban's acquisition of Sinvest has created a material, leveraged play on the tight market for offshore drilling services. Re-pricing of existing rigs and a significant pipeline of 9 drilling assets coming on-stream over the next 2 years will help Aban grow consolidated earnings 20.5x over FY06-FY09E.
- ....but at a price — Aban's consolidated net debt of US$2.1bn presents a very high level of gearing given its equity base of US$65m. While gearing will come off very rapidly with strong cash flows from operations (US$1.3bn over FY08-10E), further equity infusion in the parent entity (with consequent dilution) cannot be ruled out.
- Operating environment is supportive — Capacity is expanding across all offshore asset classes, but there is no evidence that additions have exceeded demand growth. Citigroup forecasts E&P spending to rise 7% in CY07, following a 26% growth in 2006. Spending plans are now building in higher long-term oil prices (US$53.7/bbl); however, sensitivity to oil price changes has declined.
- Risks and triggers — Slowdown in offshore services demand growth could have a huge impact on Aban given its high gearing. Re-pricing of 3 of Aban's domestic rigs, due this quarter, will be a short-term trigger for the stock.

Buy/High Risk	**1H**
from Buy/Medium Risk	
Price (03 Apr 07)	Rs2,052.45
Target price	Rs2,850.00
from Rs1,700.00	
Expected share price return	38.9%
Expected dividend yield	0.6%
Expected total return	**39.5%**
Market Cap	Rs75,921M
	US$1,761M

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 (%)
2005A	517	14.02	8.4	146.4	34.3	26.5	0.1
2006A	715	17.30	23.4	118.6	27.0	28.5	0.6
2007E	605	16.86	-2.6	121.8	26.4	21.4	0.6
2008E	5,135	127.51	656.4	16.1	6.3	69.4	1.5
2009E	14,538	355.49	178.8	5.8	3.1	80.6	2.7

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	146.4	118.6	121.8	16.1	5.8
EV/EBITDA adjusted (x)	53.0	30.4	20.4	9.0	5.5
P/BV (x)	34.3	27.0	26.4	6.3	3.1
Dividend yield (%)	0.1	0.6	0.6	1.5	2.7
Per Share Data (Rs)					
EPS adjusted	14.02	17.30	16.86	127.51	355.49
EPS reported	14.02	17.30	16.86	127.51	355.49
BVPS	59.78	76.10	77.69	323.72	655.52
DPS	2.00	13.00	13.00	30.00	55.00
Profit & Loss (RsM)					
Net sales	2,895	4,902	10,972	28,565	43,173
Operating expenses	-1,931	-3,112	-6,239	-13,173	-16,402
EBIT	**965**	**1,790**	**4,733**	**15,392**	**26,771**
Net interest expense	-190	-436	-4,029	-8,019	-7,538
Non-operating/exceptionals	84	148	941	464	509
Pre-tax profit	**859**	**1,501**	**1,646**	**7,837**	**19,742**
Tax	-343	-678	-804	-2,032	-3,685
Extraord./Min.Int./Pref.div.	0	-108	-237	-671	-1,520
Reported net income	**517**	**715**	**605**	**5,135**	**14,538**
Adjusted earnings	517	715	605	5,135	14,538
Adjusted EBITDA	1,502	2,804	6,377	19,191	30,938
Growth Rates (%)					
Sales	-3.3	69.3	123.8	160.3	51.1
EBIT adjusted	8.5	85.5	164.5	225.2	73.9
EBITDA adjusted	12.7	86.6	127.5	200.9	61.2
EPS adjusted	8.4	23.4	-2.6	656.4	178.8
Cash Flow (RsM)					
Operating cash flow	**900**	**2,294**	**2,495**	**8,960**	**19,887**
Depreciation/amortization	538	1,014	1,644	3,799	4,167
Net working capital	-154	458	8	-645	-338
Investing cash flow	**-5,587**	**-8,341**	**-35,374**	**-15,932**	**-10,201**
Capital expenditure	-5,587	-8,341	-35,374	-15,932	-10,201
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**5,310**	**3,894**	**96,213**	**-9,098**	**-5,239**
Borrowings	4,770	3,919	96,755	-7,926	-3,017
Dividends paid	-84	-109	-546	-1,261	-2,311
Change in cash	**623**	**-2,153**	**63,334**	**-16,070**	**4,446**
Balance Sheet (RsM)					
Total assets	**10,605**	**17,163**	**117,668**	**121,851**	**134,610**
Cash & cash equivalent	983	135	13,587	6,358	12,515
Accounts receivable	699	699	1,556	2,078	2,929
Net fixed assets	8,076	15,466	49,396	63,189	70,847
Total liabilities	**8,402**	**14,359**	**114,805**	**107,794**	**107,044**
Accounts payable	508	771	2,769	2,391	2,493
Total Debt	7,179	12,598	110,363	102,437	99,420
Shareholders' funds	**2,203**	**2,804**	**2,863**	**14,057**	**27,566**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	51.9	57.2	58.1	67.2	71.7
ROE adjusted	26.5	28.5	21.4	69.4	80.6
ROIC adjusted	10.1	8.9	6.8	12.7	20.2
Net debt to equity	281.3	444.4	nm	683.5	315.3
Total debt to capital	76.5	81.8	97.5	87.9	78.3

