9 November 2011 | 11 pages

Aban Offshore (ABAN.BO)

2Q: Operationally Below; Expect A 2H Pick Up

- Company Update
- Target Price Change
- Estimate Change

- **2Q below —** PAT at Rs792.5m (-11% qoq, +5% yoy) was below estimates primarily due to: (1) lower than expected qoq increase in revenues (1Q included cUS$5-6m of one-off mobilization fee for Aban Abraham), (2) lower EBITDA margins of 60% (62% in 1Q), and (3) higher interest/depreciation due to INR weakness (not much of a concern, however, given revenues, costs, debt are all largely US$-denominated).

- **Expect pick up in 2H —** We expect Aban's revenues and profitability to pick up in 3-4Q, led by: (1) commencement of the new 3-yr ONGC contract for Aban III by Nov-11E (idle in 2Q), (2) possible commencement of a new contract for Aban V (idle in 2Q, new contract yet to be awarded), and (3) fresh contribution from Aban VII (idle in 2Q, has begun a short-term contract with GSPC, and has other short-term contracts in place for the next year). Contribution from Tahara is expected to go down as it remains idle due to approval issues, though the overall impact would be lower given lower margins.

- **Rig market tightening —** As per Citi analyst Horng Han Low (see '*Singapore Drill Bits: More Resilient to Headwinds than in 2009 Downturn*' dated Nov 2), rig day rates have been trending higher YTD and are likely to continue rising in 2012, based on comments by offshore drillers and industry observers. He believes that while concerns remain over the number of newbuild completions scheduled in 2013 (31 jack-ups, 24 drillships), incoming supply will place a cap, rather than a drag, on day rates.

- **Deleveraging yet to play out —** Earlier this year, Aban had cUS$400-450m of bullet payments on its debt due in the Jan-Apr'12 period. This is now down to cUS$340m, with cUS$100m having been refinanced. We remain confident of Aban's ability to refinance the balance amount, and the next few months would be critical in this regard. Any news flow on this front would be a key stock driver, in our view, bringing to fore Aban's deleveraging argument, which we believe remains intact. We reiterate Buy with a Rs730 TP, reducing FY12-14E earnings by 3-8% to account for 1H performance and new contract announcements. Net debt currently stands at US$2.72bn (US$2.79bn as on Mar-11). We forecast operating cash flow of US$180-220m over FY12-14E.

Buy/High Risk	1H
Price (09 Nov 11)	Rs449.55
Target price	Rs730.00
from Rs790.00	
Expected share price return	62.4%
Expected dividend yield	1.8%
Expected total return	**64.2%**
Market Cap	Rs19,563M
	US$397M

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 (%)
2010A	2,727	62.69	-46.4	7.2	1.1	16.7	0.8
2011A	613	14.06	-77.6	32.0	1.1	3.3	1.8
2012E	4,179	95.89	581.8	4.7	0.9	21.0	2.2
2013E	4,703	107.90	12.5	4.2	0.8	19.7	2.4
2014E	4,905	112.53	4.3	4.0	0.6	17.5	2.4

