الجزيرة كابيتال
ALJAZIRA CAPITAL الجزيرة للأسواق المالية

May 2024

KSA Oil and Gas Drilling industry

Short Term Challenges from Oil Production Plan Revision Ahead; Sector to Drill into Growth Trajectory Afterwards

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Table of contents:

Oil & Gas relevance to continue over the coming decade, despite countries intending to switch to alternative sources of energy. Rising population, increasing energy per-capita intensity from emerging Asian economies like China, India and Indonesia to drive the O&G demand. KSA's 268bn barrels of oil reserves and 9.5tn cubic feet of gas reserves enables it to command a dominant position in the global O&G landscape. The demand drivers for the O&G industry makes KSA's O&G production 1.8x times faster than global levels over FY22-30E. This is a testament to its dominant and cost-effective position which could bode well for its drilling industry due to direct dependency on O&G demand and supply scenario. The intensified gas exploration at Jafurah field and sustenance of Saudi Aramco's capex outflow over the coming years to drive KSA's drilling expenditure which is poised to grow from USD 3bn to USD 4.9bn by FY25E, implying a 13% CAGR over FY21-25E. However, the recent chain of events impacting Aramco's expansion plans could likely pose near term uncertainty. We initiate on ADES and Arabian Drilling which could be the key beneficiaries of these attractive industry fundamentals and resilient market growth. We initiate on ADES with a TP of SAR 21.70 and an "Overweight" recommendation, due to its healthy growth prospects in the medium to long term on the back of strong footing in an attractive offshore market and solid backlog. We expect the active rigs to increase from 67 in FY23 to 88 by FY28E, which could drive a 14.1% revenue CAGR over FY23-28E amid tighter offshore rig supply. Furthermore, ADES's expansion into new geographies provides the company flexibility to deploy all suspended rigs from Aramco outside KSA by the end of FY24. We also initiate on Arabian Drilling with a TP of SAR 166.4 and a "Neutral" recommendation, despite its robust revenue growth at the back of strong rig expansions. The impact of 3 offshore rigs suspension by Aramco could be larger because of ADC's limited ability to deploy idle rigs due to i) lower exposure to offshore rigs, and ii) less significant presence outside KSA. This suspension and start-up of multiple rigs could keep the OPEX elevated and margins under pressure. We prefer ADES over Arabian Drilling within our coverage due to efficient execution in the past, better revenue growth prospects and margin expansions due to higher offshore presence.

Continuation of O&G consumption, long growth runway in the global O&G landscape, intensified gas exploration at Jafurah to drive the sector growth: O&G will play a critical role in the global energy supply over the coming decade, due to growing population, rising energy per capita across emerging Asian economies. KSA's 268mn barrels of oil reserves and 9.5tn cubic feet of gas reserves, along with its efficient production cost enables it to command a dominant position in the global O&G landscape. KSA's production capacity is poised to increase at 1.8x faster than the global production levels over 2022-30E and is a testament to its strong global position. This bodes well for KSA's drilling expenditure which is expected to increase at 13.0% CAGR from USD 3bn to USD 4.9bn by 2025E, materially outpacing the MENA region's 5.0% growth. The intensified drilling of unconventional gas at the Jafurah field is expected to act as a catalyst to the demands for onshore rigs, while the sustenance of Saudi Aramco's strong capex outflow over the coming years is expected to be the key driver for the offshore rig capacity expansion. KSA's strong growth in drilling expenditures is expected to continue despite Aramco abandoning its ambitions plan of increasing the production capacity to 13mn mmboepd by FY27E.

Aramco's latest decisions pose risk of uncertainty in the near term; ADES to be less impacted than ADC: Saudi Aramco recently announced to scrap its plans to expand maximum sustainable capacity (MSC) to 13.0 mbpd from 12.0 mbpd. This was followed by Aramco suspending contracts for selected offshore rigs with several drillers including ADES and ADC. A total of 5 offshore rigs from ADES and 3 offshore rigs from ADC were suspended for a period which may extend beyond 12 months. In case of ADES, the impact of suspension is already partially offset because of the potential deployment of 3 out of the 5 rigs for new contracts in Thailand , Qatar and Egypt, at a higher day rate, and also participating actively in new tenders for the remaining 2 rigs and expects to secure contracts by the end of FY24. Additionally, the company's expansion into new geographies such as Southeast Asia and India, provides ADES the flexibility of deploying rigs in a wider market. ADC is likely to face more brunt than ADES as this suspension is likely to pressurize the gross margins in the near term because of its lower exposure to offshore rigs and also less significant presence outside KSA, limits its ability to deploy idle offshore rigs, unlike ADES whose business is more skewed to offshore revenues.

Investment thesis and Valuation: We initiate our coverage on **ADES** and **Arabian Drilling** with a TP of **SAR 21.70 per share** and SAR **166.4 per share**, respectively. We initiate on **ADES** with an "**Overweight**" recommendation, due to its leadership in offshore market, good revenue visibility and conducive market conditions. We expect the total rigs to increase from 87 in FY23 to 101 by FY28E, and the average day rates for the offshore rig is expected to grow at CAGR of 5.7% from FY23 to FY28E mainly driven by expected increase in offshore day rates amid tighter supply. This could drive a 14.1% revenue CAGR over FY23-28E and EBITDA margin expansion from 49.4% in FY23 to 50.3% by FY28E. While we initiate on **Arabian Drilling** with a "**Neutral**" recommendation due to a higher impact of recent suspension on the margins, when compared with ADES. We expect the total rigs to rise from 49 in FY23 to 68 by FY28E. This could drive a 7.5% revenue CAGR over FY23-28E while EBITDA margin could contract by 60bps in 2024 from 42.7% in FY23. In terms of pecking order within our coverage, we prefer **ADES** over **Arabian Drilling** due to i) efficient execution as evident from its faster scale-up over FY20-23, ii) better revenue growth due to its higher skew to offshore drilling, thus making it a more premium player, and iii) better net margin expansions, iv) the company's diversified geographic exposure.

Table 1. Valuation table

Company	Recommendation	TP (SAR/share)	Upside/ Downside	Revenue CAGR (FY23-28E)	Net Profit (FY24E)	P/E (FY24E)	EV/ EBITDA (FY24E)	DY% (FY24E)
ADES	**Overweight**	**21.70**	23.2%	14.1%	772	25.8	10.5	2.3%
Arabian Drilling	**Neutral**	**166.40**	16.2%	7.5%	557	22.9	10.1	2.8%

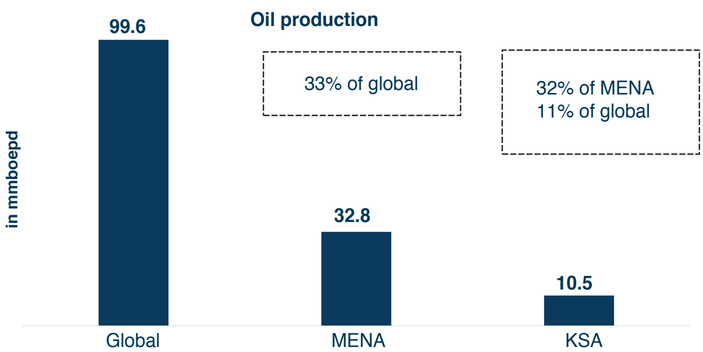
Source: AlJazira Capital research. Note: Closing price as on 14th of May, 2024. Net profit denoted in SAR mn.

Oil and Gas Industry Overview

Huge oil and gas reserves, cost efficiency, rising demand from emerging Asian economies to enable KSA to propel in the global O&G landscape

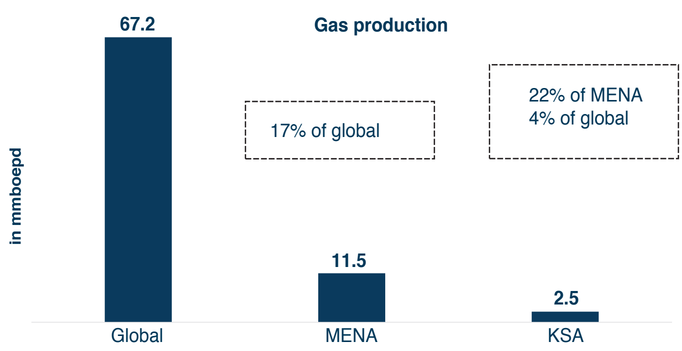
Globally oil production stood at 99.6mn barrels of oil equivalent per day (mmboepd) in 2022, whereas gas production stood at 67.2 mmboepd. Middle East and North Africa (MENA) region accounts for 33% of global oil production (33.2 mmboepd) and 16% of global gas production (11.1 mmboepd). Saudi Arabia commands a dominant position in the global O&G industry with its 268bn barrels of oil reserves and 9.5tn cubic feet of gas reserves as on 2021. Huge reserves along with efficient production cost, recovery in its GDP trends, rising O&G demand from emerging Asian economies bodes well for its drilling industry as the drilling activities largely depend upon the demand and supply scenario within the O&G industry.

Fig 1. KSA dominates MENA's oil production



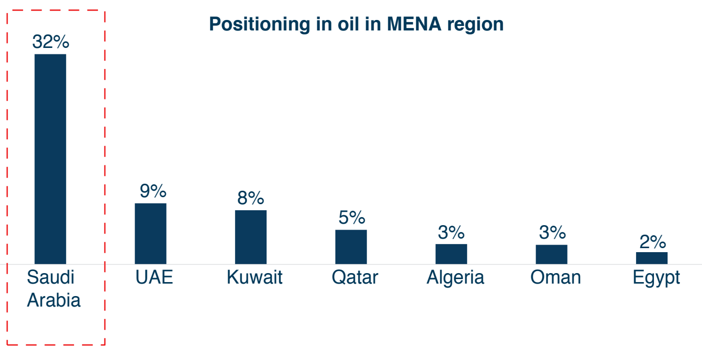
Source: ADES prospectus, AlJazira Capital research

Fig 2. KSA captures 22% of MENA's gas production



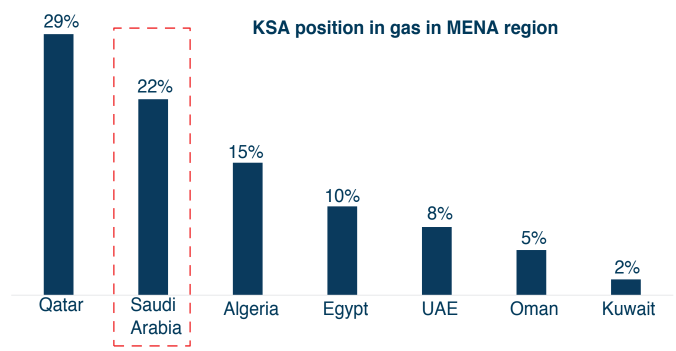
Source: ADES prospectus, AlJazira Capital research

Fig 3. KSA is largest oil producer in the MENA region



Source: ADES prospectus, AlJazira Capital research

Fig 4. KSA is 2nd largest gas producer in the MENA region



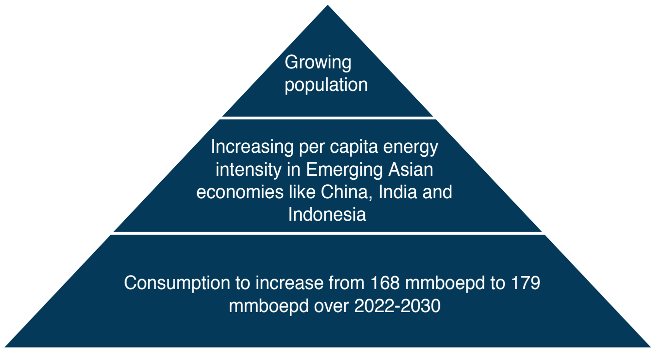
Source: ADES prospectus, AlJazira Capital research

MENA and KSA to be key beneficiaries of growing global O&G demand

O&G will continue to play a critical role in the global energy supply over the coming decade, driving increased demand for drilling activities. This growth story is likely to be driven by growing populations, increasing energy intensity per capita across Asian economies such as China, India and Indonesia. The global O&G consumption is expected to increase from 168 mmboepd in 2022 to 179 mmboepd by 2030E, at a 0.8% CAGR.

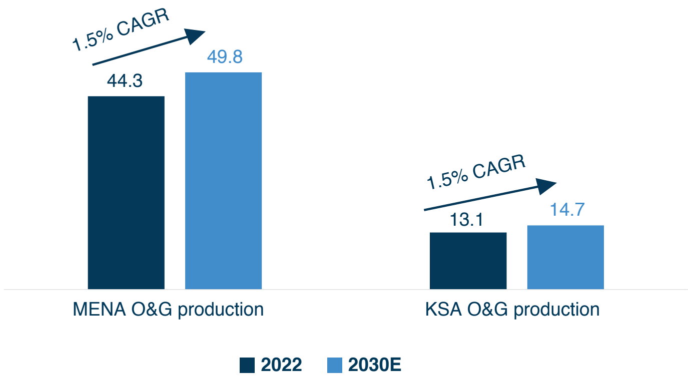
MENA region is likely to be the key beneficiary of the growing global O&G demand, as its O&G supply is expected to increase from 44.3 mmboepd in 2022 to 49.8 mmboepd by 2030E, implying a 1.5% CAGR. Saudi Arabia could be at the forefront of growing O&G demand in MENA region, given its dominant position in the region. Further despite being the second largest oil producer in the world, Saudi Arabia is the most competitive player across the globe. Over 2022-2030, Saudi Arabia's O&G production is expected to increase from 13.1 mmboepd to 14.7 mmboepd by 2030, implying a 1.5% CAGR. Further, historically global O&G demand has depicted a strong correlation with the real GDP growth rates. Over FY24E and FY25E, Emerging and Developing Asian economies such as China and India are likely to grow at 4.1% and 4.2% respectively, outpacing the global real GDP average at 3.1% and 3.2%. This should drive a higher oil and gas demand from these economies, which will bode well for KSA which is the most competitive oil and gas supplying nation globally.