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Consolidating Growth....

Aban's acquisition of Sinvest has created a material, leveraged play on the tight market for offshore drilling services. Re-pricing of a large part of Aban's existing fleet (5 assets due for re-pricing over the next 1 year) and new additions to the fleet (9 new drilling assets over the next two years) will drive an enormous 20.5x increase in net income for the company, despite the large financial costs associated with the acquisition of Sinvest assets.

For our consolidated forecasts, we have assumed that the current tightness in the offshore drilling market will continue. Current day rates for the higher specification new build assets of Sinvest (3 rigs are currently operational) range from US$170K to US$230K. For un-contracted new builds, we have assumed day rates of US$200-220K over 2007-2010E. For Aban's older 300' jack-ups, we have retained our conservative re-pricing assumption of US$130,000/day (15% below current day rates for similar assets). The tables below give day rate assumptions and contract validity for Aban and Sinvest assets.

Figure 1. Day Rate Assumptions for Aban's (standalone) Assets (US$)

Asset	Contract validity	Client	Location	FY07	FY08	FY09	FY10
JACK UP RIG - ABAN II	Oct-06	ONGC	East Coast	$56,250	$85,000	$85,000	$85,000
JACK UP RIG - ABAN III	Jan-08	ONGC	Mumbai High	$56,000	$74,500	$130,000	$130,000
JACK UP RIG - ABAN IV	Nov-07	ONGC	Mumbai High	$56,000	$79,860	$130,000	$130,000
JACK UP RIG - ABAN V	Jan-08	ONGC	Mumbai High	$55,000	$73,750	$130,000	$130,000
JACK UP RIG - ABAN VI	Oct-09	Oriental Oil	Dubai	$40,000	$40,000	$40,000	$60,000
FPU - TAHARA	Jul-07	Hardy Oil	East Coast	$23,230	$65,808	$80,000	$60,000
DRILL SHIP - FRONTIER ICE	Feb-08	ONGC	Mumbai High	$45,000	$45,000	$100,000	$100,000
JACK UP RIG - ABAN VII (ROWAN TEXAS)	spot	HOEC		$86,500	$130,000	$130,000	$130,000
DRILL SHIP - Aban Abraham		Kosmos Energy	West Africa		$295,000	$391,667	$400,000
JACK UP RIG - ABAN VIII		Under construction (Keppel) due Mar08				$180,000	$180,000

Source: Company reports and Citigroup Investment Research

Figure 2. Day Rate Assumptions for Sinvest's Assets (US$)