Source: Powered by dataCentral

Saurabh Handa
+91-22-6631-9858
saurabh.handa@citi.com

Garima Mishra
garima.mishra@citi.com

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

Fiscal year end 31-Mar	2010	2011	2012E	2013E	2014E
Valuation Ratios					
P/E adjusted (x)	7.2	32.0	4.7	4.2	4.0
EV/EBITDA adjusted (x)	8.0	7.0	7.6	6.7	6.5
P/BV (x)	1.1	1.1	0.9	0.8	0.6
Dividend yield (%)	0.8	1.8	2.2	2.4	2.4
Per Share Data (Rs)					
EPS adjusted	62.69	14.06	95.89	107.90	112.53
EPS reported	65.08	16.00	95.89	107.90	112.53
BVPS	425.51	414.75	498.94	593.96	693.62
DPS	3.60	8.00	10.00	11.00	11.00
Profit & Loss (RsM)					
Net sales	33,587	33,472	29,480	31,512	31,374
Operating expenses	-17,198	-16,512	-15,309	-15,936	-16,193
EBIT	**16,388**	**16,961**	**14,171**	**15,576**	**15,182**
Net interest expense	-9,768	-9,237	-8,670	-8,675	-8,097
Non-operating/exceptionals	1,468	478	235	47	35
Pre-tax profit	**8,089**	**8,202**	**5,735**	**6,949**	**7,120**
Tax	-2,571	-2,531	-1,251	-1,942	-1,910
Extraord./Min.Int./Pref.div.	-2,687	-4,974	-305	-305	-305
Reported net income	**2,831**	**698**	**4,179**	**4,703**	**4,905**
Adjusted earnings	2,727	613	4,179	4,703	4,905
Adjusted EBITDA	21,004	21,868	19,072	20,555	20,238
Growth Rates (%)					
Sales	10.1	-0.3	-11.9	6.9	-0.4
EBIT adjusted	44.9	3.5	-16.4	9.9	-2.5
EBITDA adjusted	21.2	4.1	-12.8	7.8	-1.5
EPS adjusted	-46.4	-77.6	581.8	12.5	4.3
Cash Flow (RsM)					
Operating cash flow	**1,710**	**699**	**8,439**	**9,850**	**10,484**
Depreciation/amortization	4,616	4,907	4,902	4,979	5,056
Net working capital	-6,015	-5,210	-946	-136	219
Investing cash flow	**-9,205**	**-11,096**	**-1,800**	**-1,800**	**-1,800**
Capital expenditure	-9,205	-296	-1,800	-1,800	-1,800
Acquisitions/disposals	0	-10,800	0	0	0
Financing cash flow	**-4,774**	**-11,481**	**-11,535**	**-7,876**	**-8,471**
Borrowings	-24,714	-11,163	-11,115	-7,405	-8,000
Dividends paid	-183	-408	-510	-561	-561
Change in cash	**-12,268**	**-21,879**	**-4,896**	**174**	**213**
Balance Sheet (RsM)					
Total assets	**173,225**	**159,713**	**150,748**	**148,413**	**144,907**
Cash & cash equivalent	2,360	5,951	762	593	412
Accounts receivable	7,691	9,692	8,884	9,497	9,455
Net fixed assets	104,090	88,679	85,578	82,399	79,142
Total liabilities	**151,418**	**138,375**	**125,741**	**119,264**	**111,414**
Accounts payable	7,891	5,764	5,076	5,426	5,403
Total Debt	141,641	130,478	119,363	111,958	103,958
Shareholders' funds	**21,807**	**21,338**	**25,007**	**29,149**	**33,493**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	62.5	65.3	64.7	65.2	64.5
ROE adjusted	16.7	3.3	21.0	19.7	17.5
ROIC adjusted	8.3	9.4	8.8	9.5	9.4
Net debt to equity	638.7	583.6	474.3	382.1	309.2
Total debt to capital	86.7	85.9	82.7	79.3	75.6

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Aban Offshore – 2QFY12 Results

Figure 1. Aban Offshore – Consolidated 2QFY12 Results (Rupees in millions)

Year to 31-Mar	Q2FY11	Q1FY12	Q2FY12	%yoy	Comments
Net Sales	**8,281**	**7,313**	**7,626**	**-8%**	Sequential increase driven by higher revenue from Aban Abraham (started on June 5) and Aban IV (commenced in end-June). Also, 1Q included cUS$5-6m of one-off mobilization fee for Aban Abraham. Aban III, V, and VII were fully idle in 2Q and should all commence in 3QE. Tahara, which was operational for 1 month in 2Q, will likely remain idle in 3QE.
Consumption - stores & spares	276	279	251	-9%	
Staff Cost	870	759	863	-1%	
Rental charges for machinery	121	132	87	-28%	
Repairs and maintenance	171	105	40	-77%	
Insurance	142	298	360	154%	
Other expenditure	1,137	1,207	1,436	26%	
Total expenditure	2,718	2,780	3,037	12%	
EBITDA	**5,563**	**4,533**	**4,588**	**-18%**	
EBITDA margin	*67.2%*	*62.0%*	60.2%		Decline largely as 1Q included ~US$5-6m of one-off mobilization revenues for Aban-Abraham (no associated costs)
Interest	2,405	2,166	2,299	-4%	Increase due to INR depreciation
Depreciation	1,230	1,231	1,337	9%	Increase due to INR depreciation
Other income	24	58	126	427%	
Exceptional items	(139)	-	-		
Profit before tax	1,812	1,193	1,079	-40%	
Current tax	795	318	329	-59%	
Deferred tax	(38)	(10)	(43)	12%	
Tax rate	*41.8%*	*25.8%*	26.5%		
Net income	1,054	886	792	-25%	
Add: Share of profit in JV	(302)	-	-	-100%	
Reported net profit	**752**	**886**	**792**	**5%**	

Source: Citi Investment Research and Analysis, Company reports

Figure 2. Aban Offshore – Consolidated Balance Sheet (Rupees in millions)