Fig 5. O&G consumption drivers to expand consumption at 0.8% CAGR over 2022-2030E



Source: ADES prospectus, AlJazira Capital research

Fig 6. MENA and KSA to be at the forefront of the growing global O&G demand



Source: ADES prospectus, AlJazira Capital research

Drilling Industry Overview

Drilling activity's presence required right from inception to production

To understand the key drives of the drilling industry, it is pivotal to understand the O&G value chain which consists of three phases, namely i) upstream, ii) mid-stream and iii) downstream. Upstream phase focuses on the exploration and production of crude oil and natural gas fields and hence are more commonly called E&P phase. The mid-stream phase is involved in storage and transportation of oil and gas from upstream to downstream, through a network of pipelines, trucks, rail, ships. The downstream phase focuses on refining, sales, marketing and distribution of crude oil and natural gas.

The drilling activity and enhancing production from existing wells is conducted in the E&P phase and that's what makes it the focus point for the drilling industry. The drilling industry heavily relies on the oil and gas (O&G) consumption patterns. An increased consumption demand often leads to an increase in the requirement for more production and thus more drilling activity. This drives the exploration & production (E&P) investments either into new projects or in existing fields to sustain the output levels. The main phases of the E&P value chain are divided into exploration, development, production and abandonment. Rigs or machineries used for drilling are a critical asset used across the E&P value chain to discover, develop and support the ongoing production of O&G.

Fig 7. Phases and their key roles in the entire E&P value chain

Phase	Details
Exploration & Appraisal	• Exploration wells are drilled to confirm the presence of O&G • Appraisal wells are drilled to identify the extent of O&G accumulations • Investment in this phase is speculative and hence risky • Phase is highly sensitive to oil prices
Development	• Formation of a development plan • Initiates drilling of production and injection wells • Less risky phase than exploration, however capital outlay is high and can result in project cancellations or deferrals
Production	• Extraction of O&G from the wells through the production and injection wells • Additional wells are drilled to offset the production declines
Abandonment	• Economically unviable well is plugged out and abandoned • Heavily depends on the use of drilling rigs

Source: Company prospectuses, AlJazira Capital research

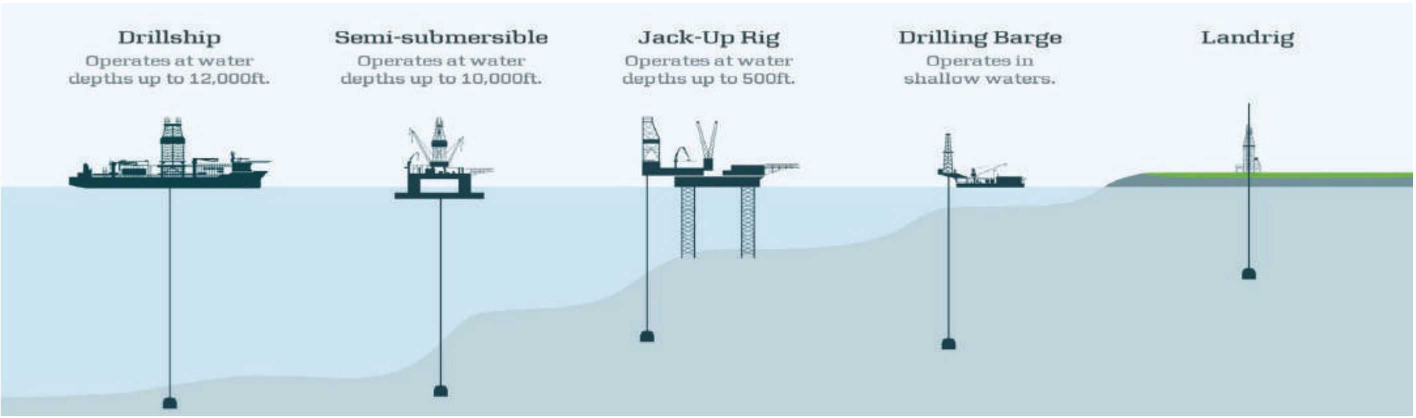
Types of Rigs and their structure

Numerous types of rigs are used to support the aforementioned phases in the E&P value chain. The type of rig used is typically decided based on the operating environment such as onshore, offshore, shallow water, harsh water and remote deepwater regions. While deploying rigs, E&P customers focus on the uptime or rig efficiency which is driven not just by specifications but also by rig crews and supply chains.

Below we have outlined the various types of rigs found in the drilling industry;

- **Onshore rig:** These rigs are used for drilling or workover operations on land and are typically differentiated by their horsepower rating. General rigs with >1,500 horsepower are considered as premium rigs.
- **Offshore rig:** These rigs are used for drilling or performing workover operations in shallow water, harsh water and remote deepwater regions. There are multiple types of offshore rigs;
    - **Jack-up rigs:** These are mobile, self-elevating rigs that are towered to a drilling location and then fixed in a position via a jacking system. They are capable of drilling upto 500ft water depth range. They are the most commonly used rigs and account for 50% of the global offshore rigs.
    - **Platform rig:** They are modular rigs installed on suitable offshore production platforms that provide drilling & workover services for shallow water wells. They account for ~28% of the global offshore rigs.
    - **Drillship:** They are floating & self-propelled rigs which sail to a location and are dynamically positioned. Speed of deployment and endurance make these rigs highly valued for deepwater exploration drilling activity. They are capable of drilling upto 12,000ft water depth range. They account for 10% of the global offshore rigs.
    - **Semisub:** They are floating rigs which are towed to a location and either moored or dynamically positioned at the drilling site. More frequently used in deeper water and harsher operating environments. They are capable of drilling upto 10,000ft water depth range. They account for 10% of the global offshore rigs.
    - **Tender rig:** They are those offshore rigs which require an existing production platform to provide drilling & workover. They account for ~3% of the global offshore rigs.

Fig 8. Types of drilling rigs and their structure



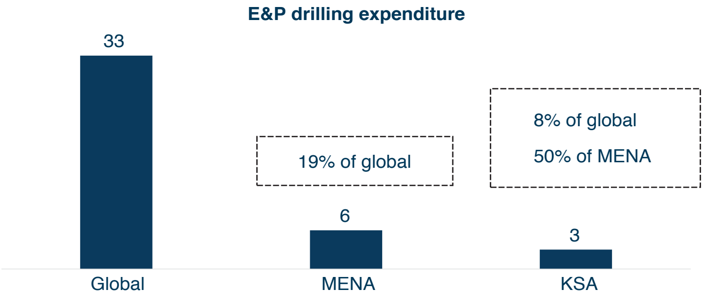
Source: AlJazira Capital research

Increasing drilling expenditure and intensified gas exploration at Jafurah to drive KSA's drilling activities

Globally in 2021, E&P companies spent USD 33bn on onshore and offshore shallow water drilling, of which MENA region accounted for 19% (USD 6bn). Saudi Arabia who is the leading oil producing nation and second largest gas producer in the MENA region, accounted for 50% of MENA region's spending (USD 3bn). Saudi Arabia has been able to capture a dominant share of the MENA region due to the multiple rig contracts awarded by the global O&G behemoth, Saudi Aramco, which had a positive effect on the drilling expenditure for Saudi Arabia.

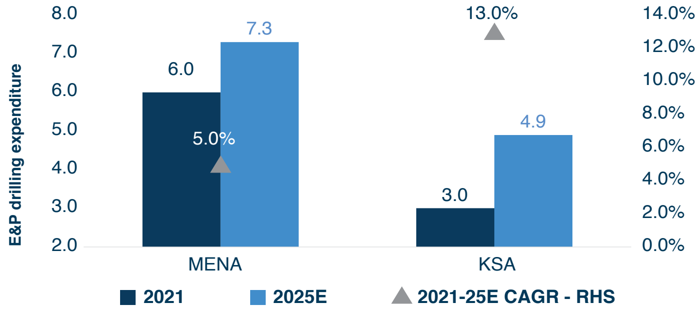
MENA region's E&P expenditure on onshore and offshore shallow water drilling is expected to inch up from USD 3bn in 2021 to USD 7bn in 2025, implying a 5.0% CAGR. However, Saudi Arabia is expected to outpace the MENA region by growing from USD 3bn in 2021 to USD 7bn in 2025, implying a 13.0% CAGR. By 2025, Saudi Arabia is expected to account for ~67% of MENA region's E&P expenditure.

Fig 9. Globally E&P companies spent USD 33bn on drilling activities, of which KSA companies account for 8%



Source: Arabian Drilling prospectus, AlJazira Capital research. Note: Drilling expenditure accounts only for onshore and offshore shallow water drilling

Fig 10. KSA's drilling expenses to outpace MENA due to increasing gas explorations and sustenance of Saudi Aramco's capex program



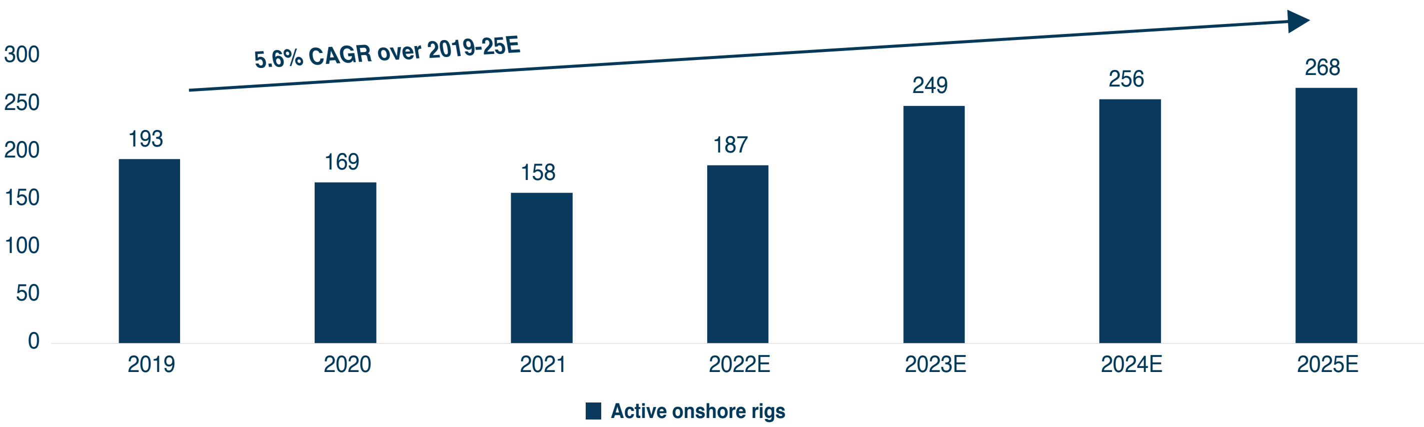
Source: Arabian Drilling prospectus, AlJazira Capital research. Note: Drilling expenditure accounts only for onshore and offshore shallow water drilling

Onshore drilling activity dominates the global drilling industry with USD 23.1bn spends by E&P companies, accounting for 70% of the total spends as on 2021. While the balance USD 9.9bn (30%) is captured by the offshore drilling. However, in Saudi Arabia, this landscape is opposite. Offshore drilling captures the dominant share of Saudi Arabia's drilling industry with USD 1.6bn spends and accounting for 53% of spends in the region (16% of global). While onshore drilling spends account for 30% to the tune of USD 1.4bn (6% of global). This is despite the number of onshore rigs in Saudi Arabia being ~3.2x higher in number than the offshore rigs.

The onshore rigs in Saudi Arabia had severely been impacted by the oil price crash in 2015. Further COVID-19 also impacted the rig operations as a large number of contracts were suspended. However, over 2019 to 2025E, the number of active onshore rig counts is expected to increase from 193 to 268, implying a 5.6% CAGR. This robust growth will be supported by Saudi Aramco's stated ambitions of maintaining crude oil capacity at 12mn barrels of oil. Further the intensified drilling for unconventional gas at the Jafurah field is expected to act as a catalyst to the demand of onshore rigs from 2021 to 2030E.

In case of offshore rigs, the demand for jack-up rigs increased substantially over the past two decades, due to large number of contracts awarded by Saudi Aramco. However, in the near term the offshore rigs are expected to be impacted due to Aramco's announcement of suspension of selected rigs from multiple rig suppliers.

Fig 11. Unconventional gas drilling at Jafurah field in KSA could drive onshore rig count over 2019-25E



Source: Arabian Drilling prospectus, AlJazira Capital research

Saudi Aramco's latest decisions relating to expansion plans pose uncertainty over the near term

Multiple events relating to Saudi Aramco's expansion plans have had the potential to change the dynamics of KSA's drilling industry. Saudi Arabia through its state oil giant Saudi Aramco decided to abandon its plans to expand its oil production capacity to 13mn barrels per day by 2027E. Saudi Aramco was directed to maintain its MSC at 12mn barrels per day. This decision was influenced by Saudi Arabia's Ministry of Energy, marking a significant departure from earlier ambitions and carries potentially profound implications for the global energy landscape.

Saudi Aramco also discovered additional 15tn cubic feet (TCF) of natural gas and 2bn barrels of condensate in the onshore Jafurah unconventional field. These discoveries increase the field's proven reserves to 229 TCF of gas and 75bn barrels of condensate. This discovery will act as a catalyst to Saudi Armco's plans of expanding its gas production by 50% by 2030. However, Aramco also announced suspension of multiple offshore rigs deployed by its existing drilling contractors, including ADES and ADC. On April 04, 2024 it suspended 5 offshore jack-up rigs deployed by ADES, for a period which may extend upto 12 months. On the same day it also suspended 3 offshore rigs deployed by ADC, for a period of 12 months. These events relating to Aramco's expansion plans pose a risk of uncertainty in the near term for the sector.