Asset	Contract validity/ Delivery	Client	Location	CY07	CY08	CY09	CY10
Jack-up -Deep Driller 1	Apr-07	Hardy	India	$185,000	$194,000	$200,000	$220,000
Jack-up -Deep Driller 2	Oct-07	Shell	Brunei	$190,000	$195,000	$200,000	$200,000
Jack-up -Deep Driller 3	May-07	Petronas	Malaysia	$170,000	$200,000	$200,000	$200,000
Jack-up -Deep Driller 4	Q207*	--	--		$220,000	$220,000	$220,000
Jack-up -Deep Driller 5	Q207*	--	--		$200,000	$200,000	$200,000
Jack-up -Deep Driller 6	Q408*	--	--			$200,000	$200,000
Jack-up -Deep Driller 7	Q109*	--	--				$200,000
Jack-up -Deep Driller 8	Q308*	--	--			$220,000	$220,000
Drillship "Deep Venture" - 50% stake	Nov-08	Exxon Mobil	West Africa		$410,000	$410,000	$410,000
Jack-up "Murmanskya"- 100% stake	Sep-07		Sakhalin-III		$215,000	$200,000	$200,000

Source: Company reports and Citigroup Investment Research. *Delivery dates for assets under construction.

Aban will generate nearly US$2bn of EBITDA over FY08-FY10, which will adequately cover interest costs (US$490m) and help pay down debt.

Figure 3. Aban's Income Statement, FY06-10E (Rs in Millions)

Year to 31 March	FY06	FY07E	FY08E	FY09E	FY10E
Net Sales	**4,902**	**10,972**	**28,565**	**43,173**	**51,151**
Growth (%)	69.3%	123.8%	160.3%	51.1%	18.5%
Cost of sales	(2,098)	(4,595)	(9,374)	(12,235)	(15,438)
EBITDA	**2,804**	**6,377**	**19,191**	**30,938**	**35,713**
Growth (%)	*86.6%*	*127.5%*	*200.9%*	*61.2%*	*15.4%*
Margins (%)	*57.2%*	*58.1%*	*67.2%*	*71.7%*	*69.8%*
Deprec., amort.	(1,014)	(1,644)	(3,799)	(4,167)	(4,689)
EBIT	1,790	4,733	15,392	26,771	31,025
Other non-opg. items	148	941	464	509	514
Interest	(436)	(4,029)	(8,019)	(7,538)	(6,255)
Profit before tax	1,501	1,646	7,837	19,742	25,284
Taxation	(678)	(804)	(2,032)	(3,685)	(3,901)
Tax rate (%)	*45%*	*49%*	*26%*	*19%*	*15%*
Minority interest	-	-	(434)	(1,282)	(1,864)
Net income	**715**	**605**	**5,135**	**14,538**	**19,282**
Net margin (%)	*14.6%*	*5.5%*	*18.0%*	*33.7%*	*37.7%*
Growth (%)	*38.4%*	*-15.3%*	*748.6%*	*183.1%*	*32.6%*

Source: Company Reports and Citigroup Investment Research

...But at a Price

Aban has borrowed c.US$1.1bn on the books of its 100% Singapore-based subsidiary Aban Singapore Pte Ltd to acquire Sinvest. We estimate consolidated gross debt of Aban at US$2.4bn (net debt of US$2.1bn) as on March 2007.

Figure 4. Aban's Consolidated Balance Sheet, FY06-10E (Rs in Millions)

Year to 31 March	FY06	FY07E	FY08E	FY09E	FY10E
Net fixed assets	**15,466**	**49,396**	**63,189**	**70,847**	**68,858**
Investments	192	1,672	1,672	1,672	1,672
Cash & bank balances	135	13,587	6,358	12,515	11,661
Accounts receivable	699	1,556	2,078	2,929	2,129
Inventory	489	1,160	1,411	1,940	1,974
Other current assets	181	890	962	1,136	1,137
Total current assets	1,505	17,193	10,808	18,520	16,901
Total assets	**17,163**	**117,668**	**121,851**	**134,610**	**128,463**
Accounts payable	771	2,769	2,391	2,493	2,508
Short-term debt	460	13,742	9,816	6,799	-
Other current liabilities	64	231	199	208	209
Total current liabilities	1,295	16,741	12,406	9,500	2,717
Deferred tax liability	656	897	1,506	2,612	3,782
Long-term debt	**12,138**	**96,621**	**92,621**	**92,621**	**73,252**
Provisions	270	546	1,261	2,311	2,311
Shareholders' equity	**2,804**	**2,863**	**11,929**	**24,156**	**41,127**
Total liabilities	**17,163**	**117,668**	**121,851**	**134,610**	**128,463**

Source: Company Reports and Citigroup Investment Research

Given Aban's low equity base (core equity of US$65m), gearing levels are very high. However, we expect the gearing levels to fall off very sharply over the next 3 years as debt gets paid down with post-capex (US$634m) cash flows of US$689m and accretion to equity.