As of:	Mar'11	Sep'11	Comments
Shareholders Funds	21,338	25,439	
-Capital	3,347	2,897	
-Reserves and surplus	17,991	22,542	
Loan funds	130,478	134,252	Net debt has declined from US$2.79bn in Mar-11 to US$2.72bn in Sep-11 (INR amount has gone up due to the sharp INR depreciation); Aban has already refinanced cUS$100m of the cUS$400-450m of bullet payments on its debt due in the Jan-Apr'12 period
Net D/E (x)	*5.8*	*5.2*	
Deferred tax liability	292	239	
Total liabilities + shareholder's funds	**152,108**	**159,930**	
Fixed assets	138,234	152,538	
Investments	153	153	
Cash and bank balances	5,951	1,195	
Current assets	15,375	16,508	
-Inventories	2,616	2,885	
-Sundry debtors	9,692	10,672	
-Loans and advances	3,067	2,951	
Current liabilities and provisions	7,605	10,464	
-Liabilities	5,764	9,051	
-Provisions	1,842	1,413	
Net current assets	7,769	6,044	
Total assets	**152,108**	**159,930**	

Source: Company Reports, Citi Investment Research and Analysis

We are revising our FY12-14E earnings down by 3-8% to account for Aban's 1H performance as well as new contract announcements.

Figure 3. Aban Offshore – Earnings Revision

Year to	Net Profit (Rs Mils.)		Diluted EPS (Rs)			Dividend Per Share (Rs)	
31-Mar	Old	New	Old	New	% Chg	Old	New
2012E	4,562	4,179	104.66	95.89	-8.4%	10.0	10.0
2013E	4,829	4,703	110.78	107.90	-2.6%	11.0	11.0
2014E	5,043	4,905	115.69	112.53	-2.7%	11.0	11.0

Source: Citi Investment Research and Analysis estimates

Figure 4. Aban Offshore – Contract Details

Asset	Day-rate (US$'000)	Client/Location	Comments
Jack-up - ABAN II	50-55	-	Contract expected to begin next qtr
Jack-up - ABAN III	63.0	ONGC	Contract ended in Apr'11; new 3-yr contract to commence in Nov'11
Jack-up - ABAN IV	63.0	ONGC	Contract ended in Dec'10; new 3-yr contract commenced in end-Jun'11
Jack-up - ABAN V	65-70	-	Contract ended in Apr'11; currently being marketed
Jack-up - ABAN VI	93.7	Middle East	Contract till Jan'14
FPU - TAHARA	Contract ended	India - Hardy Oil	Contract ended in Jul'11 - gov't approval for renewal pending
DRILL SHIP - ABAN ICE	137.0	India	Contract till Sep'12
Jack-up - ABAN VII	70.0	India	Currently working on small contracts for another ~1 yr
DRILL SHIP - Aban Abraham	270.7	Petrobras	5-year contract started on 5th Jun'11
Jack-up - ABAN VIII	170.0	Middle East	Contract till Jun'12
Jack-up -Deep Driller 1	107.5	India	Contract extended till Dec'12
Jack-up -Deep Driller 2	160.0	Middle East	Contract till Oct'12
Jack-up -Deep Driller 3	165.0	Malaysia	Contract till Oct'12
Jack-up -Deep Driller 4	160.0	Middle East	Contract till Oct'12
Jack-up -Deep Driller 5	160.0	Middle East	Contract till Sep'12
Jack-up -Deep Driller 6	125.0	Middle East	Contract till Apr-14
Jack-up -Deep Driller 7	115.0	Mexico	Contract till Dec'11 (with an option for additional 6 months)
Jack-up -Deep Driller 8	109.0	Offshore Brunei	Contract till Sep'14 (4 year contract which started in mid-Sep'10)

Source: Company Reports

Target price of Rs730

We revise our DCF-based target price to Rs730 (Rs790 earlier), on the back of minor changes to our earnings estimates. Our DCF is now based as on Mar-12E and uses a WACC of 11.5% (risk-free of 8.5%, risk premium of 6.0%, beta of 1.4, cost of equity of 16.9%, cost of debt of 8.0%, target D/E of 1.0x). Our terminal EBIT is 12% lower than FY11 EBIT to incorporate mid-cycle earnings into our valuation.

Figure 5. Aban Offshore – DCF Valuation

	FY12E	FY13E	FY14E	Terminal
EBIT	14,171	15,576	15,182	14,854
Less: Tax	(1,126)	(1,748)	(1,719)	(1,682)
Add: Depreciation	4,902	4,979	5,056	5,208
Add: Decrease in net WC	(969)	(279)	28	(500)
Less: Capex	(1,800)	(1,800)	(1,800)	(4,050)
Free Cash Flow to Firm	**15,177**	**16,728**	**16,746**	**13,830**
NPV of cash flows		16,728	16,746	
Terminal Value				116,870
Total Firm value	150,344			
Less: Net Debt	118,600			
Total Equity value	31,744			
Value per share (Rs)	**730**			

Source: Citi Investment Research and Analysis estimates

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, the consolidated entity has 17 offshore drilling assets 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/High Risk (1H). Consolidated with Sinvest, Aban is a material play on the global offshore services industry with a fleet of 18 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 US$100+ levels is a lot more encouraging for the industry, and has seen renewal of contracts by oil majors. Further, the jack-up market too has shown signs of a pick-up in activity with improving supply-demand balance and rising upstream capex budgets. With debt repayments due only in end-FY12E and Aban Pearl insurance money coming in, we believe Aban will be able to further refinance/restructure its debt, and liquidation concerns therefore remain overdone.