Competitive intensity in drilling industry

Heavy capex, requirement of technical capabilities, efficiency in production and safety and nuanced experience in identifying potential O&G opportunities, makes the industry a difficult to enter sector. However, to expand their business operations the drilling incumbents in Saudi Arabia have expanded across geographies such as Kuwait, Egypt and India. This has made them compete with numerous domestic and international players.

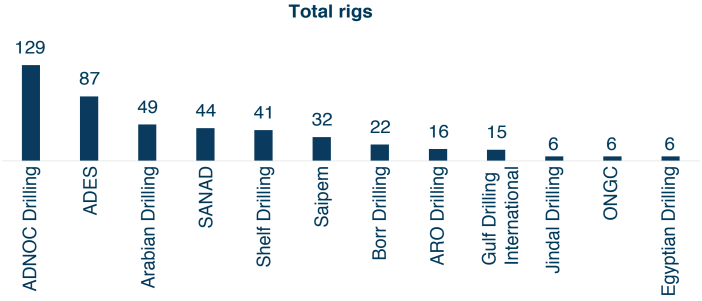
UAE based ADNOC drilling is the largest drilling player in terms of size and revenues, followed by Saudi Arabia based ADES and ADC. As on date, ADNOC drilling has a fleet size of 129 onshore and offshore rigs and commands a 29% market share. While ADES and ADC are the second largest and third largest player respectively, with a fleet size of 87 and 49 rigs respectively. Both these players command a market share of 19% and 11% respectively.

Fig 12. Revenue sizing of global drilling incumbents: ADNOC Drilling, followed by ADES and ADC are the largest players in terms of revenues

Company name	Region	Revenues - USDmn 2023	Revenues - USDmn 2019-23 CAGR	Business details
ADNOC Drilling	UAE	2,503	10.1%	• Having presence for 50+ years and plays a pivotal role in increasing UAE's oil production capacity to 5mn barrels per day by 2030E. • Currently has the highest fleet with 129 rigs.
ADES	KSA	1,155	36.7%	• The largest offshore jack-up rig operator globally, having presence in 9 countries. • It currently operates a total fleet of 87 rigs.
Arabian Drilling	KSA	927	5.4%	• Oldest player in KSA's drilling industry with current fleet size of 49 rigs and heavy reliance on Saudi Aramco as a customer. • 60% of rigs are less than 10 years of age.
Shelf Drilling	UAE	908	12.0%	• Founded in 2012 and currently operates 41 rigs distributed globally, with KSA having the maximum rigs. • Rigs are very older (34 years) compared to other players in KSA.
Borr Drilling	Bermuda	772	23.3%	• Founded in 2016 with major focus on jack-up rigs. Currently it has 22 rigs in total.
Jindal Drilling	India	62	17.0%	• Has operations in India since 1989 with major focus on offshore drilling and directional drilling. • Currently it operates with a fleet size of 6 rigs.

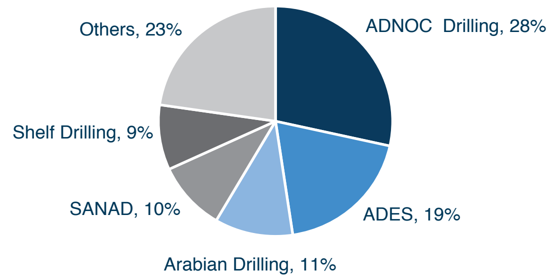
Source: Companies prospectuses, AlJazira Capital research

Fig 13. ADNOC Drilling is the largest drilling company followed by ADES and ADC



Source: Company websites, Arabian Drilling and ADES prospectus, AlJazira Capital research

Fig 14.UAE and Middle East drilling companies account for top-5 market share based on fleet size



Source: Company websites, Arabian Drilling and ADES prospectus, AlJazira Capital research

Within KSA there is a cut-throat competition between its two leading drilling companies namely ADES and ADC. Although ADC is the oldest player in KSA, ADES has scaled-up its operations and surpassed ADC, in terms of both revenues and fleet size. Having a higher skew to offshore rigs, makes ADES a more premium player and thus makes it better than ADC in terms of margin profile.

Fig 15. Financial analysis between ADES and ADC

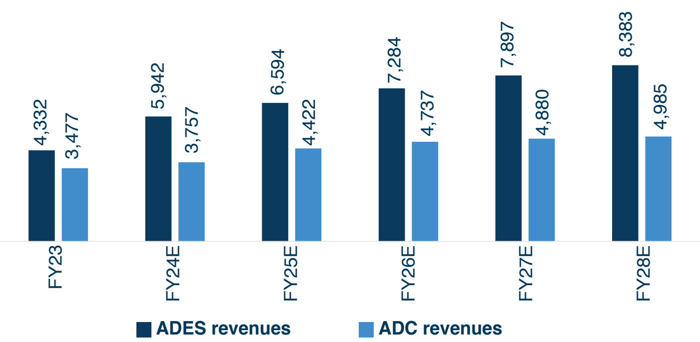
Factors	ADES	ADC	Remarks
Revenue sizing			
FY23 revenues - SAR mn	4,332	3,477	Having larger scale, higher exposure and expertise in offshore drilling, makes ADES grow faster than ADC due to the recent demand pick-up in offshore drilling due to announcement of multiple contracts by Saudi Aramco.
3yr CAGR (FY20-23)	36.7%	11.1%	
Business segments			
Onshore	27%	58%	Higher exposure to offshore drilling, makes ADES more premium player than ADC.
Offshore	73%	42%	
3yr segmental growth (FY20-23 CAGR)			
Onshore	10.8%	2.3%	ADES has not only outperformed ADC in overall revenues, but also in each of its business segments.
Offshore	56.9%	31.0%	
Total rigs	**87**	**49**	
Onshore	38	37	Having almost equal rigs in the onshore drilling, ADES has taken the lead in terms of offshore rigs.
Offshore	49	12	
Utilization	**98%**	**96%**	
Onshore	97%	95%	Better utilization rates for ADES aided its revenue growth outperformance narrative.
Offshore	99%	100%	
Profitability			
Gross margins	39.5%	28.1%	Higher business skew to offshore drilling, makes ADES a more premium player and thus enjoy higher margins than ADC. This is because the offshore drilling margins are typically 2x that of onshore rigs. However, ADC performs better in terms of net margins due to lower leverage, resulting in lower finance cost.
3yr gross margin expansion	200bps	740bps	
EBITDA margins	49.4%	42.7%	
3yr EBITDA margin expansion	840bps	-200bps	
Operating profit margins	29.7%	23.0%	
3yr operating margin expansion	810bps	730bps	
Net income margins	10.4%	17.4%	
3yr net income margin expansion	560bps	580bps	
Leverage			
Debt/equity	1.79	0.51	Higher capex intensity at ADES makes it rely on leverage, which also reflects in its elevated finance versus ADC
Finance expense as % of debt	6.9%	5.8%	
Cash Flow			
FCF	(1,520)	(487)	Higher skew to offshore rigs makes ADES typically incur higher capex as industry wide the capex for offshore rigs is normally 3.2x that of onshore rigs.
3yr FCF CAGR (FY20-23)	* NM	* NM	
Receivable days	41	100	
Return profile			
RoE	11.3%	10.5%	ADC is more friendly in terms of shareholder returns
Dividend payout	0%	74.5%	

Source: Company, AlJazira Capital research. Note: * NM means Not Meaningful

Performance of our coverage companies

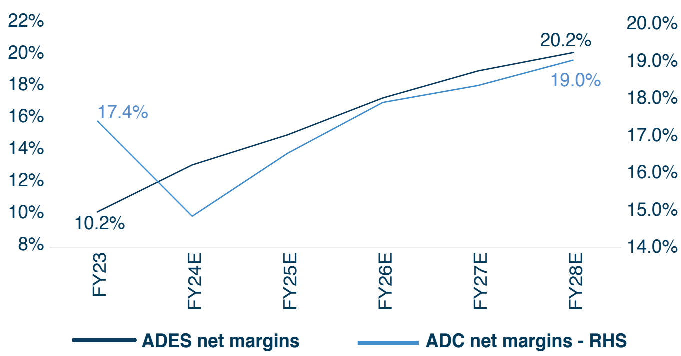
- **Revenue growth:** Within our coverage, we believe ADES could likely outperform ADC, by growing at 14.1%, while the latter growing at 7.5% over FY23-28E. Historically too ADES had outperformed ADC, due to higher skew to offshore revenues, which enabled it to be at the forefront of the demand boom in the offshore drilling activities, especially post COVID. We expect the same momentum to continue at the back of consistent growth in day rates, healthy utilization and gradual increase in active rigs.
- **EBITDA profile:** Within our coverage, we believe ADES could likely have better EBITDA margins than ADC. We expect EBITDA of ADES to grow at 14.5% CAGR and ADC's to grow at 7.2% CAGR over FY23-28E.
- **Net income margin:** Within our coverage, we believe ADES could likely have better margins than ADC. We expect net income of ADES to grow at 30.6% CAGR and ADC to grow at 9.4% CAGR over FY23-28E. This is on account of strong topline growth further aided by the decline in finance expenses.

Fig 16. ADES to grow its revenues faster than ADC over FY23-28E



Source: Company, AlJazira Capital research

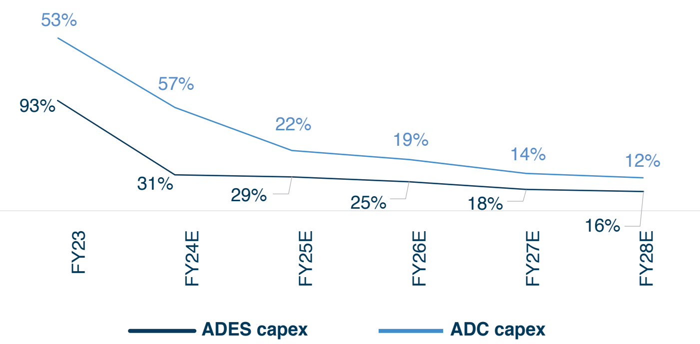
Fig 17. Higher scope of margin expansion in case of ADES versus ADC



Source: Company, AlJazira Capital research

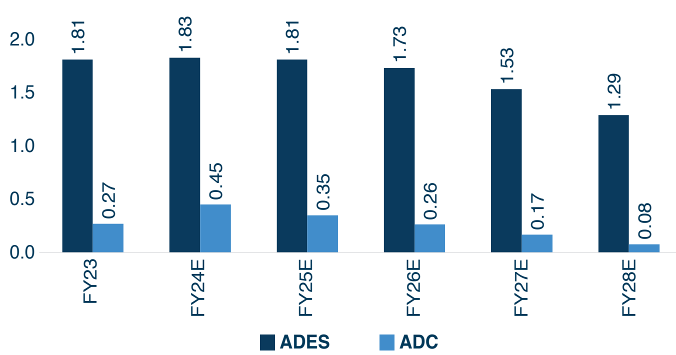
- **Capex:** The already elevated capex intensity of ADC is likely to continue in FY24E too given 13 onshore rigs are expected to be operational by FY24E and FY25E, for which the company has already initiated the capex cycle. We expect the capex intensity to inch up to 57% in FY24E, before normalizing to 14% by FY28E. In the case of ADES capex is expected to continue at comparatively lower intensity in the medium term before easing in the long term, since major expansion has already been done. Capex intensity is estimated to drop in the next five years from as high as 93% in FY23.
- **Debt profile:** ADES is more leveraged compared to ADC due to its higher exposure to the capital-intensive offshore segment. As of FY23, ADES' total debt was SAR 10.8bn with net debt to equity at 1.81x compared to SAR 3.1bn and net debt to equity of 0.27x for ADC. For ADES, the leverage level could improve, despite additional loan requirement in the medium term, as Capex is expected to ease post FY26E. We believe the total debt could reach SAR 11.1bn by FY28E. Whereas for ADC leverage is expected to reach SAR 1.4bn by FY28E.

Fig 18. Capex intensity is much lower at ADES than ADC



Source: Company, AlJazira Capital research

Fig 19. Debt profile



Source: Company, AlJazira Capital research

Investment thesis: KSA's drilling industry growth inevitable despite near term headwinds

The relevance of O&G will continue in the global energy supply over the coming decade, despite various regions intending to switch to alternative source of energy. This growth story is likely to be driven by growing populations, increasing energy intensity per capita across Asian economies, and lack of concrete execution in case of alternative energy resources. This increase in global O&G is expected to propel the drilling industry due to its direct relation to the O&G production levels. KSA could be the key beneficiary as its drilling industry is poised for a robust growth driven by i) Drilling expenditure expanding at 13.0% CAGR over 2021-25E, ii) intensified drilling of unconventional gas at the Jafurah field to drive demand for onshore rigs. Although the offshore rigs are likely to be impacted in the near term due to Aramco's announcement of suspension of selected rigs from multiple rig suppliers, KSA's growth in drilling expenditures is despite Aramco abandoning its plan of increasing production capacity to 13mn mmboepd.

Aramco's recent announcements of scrapping its plans to expand MSC to 13.0 mbpd from 12.0 mbpd and suspension of contracts for selected offshore rigs with several drillers including ADES and ADC, poses a risk of uncertainty for our coverage companies in the near term. However, we believe ADES is less likely to be impacted from this suspension versus ADC, due to its wider reach across multiple geographies and higher exposure to offshore business, which gives it the flexibility of deploying rigs in a wider market. ADC on the other hand is likely to face more brunt than ADES as this suspension is likely to pressurize the gross margins in the near term because of its lower exposure to offshore rigs and less significant presence outside KSA, which limits its ability to deploy idle offshore rigs, unlike ADES whose business is more skewed to offshore revenues.