Aban will be diluting 10.4% of its holdings in Aban Singapore (which holds 3 assets and Sinvest) on conversions of issued bonds. Further equity infusions and consequent dilution cannot be ruled out.

Figure 5. Aban's Consolidated Cash Flow Statement, FY08-10E (Rs in Millions)

Year to 31 March	FY08E	FY09E	FY10E	Cumulative (FY08-10E)	
				Rs m	US$m
Net income	5,135	14,538	19,282		
Deprec., amort.	3,799	4,167	4,689		
Net change in WC	(645)	(338)	1,952		
Cash from ops.	**8,960**	**19,887**	**28,024**	**56,870**	**1,323**
Capital expenditure	(15,932)	(10,201)	(1,112)		
Cash from investing	**(15,932)**	**(10,201)**	**(1,112)**	**(27,245)**	**(634)**
Change in borrowings	(7,926)	(3,017)	(26,168)	(37,111)	(863)
Equity raised	-	-	-		
Dividends paid	(1,261)	(2,311)	(2,311)		
Other financing	89	89	90		
Cash from financing	**(9,098)**	**(5,239)**	**(28,389)**	**(42,726)**	**(994)**
Net cash flow	**(16,070)**	**4,446**	**(1,477)**	**(13,101)**	**(305)**

Source: Company Reports and Citigroup Investment Research

Rig Market Tightness continuing...Aban's New Assets will benefit

Our global Offshore Services analyst, Geoff Kieburtz expects the market for offshore drilling services will continue to be tight over the medium term. Citigroup forecasts E&P spending to rise 7% in CY07, following a 26% growth in 2006[1]. While the spending plans are now based on higher base assumptions of oil prices (US$57/bbl for 2007 and long-term oil prices of US$53.7/bbl), sensitivity to oil price changes are declining. The survey pointed out that oil prices would have to move below US$44.4/bbl to trigger a 10% cut in spending plans.

While capacities are expanding across all offshore asset classes, there is no evidence that additions have exceeded demand growth. Of the 117 offshore assets that will be delivered over 2007-2010, 41% are contracted, and there is no sustained softening in day rates.

