Ades Holding Co.

Investment Update

ALJAZIRA CAPITAL الجزيرة للأسواق المالية

Growth story unaffected, expansion continues; maintain "Overweight" with higher TP

ADES Holding Company (ADES) maintains its strong position in the offshore drilling market. Its geographic presence has now expanded to 10 markets with the recent acquisition of two rigs in Southeast Asia. The company has already successfully secured new contracts for 3 out of 5 rigs suspended by Aramco, which are expected to start operations from Q3-24, reducing the impact of suspension. Furthermore, its medium term fleet expansion plan adding offshore rigs in Southeast Asia, India and Qatar coupled with 6 onshore rig contracts won in Kuwait are expected to drive growth for ADES over medium to long term. We project the company's active rigs to reach 87 by FY28E from the current 66. The rise in the number of active rigs is anticipated to result in a revenue CAGR of 13.4% for the FY23-28E period. EBITDA margin is expected to improve from 49.4% in FY23 to 51.0% in FY28E, while the bottom line is forecasted to grow at a CAGR of 30.0%, rising from SAR 442mn in FY23 to SAR 1,638mn in FY28E. We update our TP on ADES to SAR 24.3/share and maintain our "Overweight" recommendation.

Net profit almost doubled Y/Y in Q2-24 on robust topline growth and controlled OPEX; despite GP margin contraction: ADES posted 90.1% Y/Y growth in net income at SAR 202mn in Q2-24, above AJC's estimate of SAR 190mn. The deviation from our estimate was due to higher-than-expected revenue, lower G&A expenses and lower finance cost. Revenue jumped 48.7% to SAR 1,525mn, slightly above our estimated SAR 1,444mn. The topline growth was driven by higher number of active rigs with all 19 rigs from Aramco contract active and additional rigs deployed in India and Algeria. The suspended five offshore rigs were partially active in Q2-24 and contributed to revenue, as suspensions were effective from May/June. The gross margin decreased to 37.6% in Q2-24 from 39.9% in Q2-23 and below our expectation of 38.5%. Operating profit was up 48.2% to SAR 472mn as against our estimate of SAR 446mn. Operating margin contracted slightly by 10bps to 30.9% (in line with AJC estimate) and was supported by relatively slower growth G&A expenses (+12.3% Y/Y).

ADES placed well in jack-up market despite increased supply due to Aramco suspensions: Saudi Aramco has suspended at least 25 offshore jack-up rig contracts till today, following its announcement to halt its maximum sustainable capacity (MSC) expansion plan. The availability of suspended rigs eased the tight supply conditions in the global offshore jack-up market to some extent. This is expected to keep day rates steady in the near term as against earlier expectations of an increase in rates. However, we believe ADES' long term prospects are mostly unaffected by changing market conditions, which is evident from the ability shown by the company to swiftly deploy three out of five suspended rigs to new contracts; remaining two are also expected to be contracted by the year end. Moreover, the day rates for new contracts are higher than the company's average rates.

Ongoing offshore fleet expansion and Kuwait onshore contracts to help increase number of active rigs to 87 by FY28E, implying revenue CAGR of 13.4%: ADES recently announced the acquisition of 2 premium contracted jack-ups in Southeast Asia. These acquisitions are in line with the company's medium term expansion plan which includes doubling fleet size in Southeast Asia and India to ten,and increasing the fleet in Qatar to six. The recent acquisitions are expected to add SAR 150mn annually to EBITDA, and we assume these rigs to start contributing to ADES financials next year. For onshore, the company secured contracts for six rigs in Kuwait at a total value of SAR 2.4bn with tenure of up to 6 years. The award encompasses new contracts for four of the company's existing rigs in Kuwait, as well as for two newly constructed units. Thus, we forecast the company's total active rig count to reach 87 by FY28E from the current 66. The rise in the number of active rigs and a steady increase in day rates (offshore at 4.6% CAGR and onshore at 2.0% CAGR) are anticipated to result in a revenue CAGR of 13.4% for the FY23-28E period.

EBITDA and net margin to improve consistently, while higher depreciation to weigh on GP margin: GP margin of the company would be under pressure due to increase in depreciation this year. We forecast the GP margin to fall to 38.1% in FY24E from 39.5% in FY23 and then recover to 39.3% in FY28E. We project that the EBITDA margin will improve from 49.4% in FY23 to 51.0% in FY28E, driven by enhanced operating efficiencies and increased revenue per active rig due to new contracts at higher day rates. Concurrently, the net margin is expected to expand from 10.2% in FY23 to 20.1% in FY28E, supported by the EBITDA margin growth and anticipated reductions in finance costs following expected interest rate cuts. Consequently, net income is forecasted to grow at a CAGR of 30.0%, rising from SAR 442mn in FY23 to SAR 1,638mn in FY28E.