We initiate on **ADES** with a TP of **SAR 21.7/share** and an "**Overweight**" recommendation, due to its healthy growth prospects in the medium to long term on the back of strong footing in an attractive offshore market and solid backlog. We expect the total active rigs to rise from 67 in FY23 to 88 by FY28E, driving 14.1% revenue CAGR over FY23-28E. The EBITDA margins could expand by ~90bps over FY23-28E to 50.3% by FY28E. We also initiate on **Arabian Drilling** with a TP of **SAR 166.4/share** and an "**Neutral**" recommendation due to a higher impact of recent suspension on the gross margins, when compared with ADES. We expect the total active rigs to inch up from 47 in FY23 to 63 by FY28E, driving 7.5% revenue CAGR over FY23-28E. The EBITDA margin could contract by 60bps over FY23-28E to 42.1% by FY28E. In terms of pecking order within our coverage, we **prefer ADES over Arabian Drilling** due to i) efficient execution as evident from its faster scale-up over FY20-23, ii) better revenue growth due to its higher skew to offshore drilling, thus making it a more premium player, and iii) better net margin expansions, iv) the company's diversified geographic exposure.

Valuations: Arabian Drilling's currently trades at 8.9x 1-yr forward EV/EBITDA, and 18.2x 1-yr forward P/E ratio. While ADES trades at 10.08x 1-yr forward EV/EBITDA, and 24.1x 1-yr forward P/E ratio.

Fig 20. Financial analysis between ADES and Arabian Drilling

Company	Revenue CAGR	EBITDA margins		Net profit CAGR	Net debt/equity ratio		RoE %	
	FY23-28E	FY23	FY28E	FY23-28E	FY23	FY28E	FY23	FY28E
ADES	14.1%	49.4%	50.3%	30.6%	1.81	1.29	7.7%	20.0%
Arabian Drilling	7.5%	42.7%	42.1%	9.4%	0.27	0.08	10.5%	12.7%

Source: Company, AlJazira Capital research.

Fig 21. Upside risks

- Increased government expenditure
- More than expected economic growth
- More than expected day rate changes

Source: AlJazira Capital research

Fig 22. Downside risks

- Any directive issued to reduce the production capacity of Saudi Aramco
- Current geopolitical tensions in the Middle East intensifying

Source: AlJazira Capital research

ADES Holding Company (ADES) has expanded its business significantly in the past few years through an aggressive and cost effective acquisition strategy. The company has grown to become the leading premium jack-up player in the world. It is expected to reap the benefits of its dominance in the jack-up offshore drilling market favorable market conditions of growing demand and tight supply. The onshore segment has also expanded well with new contracts in Kuwait and Algeria. The company could also benefit in KSA from Aramco's Jafurah gas field project. The company's existing backlog of SAR 26.8bn provides a good visibility of the topline. We expect the company's total rig capacity to increase to 101 by FY28E from the current capacity of 87. Added capacity coupled with the expected increase in day rates are likely to translate into a revenue CAGR of 14.1% during FY23-28E, while net profit is expected to record a CAGR of 30.6%. The impact of recent suspension of ADES' 5 rigs by Aramco is anticipated to be nullified in the coming period with reallocation of these rigs to new projects. The company has already secured a contract to deploy three of the five suspended rigs with the expected start of operations in H2-24. In fact, this could be an opportunity for the company to earn higher day rates through new contracts. We initiate our coverage on the stock with a TP of SAR 21.70/share and an "Overweight" rating.

- **Under-invested oil and gas industry demands for new investment over the next few years, supporting the drilling activities:** Global oil and gas demand is estimated to increase by 11 mmboepd between FY22-30. Moreover, there will be around 51 mmboepd natural decline in production during this period. Hence, there is requirement of new investment towards total additional 62 mmboepd of demand. However, current committed Capex is only for 16 mmboepd of demand. Thus, additional new investment is expected over the next few years. This new investment will augur well for drilling service providers like ADES, as drilling activity will increase. Moreover, MENA region is expected to lead the way due to its low-cost production. ADES is the leading player in the MENA region and increased activity in this region would benefit the company.
- **Jack-up market dynamics favorable for ADES growth:** Offshore jack-up industry is going through a phase of scarce supply with number of new rigs supplied falling from 75 in 2018 to 20 in 2023. Furthermore, 53 jack-up rigs moved to the Middle East during 2022-23 creating tighter supply of jack-up in other markets. Thus, there is high demand for jack-ups and day rates are on the rise. ADES has one of the largest fleets of offshore premium rigs, consisting of 31 premium jack-up rigs and accounting for ~10% of global jack-up rig supply. Moreover, the company has expanded its presence outside the MENA regions as well. We expect the company's upcoming capacity addition to be focused on offshore jack-ups as the company plans to double its rig count in India (currently 3), Indonesia (1) and Thailand (1) and add three rigs in Qatar over the next two years. We expect the offshore rig capacity of ADES to reach 60 in FY28E from 49 in FY23. ADES is benefiting from the higher day rates, which are expected to continue to grow in the medium term. ADES is already witnessing higher daily rates across its target markets for new contracts and renewals. The offshore day rates for the company are forecasted to grow at CAGR of 5.7% during FY23-28E. ADES being a major jack-up market player its offshore revenue growth will be supported by attractive market conditions. Thus, we forecast offshore revenue to grow almost ~2x over the next five years to reach SAR 5.9bn.
- **Robust backlog with longer maturity to translate into strong revenue for an extended period:** ADES' current backlog of SAR 26.8bn is 6.2x the revenue in FY23, while weighted average maturity of backlog is 5.1 years. The high backlog level assures sustainability of healthy topline in the long term. The company's expansion into a new market, consistent winning of new contracts, strategy of ensuring contracts while acquiring new rigs and established relationships with existing clients make a case for the backlog to remain strong in future as well.

Recommendation	**Overweight**
Target Price (SAR)	**21.70**
Upside/(Downside)	**23.2%**

Source: Tadawul *prices as of 14th of May 2024

Key Financials

(in SAR mn, unless specified)	FY23	FY24E	FY25E	FY26E
Revenues	4,332	5,942	6,594	7,284
Growth %	75.6%	37.2%	11.0%	10.5%
Gross Profit	1,711	2,292	2,520	2,800
EBITDA	2,139	2,944	3,280	3,624
Net Income	442	772	981	1,253
Growth %	13.2%	74.6%	27.1%	27.8%
EPS	0.39	0.68	0.87	1.11
DPS	0.00	0.40	0.50	0.70

Source: Company reports, Aljazira Capital

Key Ratios

	FY23	FY24E	FY25E	FY26E
Gross Margin	39.5%	38.6%	38.2%	38.4%
EBITDA Margin	49.4%	49.5%	49.7%	49.7%
Net Margin	10.2%	13.0%	14.9%	17.2%
ROE	7.7%	12.7%	15.2%	18.1%
ROA	2.3%	3.7%	4.6%	5.6%
PE	High	25.8	20.3	15.9
PB	4.7	3.3	3.1	2.9
EV/EBITDA	17.5	10.5	9.6	8.8
Dividend Yield	0.0%	2.3%	2.8%	4.0%

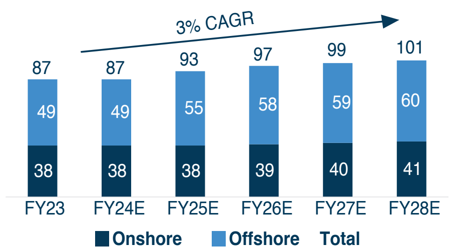
Source: Company reports, Aljazira Capital

Key Market Data

Current market price (SAR per share)	17.6
Market Cap (SAR bn)	19.9
Share Outstanding (mn)	1,129.1

Source: Company reports, Aljazira Capital

Total rig capacity



Source: Company Reports, AlJazira Capital research

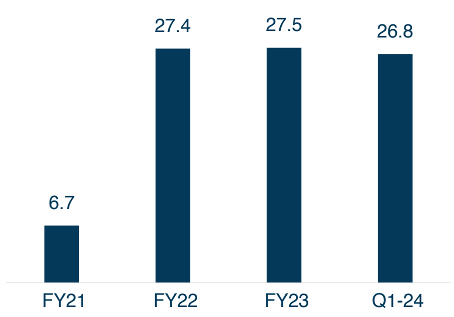
- **A better managed debt profile post repayments through IPO proceedings; expected to raise additional debt to fund MT CAPEX amid 60% dividend payout guidance:** As of December 2023, the company's total debt amounted to SAR 10.8bn. The company managed to keep gross debt level stable despite a capex of SAR 4bn in FY23, as it utilized 85% of IPO proceedings (SAR 3.1bn) to repay debt. Debt to equity ratio improved significantly from 4.9x in FY22 to 1.9x in FY23 due to a steady debt level and increase in equity through profit growth. Backlog to net debt ratio of 2.77x indicates sufficient cash flow generating ability to service the debt. We estimate the company will require additional debt over the next few years to fund the recently announced medium term CAPEX of SAR 5.5bn. We expect most of the upcoming CAPEX to be funded by debt, as expected dividend payout (60% guided by the management) will put pressure on ADES' cashflows. However, the CAPEX intensity would be comparatively lower in future as the phase of aggressive fleet expansion is behind us. Thus, we believe the company is comfortably placed to fund announced CAPEX and maintain leverage level steady in the medium term and lower thereafter (D/E is anticipated to ease to 1.3x by FY28E).
- **Suspension of 5 rigs – a near term headwind with a factor of uncertainty but could be a blessing in disguise:** Aramco recently suspended 5 jack-up rigs deployed by ADES. This followed Aramco's earlier announcement to cancel the plan of raising MSC from 12 mbpd to 13 mbpd. There is also a possibility that Aramco may extend the current 12 months suspension or announce suspension of more rigs, adding uncertainty to the expected revenue from the largest client. However, the impact of suspension is already partially offset with 3 out of 5 rigs expected to be deployed for new contracts in Thailand, Qatar and Egypt in H2-24. The remaining two rigs are actively tendering, and the company expects those to secure a new contract by the end of FY24. Furthermore, ADES has the opportunity to deploy these rigs at current higher rates. The company's recent contracts including Thailand and Qatar are signed at much higher rates than average day rates for the company. Additionally, the company's expansion into new geographies such as Southeast Asia and India provides scope for deploying rigs across its 9 markets. Moreover, the company has flexibility to shift its jack-up rigs from oil to gas (4 jack-ups are currently working on gas exploration). Thus, it is possible that the challenge posed by Aramco's suspension could turn into an opportunity for the company.
- **Investment thesis and Valuation:** We believe, despite the recent negative news, ADES' long term prospects are positive, supported by its market leadership, attractive market conditions and wider market presence. We anticipate the company's fleet capacity to increase to 101 by FY28E from 87 in FY23, while average active rigs are estimated to reach 88 by FY28E (FY23: 67). In addition to the higher number of active rigs, ADES' topline is expected to be bolstered by an anticipated rise in day rates, particularly for offshore segment average day rates for the company are forecasted to reach USD 83,000 per day (FY23-28E CAGR of 5.7%). Thus, we forecast the top line to reach SAR 8.4bn in FY28E growing at CAGR of 14.1% during FY23-28E. ADES' EBITDA margin is estimated to improve slowly to 50.3% in FY28E from 49.4% due to higher revenue per rig driven by rising day rates and expected optimization of operating cost as the scale increases. This would boost the company's bottom line. Net profit is forecasted to compound at a very strong CAGR of 30.6% during FY23-28E to reach SAR 1.7bn in FY28E from SAR 442mn in FY23. We value ADES with 50% weightage to DCF (WACC=8.3%, terminal growth rate=2.50%) and 50% weight to FY24E EV/EBITDA (11.5x) to arrive at a TP of **SAR 21.70/share**, implying 23.2% upside. Hence, we recommend an "**Overweight**" rating on the stock.

Operating metrics

	FY23	FY24	FY25	FY26	FY27	FY28
Active rigs	**67**	**73**	**78**	**82**	**85**	**88**
Onshore	26	30	30	31	33	34
Offshore	41	44	48	51	52	54
Day rate USD '000						
Onshore	43*	44	45	46	47	48
Offshore	63*	72	78	79	81	83

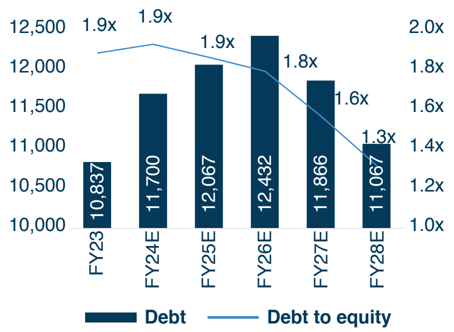
*FY23 rates based on our calculations

Backlog trend (SAR bn)



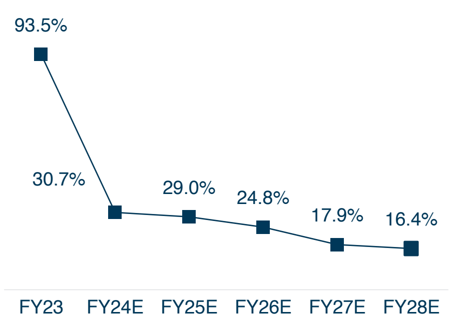
Source: Company Reports, AlJazira Capital research

Gross debt (SAR mn) and debt to equity(x)



Source: Company Reports, AlJazira Capital research

Capex as % of revenue



Source: Company Reports, AlJazira Capital research

Company Overview

ADES, originally established in Egypt in 2002, was incorporated as **ADES Holding Company (ADES)** in Saudi Arabia in 2022. The company and its subsidiaries are a leading provider of oil and gas drilling and production services in the MENA region. ADES is currently (as of December 2023) operating in 7 markets: KSA, Kuwait, Egypt, Algeria, Tunisia, Qatar, and India. The company will be expanding its operations in Indonesia (with a new contract which is expected to commence in H2-24) and in Thailand (received letter of intent). ADES has established itself as a leading international drilling services provider globally and it is the largest offshore jack-up drilling rig operator in the world. The company's portfolio of services primarily includes onshore and offshore contract drilling and workover services, which include maintenance, repairs and enhancement of oil well production. The company has a combined fleet of 87 rigs, of which a total of 38 are onshore drilling rigs, 46 jack-up offshore drilling rigs, two jack-up barges, and one mobile offshore production unit ("MOPU"). ADES Investments Holding Ltd. (36.5%), PIF (23.8%) and Al Zamil Company for Investment Ltd. (6.7%) are the major shareholders in the company.