Figure 6. Newbuilds and Contracting Status

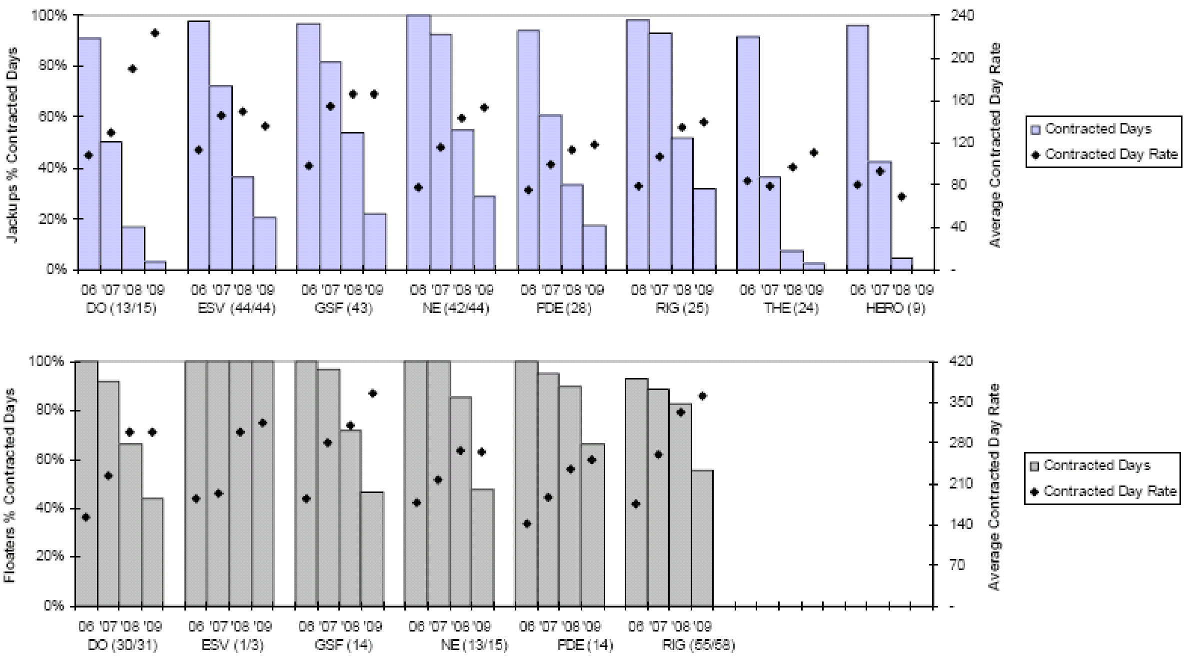
	Newbuilds By Delivery Date						
Year	**Jackups**	**Semis**	**Ships**	**Barges**	**Subs**	**Tenders**	**Total**
2007	20	2	1	0	0	1	24
2008	30	12	3	0	0	1	46
2009	14	16	8	0	0	0	38
2010	2	6	0	0	0	0	8
Undetermined	0	0	0	0	0	1	1
Total	**66**	**36**	**12**	**0**	**0**	**3**	**117**
% Uncontracted	**77.3%**	**33.3%**	**50.0%**	**--**	**--**	**0.0%**	**59.0%**

Source: ODS-Petrodata and Citigroup Investment Research

[1] The E&P Spending Survey, Dec 14, 2006: Geoff Kieburtz, W. Michael McNair, and others. To access the report, click on: https://www.citigroupgeo.com/pdf/SNA00673.pdf

Similarly, global players are witnessing increasing visibility of contracts for their fleets as represented in the charts below. Important for Aban, contracted day rates for jack-ups (which form a bulk of its fleet) continue to be robust till CY09.

Figure 7. Contracted Days and Day Rates for US Offshore Services Companies

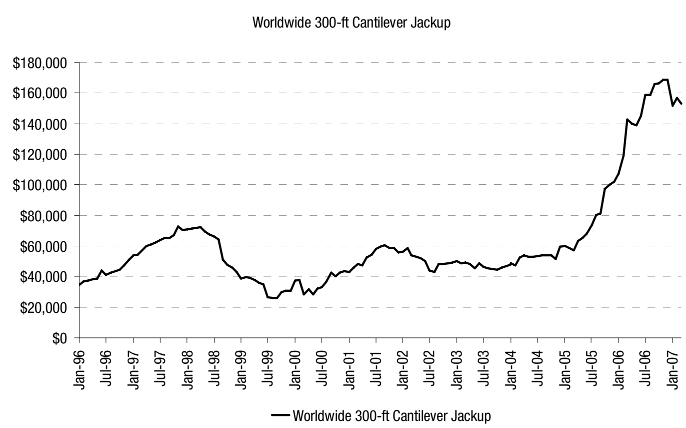


Note: Numbers in parentheses represent fleet size in 2007/2009. Data as of 3/1/2007.

Source: Citigroup Investment Research and Company Reports

Recent jack-up day rates have eased in the key Gulf of Mexico market due to uncertainties over natural gas prices. With 10-15 jack-ups likely to leave GoM to move to international markets, jack-up rates are likely to firm again.

