

Company

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Aban Offshore (ABAN.BO)

Equity

Alert: Aban Pearl Sinks; Significant Impact on Equity Value

Aban Pearl sinks – In an unfortunate incident, one of Aban's semi-sub rigs (Aban Pearl), which was contracted at a day rate of US\$358K (c.US\$290K post-tax) with PDVSA of Venezuela for a long-term contract (till 2015), has sunk. It was drilling in the Mariscal Sucre offshore natural gas project, off the coast of Venezuela's Sucre state. We do not have too many details at this stage as to the extent of the damage except that the crew on the rig has been evacuated and are safe. Press reports (source: BBC) indicate there is no spillage, which is a relief given the recent BP episode in GoM.

12% full year impact on EBITDA – While the rig itself is fully insured, the loss of revenues will have to borne by the company, and the impact on earnings could be meaningful. Assuming the rig earned revenues for one month (April), the full year impact on our FY11E EBITDA would be ~12% or ~US\$67m. This is assuming, at this stage, that the company does not have to pay additional damages. However, given the high leverage, the impact on PAT could be more severe (~30%), although cash flow (and therefore EBITDA) impact is more pertinent, in our view.

Expect significant impact on stock price – The rig is fully insured for a sum of c.US\$240m. Assuming the company can claim this entire amount and pay down its debt, its net debt would reduce from c.US\$3bn currently to ~US\$2.7bn. Using a 7x EV/EBITDA multiple yields an EV (ex-Aban Pearl) of ~US\$3.5bn, which after reducing net debt yields an implied equity value of US\$800-850m. Given the current market cap of US\$980m, this could result in downside of ~15% on the equity value.

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Aban Offshore (ABAN.BO; Rs1,017.35; 1M)

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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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 as Buy/Medium Risk (1M). Consolidated with Sinvest, Aban is a material play on the global offshore services industry with a fleet of 20 assets. Offshore fundamentals had deteriorated temporarily with E&P companies announcing capex cuts and customers delaying decision-making in awarding contracts in the midst of the sustained decline in crude prices, the credit crunch, and a weakening global economy. However, improvement in global macroeconomic fundamentals and crude settling at above US\$70 levels and approaching the US\$80 mark is a lot more encouraging for the industry, and has seen renewal of contracts by oil majors. Further, the jack-up market too, where the demand-supply balance has not been too favourable, has shown signs of a pick-up in activity, as exemplified by long-term contracts for 4 of Aban's idle Deep Driller rigs with the decline in day rates lower than expected. Lastly, fears on Aban's leverage, which have been a significant concern for investors, seem to be subsiding with debt restructuring, recent capital raising, and improving asset utilisations.

Valuation

Our target price for Aban of Rs1,446 is based on our DCF for Sep-10E. Our DCF is based on three years of explicit cash flow forecasts and the following key assumptions: day rates based on actuals for 16 of the contracted rigs, US\$110-120K for 3 of the idle rigs, and no contract assumed for 1 of the idle rigs; steady state earnings assumed beyond FY12 based on a payback period of 5½ years; terminal EBIT 18% lower than peak (FY11E) EBIT; terminal post-tax ROIC of 9%; WACC of 10.4% (risk-free of 7.0%, risk premium of 6.0%, beta of 1.4, cost of equity of 15.1%, cost of debt of 7.0%, target D/E of 1.0x); and terminal growth rate of 2%, in line with global GDP forecasts. 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 FY11-12E. On our target price, Aban would trade at 7.2x FY11E EV/EBITDA.

Risks

We rate Aban Medium Risk as opposed to the Speculative Risk rating suggested by our quantitative risk rating system. We give Aban a lower risk rating to factor in changing macro environment, improving outlook for offshore services and the jack-up market, reduced fears on the company's high leverage given increased likelihood of debt restructuring, and recently announced new order wins for longer durations at higher than expected rates. Key downside risks that could impede the stock from reaching our target price are: decline in crude prices; failure to restructure debt; failure to announce new contracts for its remaining idle 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
Covered since June 6 2007



Date	Rating	Target Price	Closing Price
1 13-Aug-07	*1M	*3,530.00	2,849.40
2 17-Sep-07	1M	*3,830.00	3,094.70
3 7-Dec-07	1M	*5,895.00	4,873.95
4 21-Apr-08	1M	*4,810.00	3,624.30

Date	Rating	Target Price	Closing Price
5 22-Jul-08	*1H	*3,600.00	2,568.40
6 30-Oct-08	*1S	*1,200.00	702.80
7 1-Feb-09	*3S	*520.00	484.20
8 25-Aug-09	*1M	*1,550.00	1,210.45

Date	Rating	Target Price	Closing Price
9 7-Jan-10	1M	*1,650.00	1,443.90
10 28-Jan-10	1M	*1,446.00	1,129.95

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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