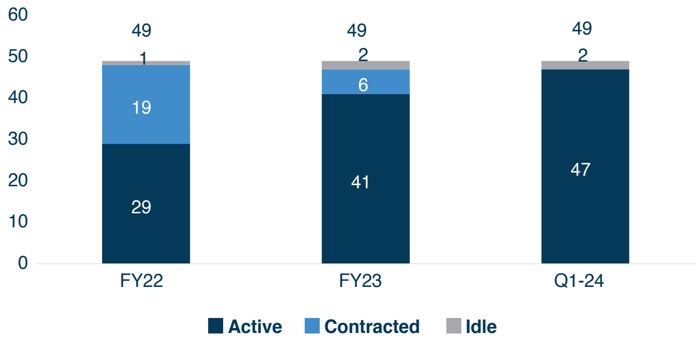
Business model

Offshore and onshore drilling services are the key business activities supported by other related services:

ADES' business activities are classified as Offshore drilling and Workover, Onshore drilling and Workover, MOPU services, Jack-up Barge and Project services and Other services.

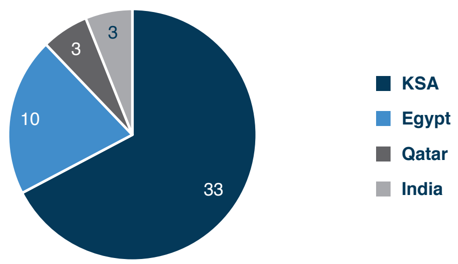
Offshore drilling and Workover: The company's offshore drilling and workover services are currently focused on shallow water (up to 400 feet) with non-harsh environments catering mainly to the development, production and workover phase of the oil and gas life cycle. ADES's offshore fleet consists of 46 jack-up rigs, two jack-up barges and one MOPU making it the largest jack-up offshore drilling operator globally. The company's offshore activities are spread across KSA, Egypt, Qatar, India, and also has new contracts in Indonesia and Thailand. ADES operates through a mix of legacy and premium rigs. The company has one of the largest fleets of premium rigs, consisting of 31 premium jack-up rigs and accounting for ~10% of global jack-up rig supply.

Fig 23. Increase in active offshore rigs



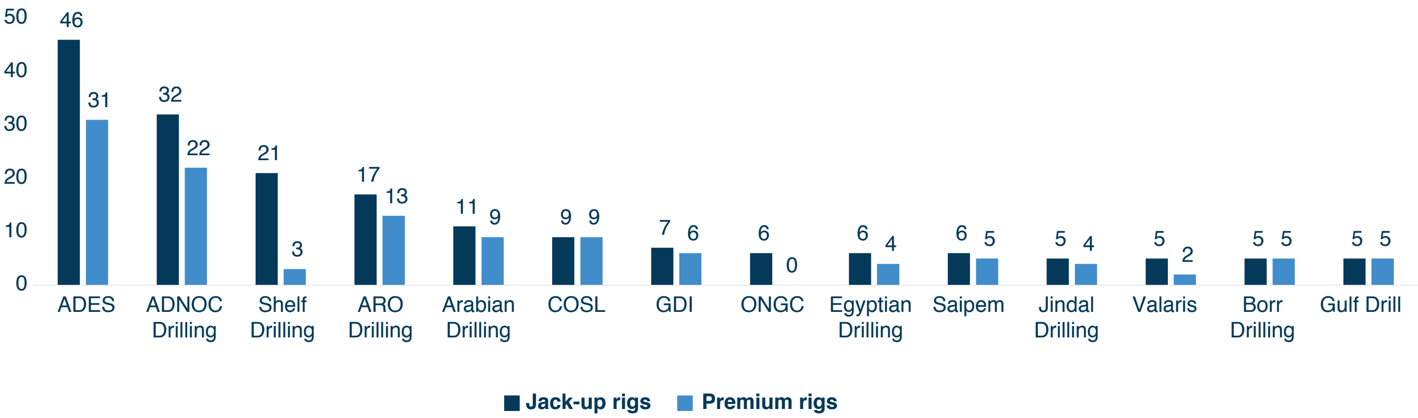
Source: Company Reports, AlJazira Capital research

Fig 24. Largest offshore fleet deployed in KSA



Source: Company Reports, AlJazira Capital research

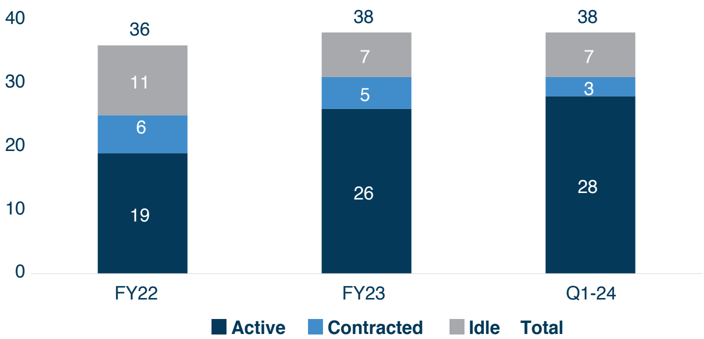
Fig 25. Leading premium jack-up player in target geographies



Source: Company Reports, AlJazira Capital research

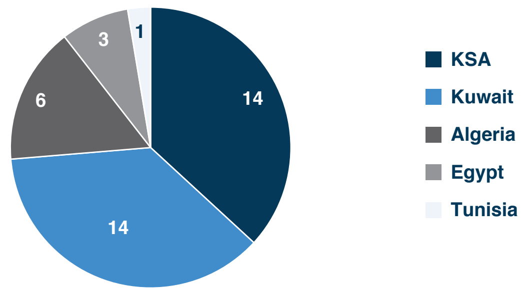
Onshore drilling and Workover: ADES provides onshore drilling services in the MENA region with a fleet of 38 rigs. The company's rigs are currently located in KSA, Kuwait, Algeria, Egypt and Tunisia. As of December 2023, the company had 26 active rigs and 5 contracted rigs across the above mentioned geographies. ADES's onshore drilling operations are more focused in GCC (KSA and Kuwait: 28 out of 38 rigs). These markets are considered relatively premium and high growth. They enjoy higher day rates and have higher HP (horsepower) rated rigs. ADES is the market leader in the MENA region in terms of > 3000 HP rigs (10 rigs).

Fig 26. Increase in active onshore rigs



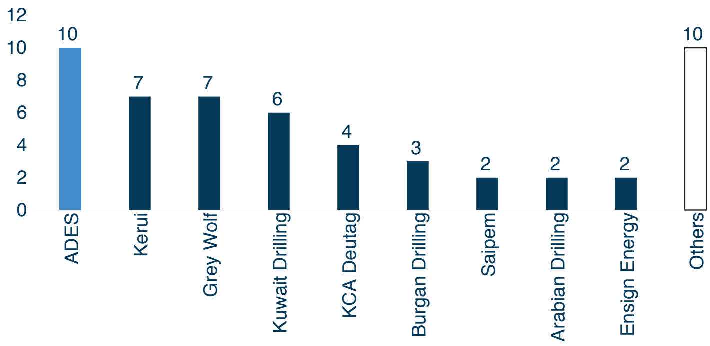
Source: Company Reports, AlJazira Capital research

Fig 27. Onshore fleet concentrated KSA and Kuwait



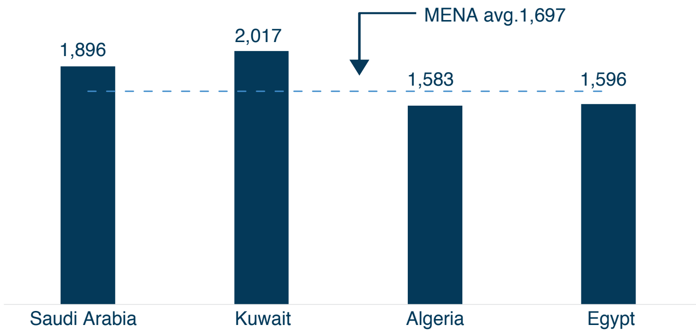
Source: Company Reports, AlJazira Capital research

Fig 28. ADES leadership in >3000 HP rigs in MENA



Source: Company Reports, AlJazira Capital research

Fig 29. Higher day rates in KSA and Kuwait (USD/day)

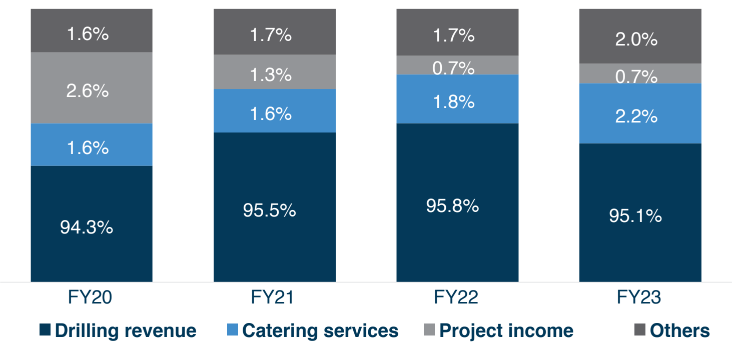


Source: Company Reports, AlJazira Capital research

Drilling revenue forms ~95% of the topline; growth in offshore revenue outpaced onshore over the past few years

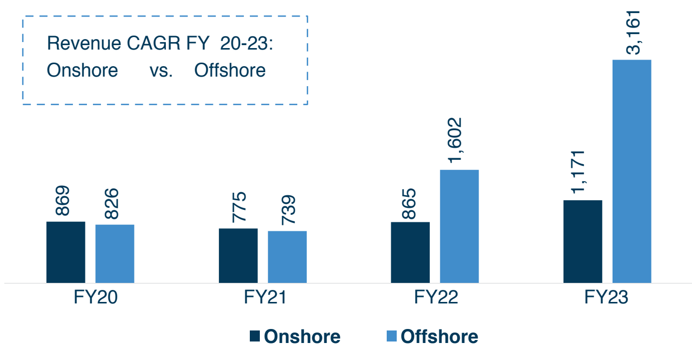
ADES bifurcates its revenue into Units of operation (drilling services), Catering services, Project income, and Others. The contribution of revenue from Units of operations i.e drilling revenue averaged at 95.2% during FY20-23. The contribution from other segments has been minuscule, averaging below 2% during the same period – Catering (1.9%), Project income (1.1%) and Others (1.8%). Over the years ADES' revenue mix has shifted from onshore to offshore, as driven by aggressive acquisition of offshore rigs and large contract signings. Offshore contribution to revenue increased from 48.7% in FY20 to 73.0% in FY23 (Q1-24: 77%). Offshore revenue growth outpaced that of onshore revenue during FY20-23 (offshore CAGR of 56.4% vs. onshore CAGR of 10.4%).

Fig 30. Drilling revenue forms ~95%



Source: Company Reports, AlJazira Capital research

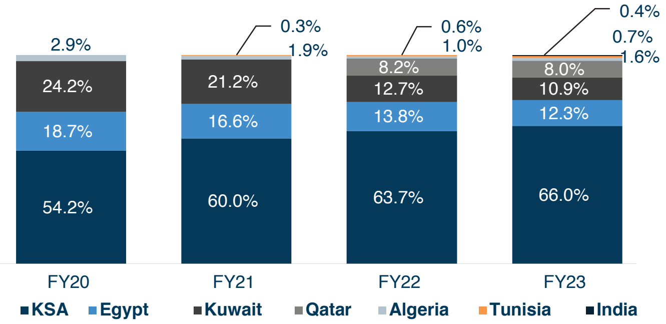
Fig 31. Offshore drilling a key driver for topline growth



Source: Company Reports, AlJazira Capital research

Geographically, KSA generates a significant chunk of total revenue for ADES with Egypt and Kuwait being other key contributors. Revenue from KSA has grown strongly during FY20-23 at CAGR of 46% leading total revenue CAGR to 37%. Thus, KSA's contribution to total revenue has also increased from 54.2% in FY20 to 66.0% in FY23 (Q1-24: 72%). The mega contract signing with Saudi Aramco helped ADES revenue growth in the Kingdom. Egypt (12.3%), Kuwait (10.9%) and Qatar (8.0%) were other key geographies for ADES in FY23.