Figure 8. Jack-up Day Rates (US$)



Source: ODS, Citigroup Investment Research

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 9 offshore drilling assets and one FPU and has a pipeline of 9 more drilling assets (including 2 bare boat charters) which will come on stream during 2007-2009. 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 Rs2850 (Rs1700 earlier based on a DCF of Aban standalone) is based on 8x FY09E consolidated EPS in line with average target P/E multiples for its global peer group. Consolidated with Sinvest, Aban is a material play on the global offshore services industry with a pipeline of 9 assets (2 refurbished drillships, 6 new jackups, and 1 refurbished jack-up - including 2 bare boat charters for a drillship and a jackup) which will come on stream over CY07-09 (adding to an existing fleet of 10 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 (US$2.4bn) over the next three years. We see growth in earnings as a key share-price driver.

Valuation

Our target price for Aban of Rs2850 is based on 8x FY09E consolidated earnings, in line with global peers (US and Asian offshore companies) — earlier target price of Rs1700 was based on a DCF for Aban standalone assets. We believe that Aban should trade in line with its peers — despite the company being smaller in size — as a large part of its existing fleet is locked into long-term contracts, which provides high visibility to the company’s volume-led earnings growth prospects. Also, it has a long and good track record of managing new acquisitions and deploying them. As a cross-check, a Price/Cash Earnings of 6.2x FY09E, in line with the target P/CEPS of its peers, supports our target.

Figure 9. Valuation Comparisons

Company Name	RIC Code	Rating	Mkt cap (US$m)	Target P/E (x) CY08/FY09E	Target P/CEPS (x) CY08/FY09E
Aban Offshore	ABAN.BO	1H	1,678	8.0	6.2
Todco	THE.N	1H	2,365	7.1	5.5
Ensco International Inc	ESV.N	1H	8,313	7.8	6.7
Nabors Industries Ltd	NBR.N	1H	8,355	8.1	5.5
Pride International Inc	PDE.N	1H	5,196	7.9	5.7
Hercules Offshore Inc	HERO.O	1H	860	8.2	6.3
China Oilfield Services	2883.HK	1L	3,221	16.8	9.6

Source: Citigroup Investment Research

Risks

Our quantitative risk-rating system, which tracks 260-day historical share-price volatility, rates Aban at Medium Risk. We, however, assign a High Risk to the stock due to the cyclical nature of the business, revenue concentration, and high leverage. Key risks that could prevent the shares reaching our target are: E&P activity decline; long-term day rates 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 could adversely impact cash flows; and currency fluctuations.

Appendix A-1

Analyst Certification

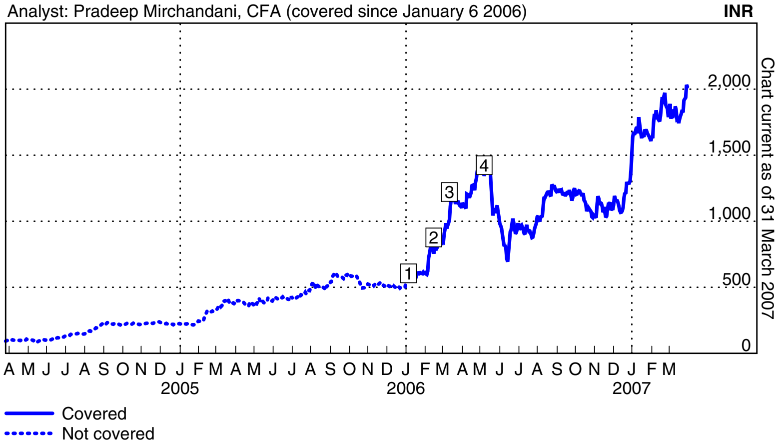
We, Pradeep Mirchandani, CFA and Rahul Singh, research analysts and the authors of this report, hereby certify that all of the views expressed in this research report accurately reflect our personal views about any and all of the subject issuer(s) or securities. We also certify that no part of our compensation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

IMPORTANT DISCLOSURES

Aban Offshore (ABAN.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Pradeep Mirchandani, CFA (covered since January 6 2006)



#	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

*Indicates change.

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Citigroup Investment Research Global Fundamental Coverage (3215)	45%	40%	15%
% of companies in each rating category that are investment banking clients	45%	42%	32%
India -- Asia Pacific (130)	58%	14%	28%
% of companies in each rating category that are investment banking clients	42%	50%	42%

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