Recommendation	Overweight
Target Price (SAR)	24.3
Upside / (Downside)*	21.7%

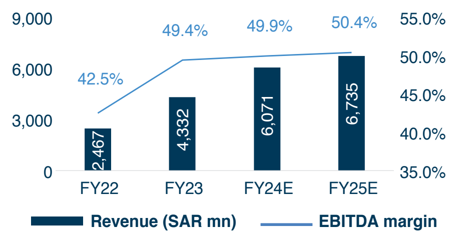
Source: Tadawul *prices as of 29th of September 2024

Key Financials

in SAR mn, (unless specified)	FY22	FY23	FY24E	FY25E
Revenue	2,467	4,332	6,071	6,735
Growth %	62.9%	75.6%	40.1%	10.9%
Gross Profit	891	1,711	2,311	2,619
EBITDA	1,049	2,139	3,031	3,395
Net Income	390	442	795	1,047
Growth %	262%	13.2%	79.7%	31.8%
EPS	0.35	0.39	0.70	0.93
DPS	0.00	0.00	0.40	0.50

Source: Company reports, Aljazira Capital Research

Revenue and EBITDA margin



Source: Company reports, Aljazira Capital Research

Key Ratios

	FY22	FY23	FY24E	FY25E
Gross Margin	36.1%	39.5%	38.1%	38.9%
EBITDA Margin	42.5%	49.4%	49.9%	50.4%
Net Margin	15.8%	10.2%	13.1%	15.5%
ROE	17.6%	7.7%	13.1%	16.0%
ROA	2.7%	2.3%	3.8%	4.8%
P/E	High	High	28.9	21.9
P/B	NM	4.7	3.8	3.5
EV/EBITDA (x)	NM	17.5	11.2	10.1
Dividend Yield	NM	0.0%	2.0%	2.5%

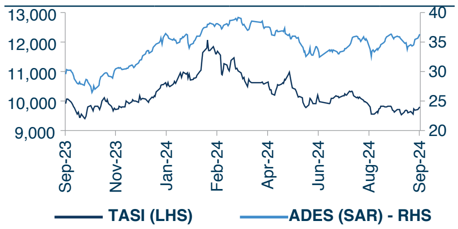
Source: Company reports, Aljazira Capital Research

Key Market Data

Market Cap (SAR bn)	23.0
YTD%	-15.3%
52 weeks (High)/(Low)	26.10/14.84
Share Outstanding (mn)	1,129.1

Source: Company reports, Aljazira Capital Research

Price Performance



Source: Tadawul, Aljazira Capital Research

Head of Sell-Side Research
Jassim Al-Jubran
+966 11 2256248
j.aljabran@aljaziracapital.com.sa

Medium term CAPEX plan demands additional debt but leverage likely to ease in the long term: ADES' medium term capacity expansion plan is estimated to require an investment of around SAR 5.5bn, which we believe will be funded by raising debt, as the company is also committed to 60% dividend payout. However, with growing operating cash flows and future cash flows being secured with a healthy backlog of SAR 28bn, the company is well placed to service the additional debt. In the long term, we expect CAPEX intensity to ease post FY26E. We expect leverage (debt/equity) to ease over the long term from 1.9x in FY23 to 1.3x in FY28E.

Investment thesis and valuation: ADES has a stronghold in offshore premium jack-up market. Its expanded market presence, ability to win new contracts and track record of successful and cost effective acquisition of contracted rigs are expected to drive future growth. ADES is estimated to register revenue CAGR of 13.4% during FY23-28E on the back of increase in number of active rigs to 87 from current 66 and a gradual growth in day rates. The average day rates are estimated to increase at CAGR of 4.6% for offshore business and at CAGR of 2.0% for onshore business during FY23-28E. The company's EBITDA margin will improve from 49.4% in FY23 to 51.0% in FY28E, driven by enhanced operating efficiencies and increased revenue per active rig due to new contracts at higher day rates. The net income is forecasted to grow at a CAGR of 30.0%, rising from SAR 442mn in FY23 to SAR 1,638mn in FY28E.

We valued ADES with 50% weightage to DCF (WACC=8.2%, terminal growth rate=2.5%) and 50% weight to FY25E EV/EBITDA (11.0x) to arrive at a TP of **SAR 24.3/share**, implying 21.7% upside. Hence, we maintain our "**Overweight**" rating on the stock. The stock is currently trading at P/E of 21.9x and EV/EBITDA of 10.1x, while dividend yield is expected at 2.5%, based on our FY25E estimates. Downside risks to our valuations are 1) Delay in securing contracts for remaining 2 suspended rigs 2) easing of jackup market leading to lower than expected day rates 3) higher than expected CAPEX due to higher acquisition cost per rig. Major upside risks to our valuation are 1) More aggressive expansion than anticipated 2) winning contracts for unconventional gas expansion program from Aramco 3) securing new contracts for suspended rigs at significantly higher rates.