Fig 32. Aramco contracts drive KSA contribution higher



Source: Company Reports, AlJazira Capital research

Successful track record of value-enhancing acquisitions helped an impressive expansion in short period

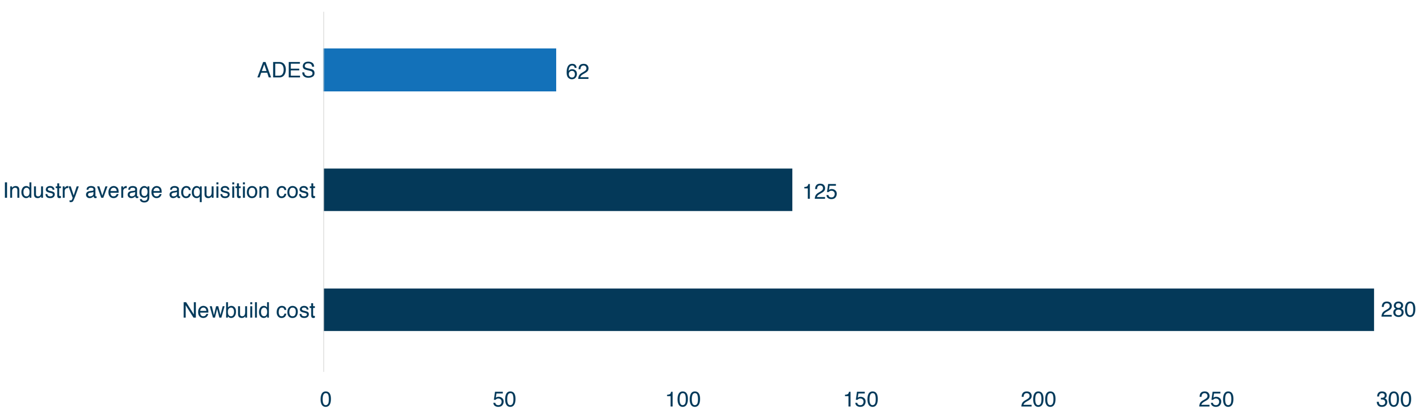
ADES has significantly expanded its fleet size as well as geographic presence in the past 7 years through acquisitions. The company operates on "Buy to Contract" and "Contract Acquisition" models. Under the "Buy to Contract" model such targets are identified where a drilling contract is finalized before or alongside the acquisition. Under the "Contract Acquisition" model, rigs with ongoing contracts are acquired or existing contracts are replaced with new contracts with ADES. These models help minimize uncertainty and idle time. Moreover, ADES' acquisitions have been cost effective with acquisition costs below the industry average, creating higher values for the company. Average acquisition cost of premium jack-ups acquired by ADES is USD 62mn compared to industry average for acquisition cost of USD 125mn and a cost of USD 280mn for newbuild rig. ADES generally finances its acquisition through leverage with a targeted backlog to net debt ratio of 2x or higher. As of December 2023, the backlog to net debt ratio was 2.8x ensuring debt obligations are well covered. Moreover, ADES' acquisitions strategy targets 5-7 years of payback period and a minimum unlevered IRR of 18-22%.

Fig 33. ADES fleet expansion through acquisitions

Year	Acquired from	No. of rigs	Acquisition rationale
2016	**Hercules**	3 jack-up rigs	Entry into KSA offshore market
2018	**Nabors**	3 jack-up rigs	Consolidation of market share with Aramco
2018-19	**Weatherford**	31 onshore rigs	Entry into onshore gas market and Kuwait market
2021	**Noble**	4 jack-up rigs	Access to KSA offshore gas drilling
2022	**Vantage**	3 jack-up rigs	Entry into Qatar market
2022	**Seadrill**	7 jack-up rigs	Strengthening presence in KSA

Source: Company, AlJazira Capital research.

Fig 34. Rig acquisition cost well-below industry average (USD mn)



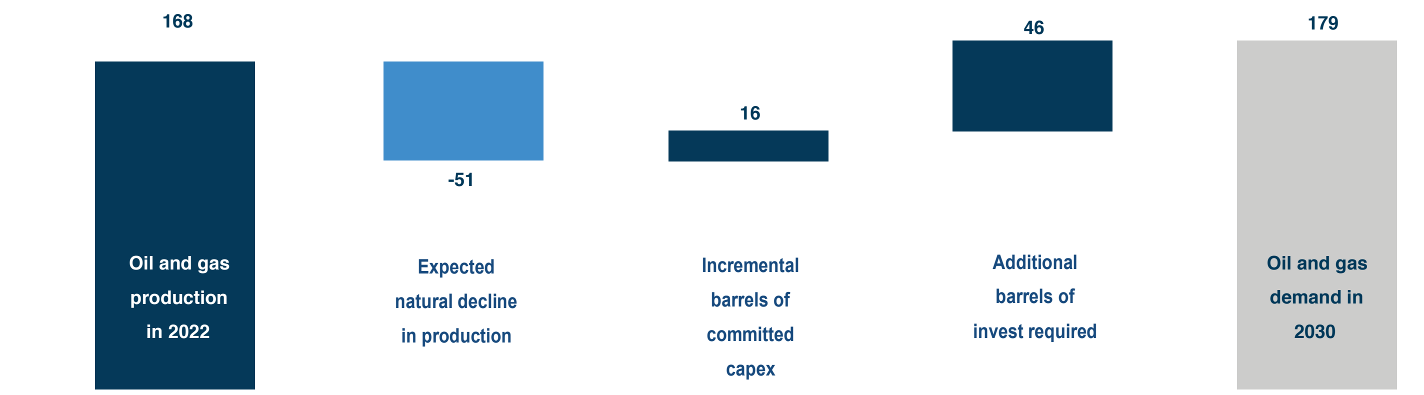
Source: Company Reports, AlJazira Capital research

Business Analysis

Oil and gas demand outlook calls for new investments into drilling activity; ADES target market likely to lead the upcoming investments

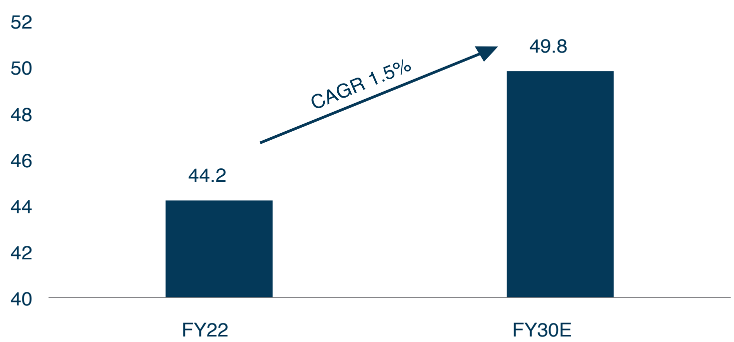
Global oil and gas industry is required to invest for additional 62 mmboepd of demand from 2022-2030. This includes 11 mmboepd of incremental demand and 51 mmboepd of natural production decline estimated during this period. The expected new investment bodes well for the drilling services provider as drilling activity will increase. MENA region, known for its low lifting, is expected to lead the upcoming investment. MENA oil & gas supply is expected to increase from 44.2 mmboepd to 49.8 mmboepd between 2022 and 2030 i.e more than half incremental demand during this period. The GCC region's share of global oil production is estimated to increase from 20% in 2022 to 22% by 2030. ADES, being a key player in these regions, is set to benefit.

Fig 35. Oil and gas demand outlook (in mmboepd)



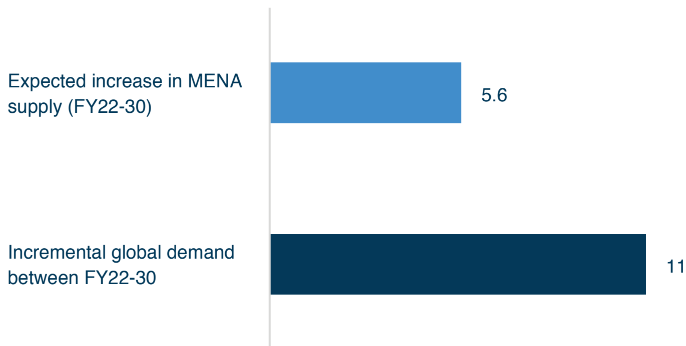
Source: Westwood Global Energy, AlJazira Capital research

Fig 36. MENA oil and gas supply growth



Source: Westwood Global Energy, AlJazira Capital research

Fig 37. MENA to fulfill half of the incremental demand

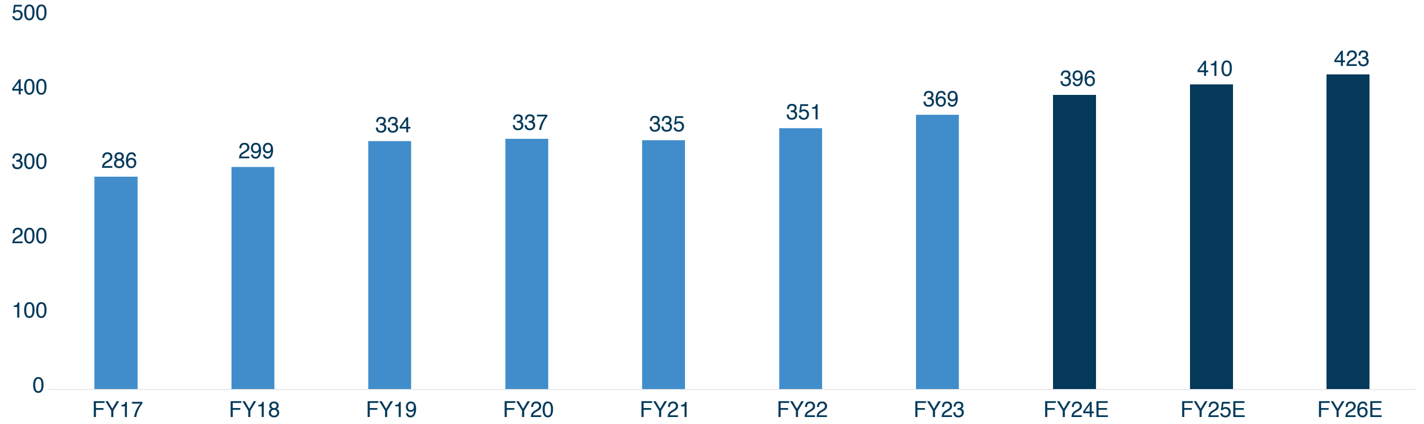


Source: Westwood Global Energy, AlJazira Capital research

Leadership in attractive jack-up market; tight market conditions translating into higher day rates and utilization

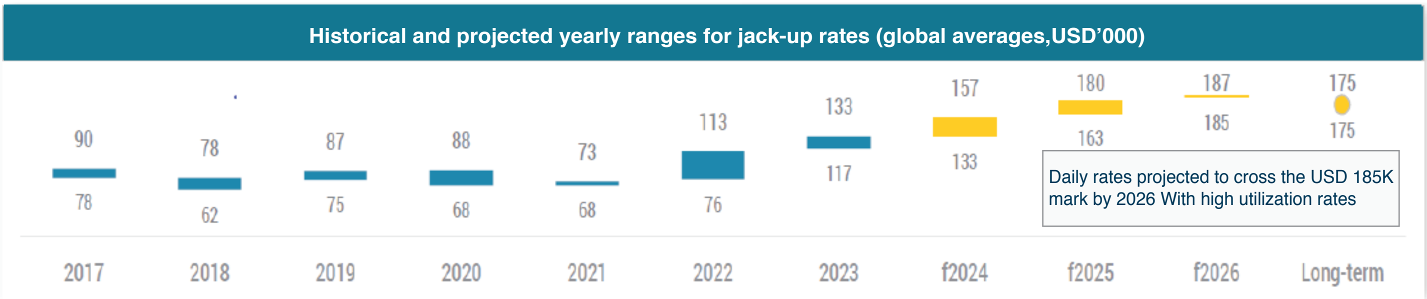
The global jack-up market is facing a significant tightness, as the number of rigs supplied decreased from 75 in 2018 to 20 in 2023 creating high demand for existing rigs. As a result, jack-up day rates have increased, and utilization levels have also improved. The offshore utilization rates globally reached 95% in FY23. ADES has one of the largest fleets of offshore premium rigs, consisting of 31 premium jack-up rigs and accounting for ~10% of global jack-up rig supply. Thus, the company is bound to benefit from the tighter markets. The jack-up day rates are expected to continue to move upwards in the medium term. ADES is already witnessing higher daily rates across its target markets for new contracts and renewals. Moreover, we estimate ADES' effective utilization to remain between 95-98% in the coming years. Overall, we believe ADES is placed well to reap benefits of tighter demand supply dynamics in the jack-up market.