Valuation

Our target price for Aban of Rs730 is based on our DCF for Mar-12E. 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 FY14E based on a payback period of 6 years; terminal EBIT 12% lower than peak (FY11) EBIT; terminal post-tax ROIC of 9%; WACC of 11.5% (risk-free of 8.5%, risk premium of 6.0%, beta of 1.4, cost of equity of 16.9%, 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 nearer-term cash flows to be tempered to factor in lower, mid-cycle earnings beyond FY13-14E.

Risks

We rate Aban shares High Risk because the company continues to be significantly leveraged and as its core business is dependent on the global scenario for the drilling industry, which is cyclical in nature. The key downside risks to our investment thesis on Aban are: 1) Failure to refinance/restructure debt; 2) Equity dilution; 3) Sharp decline in crude prices; 4) Failure to renew contracts for rigs resulting in increased downtime; 5) Deterioration in global economy. If any of these risk factors has a greater downside impact than we anticipate, the share price will likely have difficulty attaining our target price.

Appendix A-1

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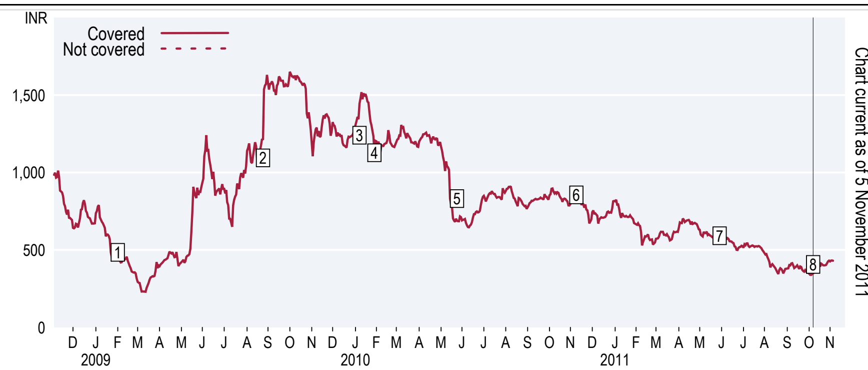
IMPORTANT DISCLOSURES

Aban Offshore (ABAN.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Saurabh Handa



	Date	Rating	Target Price	Closing Price
1	1-Feb-09	*3S	*520.00	484.20
2	25-Aug-09	*1M	*1,550.00	1,210.45
3	7-Jan-10	1M	*1,650.00	1,443.90
4	28-Jan-10	1M	*1,446.00	1,129.95
5	25-May-10	*1H	*1,104.00	688.30
6	9-Nov-10	1H	*1,122.00	848.05
7	29-May-11	1H	*790.00	560.90
8	7-Oct-11	Stock rating system changed		

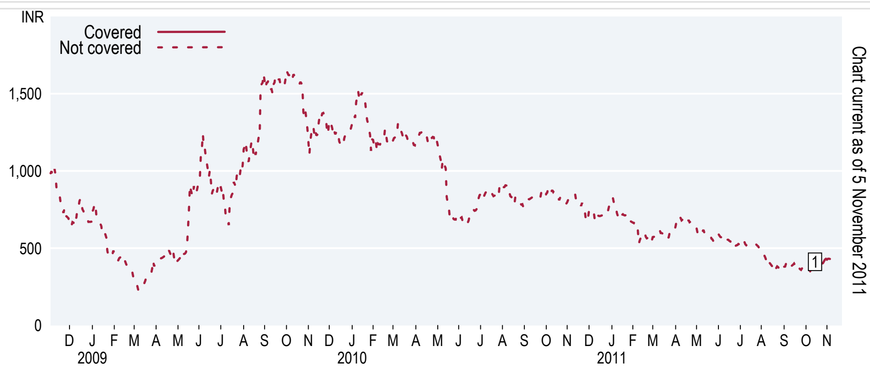
* Indicates change

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



	Date	Rating	Target Price	Closing Price
1	14-Oct-11	*ADD LP	-	405.35

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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	12 Month Rating			*Relative Rating*		
Data current as of 10 Oct 2011	**Buy**	**Hold**	**Sell**	**Buy**	**Hold**	**Sell**
Citi Investment Research & Analysis Global Fundamental Coverage	59%	34%	7%	10%	79%	10%
% of companies in each rating category that are investment banking clients	45%	42%	37%	50%	43%	46%

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