Blended valuation summary

	TP (SAR)	Weight	Weighted TP
DCF	24.5	50%	12.2
EV/EBITDA	24.1	50%	12.1
Blended TP			**24.3**
Up/Downside (%)			**21.7%**

Source: AlJazira Capital research

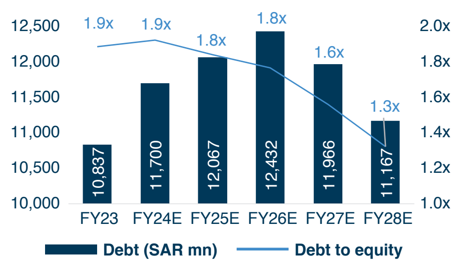
Active rigs and day rates

Operating metrics

	FY23	FY24E	FY25E	FY26E	FY27E	FY28E
Active rigs	67	72	77	81	84	87
Onshore	26	27	27	28	30	31
Offshore	41	45	50	53	54	56
Day rate USD '000						
Onshore	43	44	44	45	46	47
Offshore	63	70	76	77	78	79

Source: Company reports, AlJazira Capital research

Total debt and leverage



Source: Company reports, AlJazira Capital research

Key Financial Data

Amount in SAR mn, unless otherwise specified	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E	FY27E	FY28E
Income statement									
Revenues	1,695	1,514	2,467	4,332	6,071	6,735	7,215	7,715	8,132
Y/Y		**-10.7%**	**62.9%**	**75.6%**	**40.1%**	**10.9%**	**7.1%**	**6.9%**	**5.4%**
Cost of revenue	(1,059)	(975)	(1,576)	(2,621)	(3,759)	(4,116)	(4,382)	(4,678)	(4,935)
Gross profit	**637**	**539**	**891**	**1,711**	**2,311**	**2,619**	**2,833**	**3,038**	**3,197**
General & administration expense	(178)	(158)	(246)	(370)	(418)	(469)	(495)	(522)	(542)
EBITDA	**680**	**657**	**1,049**	**2,139**	**3,031**	**3,395**	**3,638**	**3,922**	**4,147**
Y/Y		**-3.3%**	**59.5%**	**104.0%**	**41.7%**	**12.0%**	**7.2%**	**7.8%**	**5.7%**
Operating profit	**366**	**(20)**	**334**	**1,285**	**1,723**	**1,993**	**2,169**	**2,340**	**2,470**
Y/Y		**NM**	**NM**	**284.3%**	**34.1%**	**15.6%**	**8.9%**	**7.8%**	**5.6%**
Financial charges	(245)	(305)	(303)	(711)	(755)	(737)	(637)	(573)	(515)
Income before zakat	**116**	**149**	**468**	**529**	**953**	**1,249**	**1,525**	**1,759**	**1,948**
Zakat	(34)	(35)	(71)	(77)	(144)	(187)	(229)	(264)	(292)
Net income	**74**	**108**	**390**	**442**	**795**	**1,047**	**1,281**	**1,479**	**1,638**
Y/Y		**46.5%**	**262.2%**	**13.2%**	**79.7%**	**31.8%**	**22.3%**	**15.4%**	**10.8%**
EPS (SAR)	0.07	0.10	0.35	0.39	0.70	0.93	1.13	1.31	1.45
DPS (SAR)	-	-	-	-	0.40	0.50	0.70	0.75	0.75
Balance sheet									
Assets									
Cash & equivalent	234	233	191	432	761	607	690	455	234
Other current assets	850	918	1,500	1,924	2,224	2,518	2,752	2,993	3,240
Total current assets	**1,084**	**1,151**	**1,691**	**2,356**	**2,984**	**3,125**	**3,443**	**3,448**	**3,474**
Property plant & equipment	3,795	5,358	12,066	16,150	16,872	17,619	18,188	18,414	18,442
Right of use assets	73	64	391	644	532	423	335	252	184
Total assets	**5,190**	**6,692**	**14,501**	**19,422**	**20,709**	**21,517**	**22,338**	**22,500**	**22,512**
Liabilities & owners' equity									
Trade payables	560	497	1,085	1,639	1,821	1,872	1,912	1,967	2,033
Other current liabilities	396	480	1,075	1,508	1,361	1,380	1,400	1,346	1,090
Total current liabilities	956	977	2,161	3,147	3,182	3,252	3,312	3,313	3,122
Lease liabilities – non-current	52	38	270	487	386	308	250	207	175
Long term loans	1,145	3,638	9,575	9,170	10,280	10,703	11,105	10,736	10,225
Total non-current liabilities	**2,531**	**3,792**	**10,082**	**10,498**	**11,416**	**11,679**	**11,958**	**11,497**	**10,917**
Share capital	-	-	1	1,129	1,129	1,129	1,129	1,129	1,129
Reserves	1,667	1,894	2,221	4,619	4,954	5,429	5,910	6,533	7,316
Total owners' equity	**1,667**	**1,894**	**2,222**	**5,748**	**6,083**	**6,558**	**7,039**	**7,662**	**8,445**
Non-controling interests	**35**	**30**	**36**	**29**	**29**	**29**	**29**	**29**	**29**
Total equity & liabilities	**5,190**	**6,692**	**14,501**	**19,422**	**20,709**	**21,517**	**22,338**	**22,500**	**22,512**
Cashflow statement									
Operating activities	620	317	1,146	2,283	2,532	2,735	3,003	3,279	3,473
Investing activities	(438)	(1,464)	(6,438)	(3,736)	(1,812)	(1,905)	(1,804)	(1,573)	(1,477)
Financing activities	(397)	1,145	5,250	1,886	(391)	(984)	(1,116)	(1,942)	(2,217)
Change in cash	(214)	(1)	(42)	432	328	(154)	84	(235)	(221)
Ending cash balance	**234**	**233**	**191**	**432**	**761**	**607**	**690**	**455**	**234**
Liquidity ratios									
Current ratio (x)	1.1	1.2	0.8	0.7	0.9	1.0	1.0	1.0	1.1
Quick ratio (x)	0.9	1.0	0.7	0.6	0.8	0.9	0.9	0.9	1.0
Profitability ratios									
Gross profit margin	37.5%	35.6%	36.1%	39.5%	38.1%	38.9%	39.3%	39.4%	39.3%
Operating margin	21.6%	-1.3%	13.6%	29.7%	28.4%	29.6%	30.1%	30.3%	30.4%
EBITDA margin	40.1%	43.4%	42.5%	49.4%	49.9%	50.4%	50.4%	50.8%	51.0%
Net profit margin	4.3%	7.1%	15.8%	10.2%	13.1%	15.5%	17.8%	19.2%	20.1%
Return on assets	1.4%	1.6%	2.7%	2.3%	3.8%	4.9%	5.7%	6.6%	7.3%
Return on equity	4.4%	5.7%	17.6%	7.7%	13.1%	16.0%	18.2%	19.3%	19.4%
Leverage ratio									
Net Debt / equity (x)	1.49	2.04	4.78	1.81	1.80	1.75	1.67	1.50	1.29
Market/valuation ratios									
EV/sales (x)	NM	NM	NM	4.9	5.6	5.1	4.8	4.5	4.2
EV/EBITDA (x)	NM	NM	NM	17.5	11.2	10.1	9.5	8.8	8.2
Market-Cap	NM	NM	NM	27,098	22,965	22,965	22,965	22,965	22,965
P/E ratio (x)	NM	NM	NM	61.3	28.9	21.9	17.9	15.5	14.0
P/BV ratio (x)	NM	NM	NM	4.7	3.8	3.5	3.3	3.0	2.7
DY (%)	NM	NM	NM	0.0%	2.0%	2.5%	3.4%	3.7%	3.7%