Fig 38. Estimated growth in jack-up demand (in Rig years)



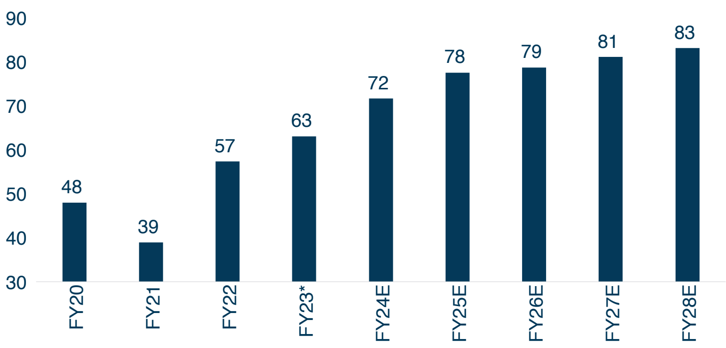
Source: Westwood Global Energy, AlJazira Capital research

Fig 39. Jack-up rates moving up in tighter market



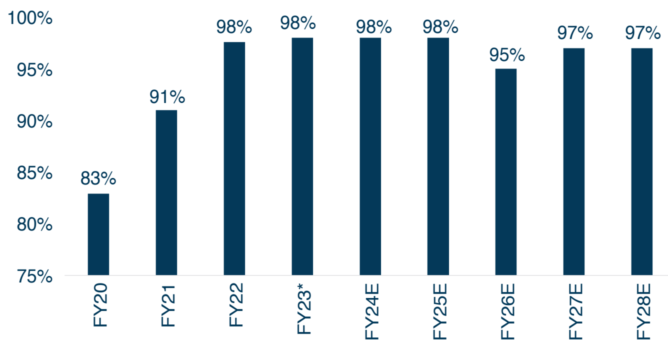
Source: Clarksons Securities Research, Company Reports, AlJazira Capital research

Fig 40. ADES offshore day rates (USD '000)



Source: Company Reports, AlJazira Capital research
*FY23 rates based on our calculations

Fig 41. ADES offshore effective utilization

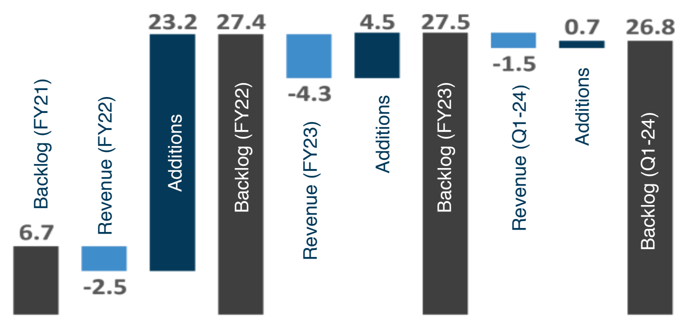


Source: Westwood Global Energy, AlJazira Capital research
*FY23 rates based on our calculations

Robust backlog of SAR 26.8bn amounts to around 4 years of forecasted revenue

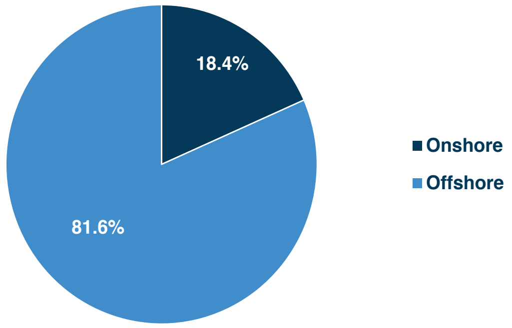
As of March 2024, ADES' backlog stood at SAR 26.8bn. The company's outstanding backlog is 6.2x the FY23 revenue and weighted average contract maturity of 5.1 years, indicating long term revenue visibility. Based on our forecasts the amount approximately equal to the current outstanding backlog will be recognized until FY27E in the company's top line with a CAGR of 16.2% during this period. Moreover, the backlog level is likely to remain healthy over the next few years with anticipated renewal of few contracts, the company's ongoing expansion outside MENA region and expected higher rates in the offshore contracts (as offshore contracts account for 81.6% of existing backlog).

Fig 42. Backlog trend (SAR bn)



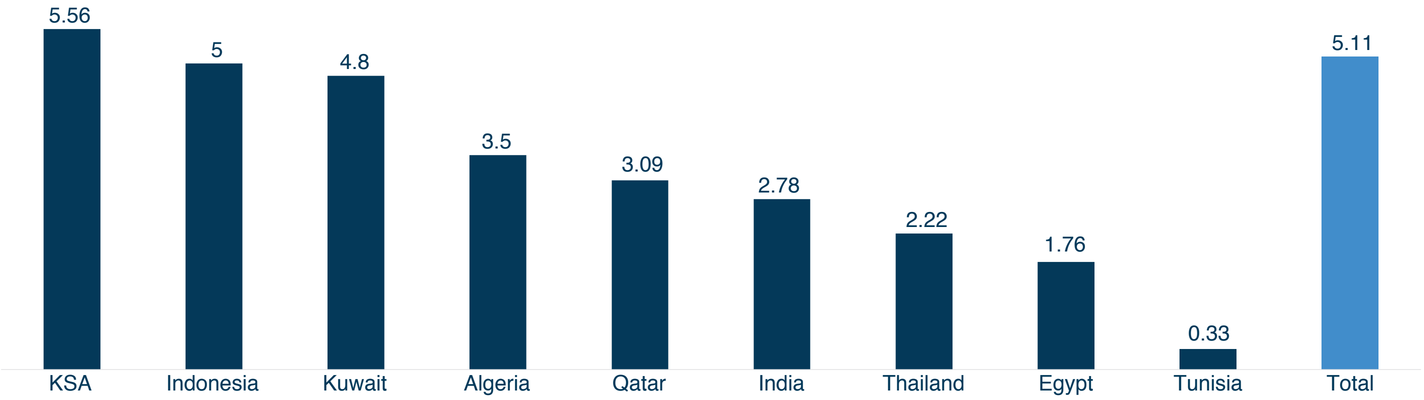
Source: Company Reports, AlJazira Capital research

Fig 43. Backlog by type of activity (Q1-24)



Source: Company Reports, AlJazira Capital research

Fig 44. Weighted average remaining contract maturity (in years)



Source: Company Reports, AlJazira Capital research

Aramco's latest decision poses risk of uncertainty but could be an opportunity in disguise

Saudi Aramco recently announced to scrap its plans to expand maximum sustainable capacity (MSC) to 13.0 mbpd by 2027 from 12.0 mbpd. This was followed by Aramco suspending contracts for selected rigs with several drillers including ADES. A total of 5 offshore jack-up rigs from ADES' fleet were suspended for a period that may extend up to 12 months. However, ADES has maintained its financial guidance for FY24 despite the suspension. The company has already announced moving one of the suspended offshore rigs to Thailand, where operations for new contract will start in H2-24. Two more rigs were contracted in Qatar and Egypt also expected to start operation in H2-24. Thus, any impact from suspension of at least 3 rigs is mostly negated. ADES is also participating actively in new tenders for the remaining 2 rigs and expects to secure contracts by the end of FY24. We believe given the company's dominant position in the jack-up market and its presence across 9 countries would possibly enable it to deploy the remaining rigs as well. However, we assume a net impact of around 2-3 rigs in FY24 and maximum impact in Q2-24. Although there persists an additional risk of Aramco extending the suspension or suspending the contracts for a few more rigs, the flexibility ADES to shift offshore oil rigs to offshore gas projects seems to have limited the impact on the company.

On the other hand, new contracts where the jack-up will be deployed are at higher rates. The day rate of Thailand contract estimated at ~USD 102,000 per day and that of Qatar at ~USD 110,000 per day as per our calculations based on the announced contract values. If ADES successfully deploys all suspended rigs under new contracts and is able to get higher day rates it could be an upside for its revenue. It is noteworthy that recent contracts in the jack-up market are signed at higher rates as the market is tight. Especially with jack-ups being concentrated in the MENA region other market such Southeast Asia are experiencing scarcity and ADES has already entered these markets with contracts in Indonesia and Thailand. Thus, it is possible that the company could turn the challenge posed by Aramco's suspension into an opportunity.

Risk Factors

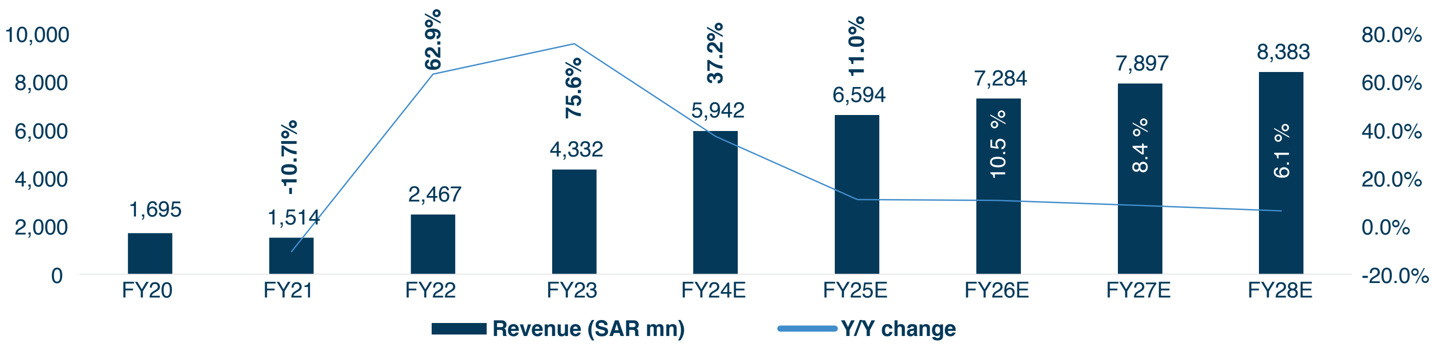
- **Dependency on activity in volatile oil and gas industry:** The company's business is completely dependent on exploration, development and production in the oil and gas industry which is highly volatile and exposed to risk related to oil and gas supply-demand, economic environment, geopolitical factors and oil producing nations' policies.
- **Concentration of revenue from top clients and rigs:** NOCs in the GCC region are among the largest clients of the company with Saudi Aramco, Kuwait Oil Company and Qatar Energy accounting for 86% of the company's backlog as of March 2024. Loss of contracts with these major clients or any change in their future plans of oil and gas exploration and production would impact the company.
- **Change in government laws and regulations in the company's operating markets:** ADES operates across 9 countries and its operations are affected by government rules and regulations in these countries. Thus, the company is exposed to risk related to any changes in government laws and regulations.

Risk Factors

Rising day rates, increase in active rigs and healthy utilization rates to drive revenue CAGR of 14.1% during FY23-28E

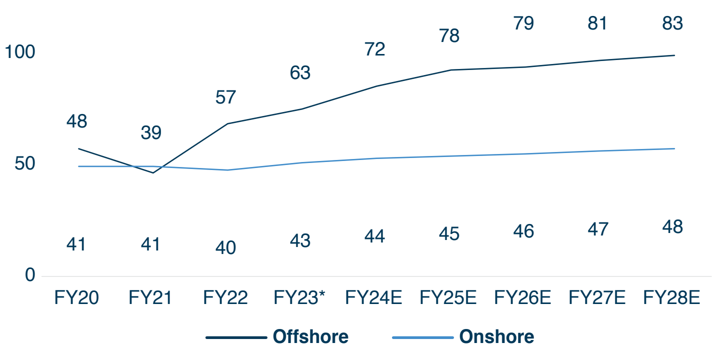
ADES revenue has expanded exponentially in the past two years from SAR 1.5bn in FY21 to SAR 4.3bn in FY23 driven by aggressive fleet expansion along with signing of mega contract with Saudi Aramco. Going forward we forecast revenue to increase at a CAGR of 14.1% during FY23-28E. In FY24, revenue growth of 37.2% is likely to be driven by ramp up and deployment of remaining rigs in existing contracts (5 rigs for Aramco contract) and new contracts singed including Indonesia, Thailand and Qatar. The negative impact from suspension of 5 rigs would limit the revenue growth. However, we anticipate the net impact of suspension to be equal to around 2-3 rigs, with 3 rigs already securing new contracts. In the long run, the expected continuous increase in day rates would drive the revenue growth. The growth in offshore day rates is expected to be higher than onshore rigs owing to the tighter market conditions. Additionally, we expect the company to continue to expand its fleet in future but at a slower rate as it already has a large fleet of 87 rigs. We anticipate the company to continue to command a healthy effective utilization rate of around 95-98% owing to its market leading position, existing long term contracts and the attractive markets it operates in.

Fig 45. Historical and forecasted revenue and Y/Y growth



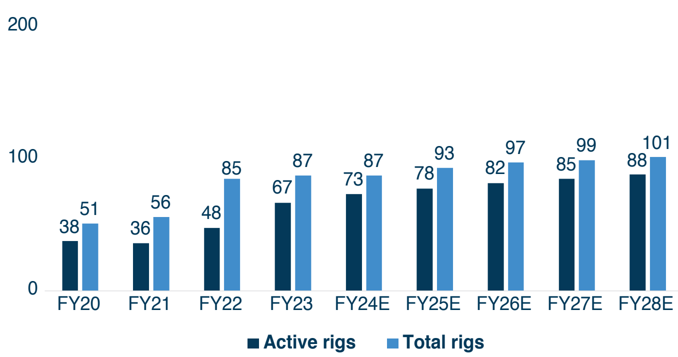
Source: Company Reports, AlJazira Capital research

Fig 46. Offshore and onshore day rates (USD '000)



Source: Company, AlJazira Capital research
*FY23 rates based on our calculations

Fig 47. Total and active rig count

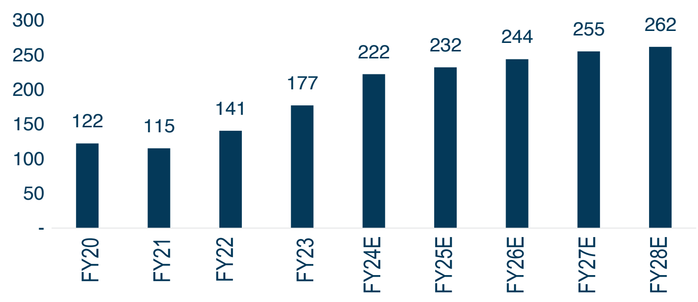


Source: Company, AlJazira Capital research

EBITDA and net margins to see consistent expansion with higher revenue per rig, OPEX optimization and lower finance cost

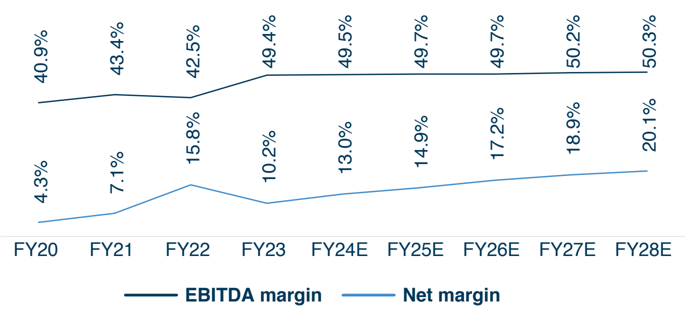
We anticipate the EBITDA margin to improve gradually, reaching 50.3% in FY28E from 49.4% in FY23 reflecting higher revenue per active rig with the new contracts being inked at higher day rates. The revenue per rig is expected to grow at CAGR of 8.2% from FY23 to FY28E mainly driven by expected increase in offshore day rates amid tighter supply. In addition to higher revenue per rig, EBITDA margin will also be supported by optimization of operating cost as the scale expands. Net margin is anticipated to widen significantly from 10.2% in FY23 to 20.1% in FY28E supported by EBITDA margin expansion and comparatively lower finance cost on account of expected interest rate cuts. Accordingly, net income is forecasted to expand at a robust CAGR of 30.6% from SAR 442mn in FY23 to SAR 1,681mn FY28E.