Source: Company reports, Aljazira Capital Research, * market price as of September 24, 2024

الجزيرة كابيتال
ALJAZIRA CAPITAL الجزيرة للأسواق المالية

RESEARCH DIVISION

Head of Sell-Side Research - AGM
Jassim Al-Jubran
+966 11 2256248
j.aljabran@aljaziracapital.com.sa

RESEARCH DIVISION

AlJazira Capital, the investment arm of Bank AlJazira, is a Shariaa Compliant Saudi Closed Joint Stock company and operating under the regulatory supervision of the Capital Market Authority. AlJazira Capital is licensed to conduct securities business in all securities business as authorized by CMA, including dealing, managing, arranging, advisory, and custody. AlJazira Capital is the continuation of a long success story in the Saudi Tadawul market, having occupied the market leadership position for several years. With an objective to maintain its market leadership position, AlJazira Capital is expanding its brokerage capabilities to offer further value-added services, brokerage across MENA and International markets, as well as offering a full suite of securities business.

RATING TERMINOLOGY

1. Overweight: This rating implies that the stock is currently trading at a discount to its 12 months price target. Stocks rated "Overweight" will typically provide an upside potential of over 10% from the current price levels over next twelve months.
2. Underweight: This rating implies that the stock is currently trading at a premium to its 12 months price target. Stocks rated "Underweight" would typically decline by over 10% from the current price levels over next twelve months.
3. Neutral: The rating implies that the stock is trading in the proximate range of its 12 months price target. Stocks rated "Neutral" is expected to stagnate within +/- 10% range from the current price levels over next twelve months.
4. Suspension of rating or rating on hold (SR/RH): This basically implies suspension of a rating pending further analysis of a material change in the fundamentals of the company.

Disclaimer