Fig 48. Revenue per active rig per day (SAR '000)



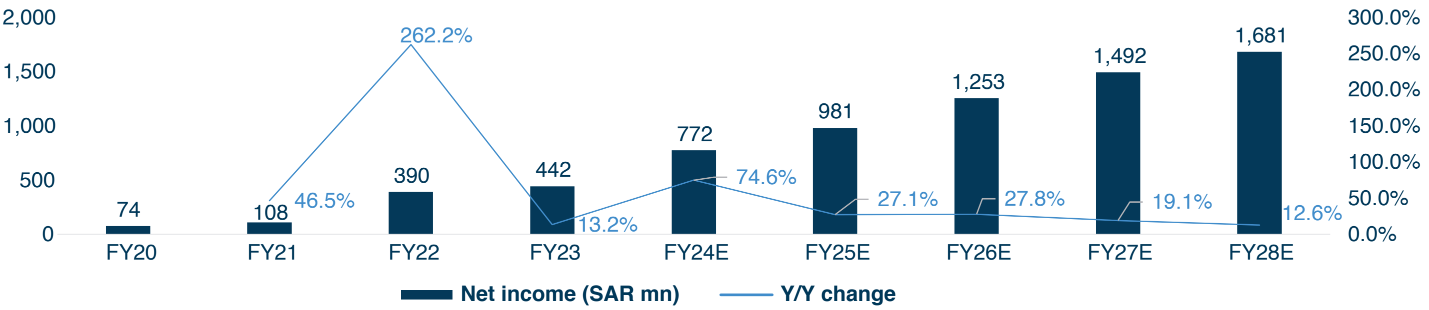
Source: Company Reports, AlJazira Capital research

Fig 49. EBITDA and net margin trend



Source: Company, AlJazira Capital research

Fig 50. Historical and forecasted net income and Y/Y growth

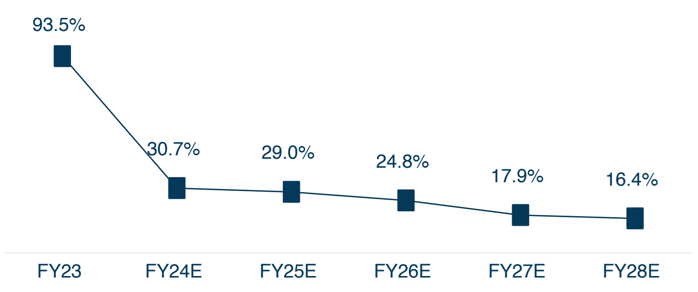


Source: Company Reports, AlJazira Capital research

May need additional debt to fund medium term Capex, leverage and capex intensity to ease in long term

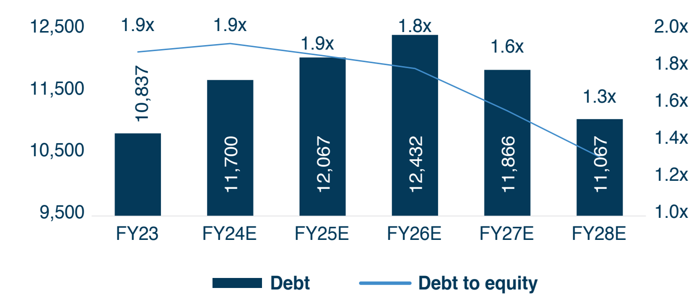
ADES added more than 30 rigs to its portfolio in the last two years leading to higher Capex. Going forward, the management expect investments of SAR 5.5bn in the next two years. Accordingly, ADES may have to raise additional debt. However, with repayment of some portion of debt with 85% IPO proceeding (SAR 3.1bn) has provided room for the company to leverage the balance sheet. We estimate the medium term CAPEX to be mostly funded by debt, as dividend as guided by the management at 60% payout will put pressure on cash flows of the company. However, with growing operating cash flows and future cash flows being secured with a healthy backlog the company is well placed to service the additional debt. In the long term, we expect CAPEX intensity to ease post FY26E. As a result, we expect leverage lever to ease to comfortable levels.

Fig 51. Capex as % of revenue



Source: Company, AlJazira Capital research

Fig 52. Gross debt (SAR mn) and debt to equity (x)



Source: Company, AlJazira Capital research

Investment Thesis and Valuation

ADES' long term prospects are supported by its 1) market leadership 2) attractive market conditions and 3) wider market presence. We believe recent negative news related to the suspension of contracts from Aramco will have a limited short term impact on the company's performance, based on current announcements. However, the company could leverage its dominant market position in the offshore segment to nullify the impact (already secured contracts for three out of 5 suspended rigs). Moreover, the company's, medium term expansion plan focusing on Southeast Asia and India (doubling rigs there) would further diversify its business and benefit from the high demand in these markets. We anticipate the company's fleet capacity to increase to 101 by FY28E from 87 in FY23, while average active rigs are estimated to reach 88 by FY28E (FY23: 67). In addition to the higher number of active rigs, ADES' topline is expected to be bolstered by an anticipated rise in day rates, particularly for offshore segment average day rates for the company are forecasted to reach USD 83,000 per day (FY23-28E CAGR of 5.7%). Thus, we forecast the top line to reach SAR 8.4bn in FY28E growing at CAGR of 14.1% during FY23-28E. ADES' EBITDA margin is estimated to improve slowly to 50.3% in FY28E from 49.4% due to higher revenue per rig driven by rising day rates and expected optimization of operating cost as the scale increases. This along with along with a likely decline in finance expenses with anticipated rate cuts would boost the company's bottom line. Net profit is forecasted to post a very strong CAGR of 30.6% during FY23-28E to reach SAR 1.7bn in FY28E from SAR 442mn in FY23.

We have performed 50% DCF and 50% EV/EBITDA based valuation based on our forecasts for the next five years. We assumed risk free rate of 3.5%, market risk premium of 6.3% and beta of 1.3 to arrive at WACC of 8.3%. Terminal growth rate is assumed at 2.5%. Our valuation of ADES based on DCF yielded an enterprise value of SAR 36.0bn and a fair value to equity shareholders of SAR 25.6bn, which translated into a value of SAR 22.7 per share. We also have valued ADES using a relative valuation method based on 10% premium to 12-month forward EV/EBITDA multiple for domestic peers (Arabian Drilling). Based on the EV/EBITDA based valuation our value is SAR 20.8 per share. Further assigning 50% weightage to DCF and 50% to EV/EBITDA based valuation methodology, we have arrived at a weighted target price of **SAR 21.70 per share**.

Fig 53. Discounted Cash Flow model

	FY24E	FY25E	FY26E	FY27E	FY28E
NOPAT	**1,490**	**1,634**	**1,822**	**2,006**	**2,144**
Depreciation & Amortization	1,106	1,259	1,367	1,478	1,557
Change in working capital	-280	-388	-312	-284	-270
Capex	-1,823	-1,911	-1,810	-1,579	-1,483
FCFF	**494**	**594**	**1,067**	**1,621**	**1,950**
Discounting factor	1.0	0.9	0.8	0.8	0.7
Present value of FCFF	**470**	**525**	**886**	**1,270**	**1,418**
Sum of present value					**4,570**
PV Terminal Value					31,431
Enterprise value					**36,001**
Equity value to common shareholders					25,596
No of outstanding shares (mn)					1,129
Fair value per share					**22.70**

Source: AlJazira Capital research

Fig 54. DCF key assumptions

		Risk premium				
		5.3%	5.8%	6.3%	6.8%	7.3%
Terminal growth rate	**1.9%**	22.8	21.0	19.3	17.9	16.5
	2.2%	24.8	22.7	20.9	19.3	17.8
	2.5%	27.1	24.7	22.7	20.8	19.2
	2.8%	29.7	27.0	24.7	22.6	20.8
	3.1%	32.8	29.7	27.0	24.7	22.6

Source: AlJazira Capital research

Above is an illustration of sensitivity of our DCF based target price to the changes in terminal growth rate (range: 1.9%-3.1%) and risk premium (range: 5.3%-7.3%). The sensitivity analysis indicates valuation in the range between a minimum of SAR 16.5 (at terminal growth rate of 1.9% and risk premium of 7.3%) and a maximum of SAR 32.8 per share (at terminal growth rate of 3.1% and risk premium of 5.3%).

Fig 55. Relative valuation using EV/EBITDA multiple

FY24E EV/EBITDA (x)	11.5
Enterprise value (SAR mn)	33,859
Debt	10,837
Cash	432
TP (SAR per share)	**20.8**

Source: AlJazira Capital research

Fig 56. Weighted valuation summary

	TP (SAR)	Weight	Weighted TP
DCF	22.7	50%	11.3
EV/EBITDA	20.8	50%	10.4
Total			**21.7**

Source: AlJazira Capital research

Fig 57. Key upside risks

- Saudi Aramco revoking suspension of rigs earlier than expected.
- Higher than expected day rates and utilization rates
- Better than expected economic growth.
- More than expected active rigs driven by higher number of contract wins

Source: AlJazira Capital research

Fig 58. Key downside risks

- Extension of suspension period by Aramco, suspension of additional rigs.
- Easing of offshore market supply leading to lower than expected day rates and utilization
- Adverse impact of geopolitical conflicts on economic growth and oil and gas production in the Middle East

Source: 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	5,942	6,594	7,284	7,897	8,383
Y/Y		**-10.7%**	**62.9%**	**75.6%**	**37.2%**	**11.0%**	**10.5%**	**8.4%**	**6.1%**
Cost of revenue	(1,059)	(975)	(1,576)	(2,621)	(3,650)	(4,074)	(4,485)	(4,834)	(5,116)
Gross profit	**637**	**539**	**891**	**1,711**	**2,292**	**2,520**	**2,800**	**3,063**	**3,267**
General & administration expense	(178)	(158)	(246)	(370)	(454)	(499)	(543)	(580)	(608)
EBITDA	**694**	**657**	**1,049**	**2,139**	**2,944**	**3,280**	**3,624**	**3,960**	**4,217**
Y/Y		**-5.3%**	**59.5%**	**104.0%**	**37.7%**	**11.4%**	**10.5%**	**9.3%**	**6.5%**
Operating profit	**366**	**(20)**	**334**	**1,285**	**1,753**	**1,922**	**2,144**	**2,360**	**2,522**
Y/Y		**NM**	**NM**	**284.3%**	**36.4%**	**9.6%**	**11.6%**	**10.1%**	**6.9%**
Financial charges	(245)	(305)	(303)	(711)	(766)	(749)	(649)	(583)	(522)
Income before zakat	**116**	**149**	**468**	**529**	**920**	**1,167**	**1,488**	**1,769**	**1,992**
Zakat	(34)	(35)	(71)	(77)	(138)	(175)	(223)	(265)	(299)
Net income	**74**	**108**	**390**	**442**	**772**	**981**	**1,253**	**1,492**	**1,681**
Y/Y		**46.5%**	**262.2%**	**13.2%**	**74.6%**	**27.1%**	**27.8%**	**19.1%**	**12.6%**
EPS (SAR)	0.1	0.1	0.3	0.4	0.7	0.9	1.1	1.3	1.5
DPS (SAR)	-	-	-	-	0.4	0.5	0.7	0.8	0.8
Balance sheet									
Assets									
Cash & equivalent	234	233	191	432	611	346	412	268	227
Other current assets	850	918	1,500	1,924	2,164	2,454	2,768	3,064	3,323
Total current assets	**1,084**	**1,151**	**1,691**	**2,356**	**2,774**	**2,801**	**3,181**	**3,332**	**3,551**
Property plant & equipment	3,795	5,358	12,066	16,150	17,010	17,813	18,387	18,455	18,385
Right of use assets	73	64	391	644	540	431	343	260	192
Total assets	**5,190**	**6,692**	**14,501**	**19,422**	**20,639**	**21,389**	**22,286**	**22,449**	**22,551**
Liabilities & owners' equity									
Trade payables	560	497	1,085	1,639	1,783	1,833	1,967	2,093	2,180
Other current liabilities	396	480	1,075	1,508	1,366	1,391	1,420	1,380	1,147
Total current liabilities	**956**	**977**	**2,161**	**3,147**	**3,149**	**3,224**	**3,387**	**3,472**	**3,327**
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	10,636	10,125
Total non-current liabilities	**2,531**	**3,792**	**10,082**	**10,498**	**11,400**	**11,663**	**11,942**	**11,380**	**10,799**
Share capital	-	-	1	1,129	1,129	1,129	1,129	1,129	1,129
Reserves	1,667	1,894	2,221	4,619	4,933	5,344	5,800	6,439	7,267
Total owners' equity	**1,667**	**1,894**	**2,222**	**5,748**	**6,063**	**6,473**	**6,929**	**7,568**	**8,396**
Non-controling interests	**35**	**30**	**36**	**29**	**29**	**29**	**29**	**29**	**29**
Total equity & liabilities	**5,190**	**6,692**	**14,501**	**19,422**	**20,639**	**21,389**	**22,286**	**22,449**	**22,551**
Cashflow statement									
Operating activities	620	317	1,146	2,283	2,401	2,641	3,001	3,320	3,552
Investing activities	(438)	(1,464)	(6,438)	(3,736)	(1,823)	(1,911)	(1,810)	(1,415)	(1,371)
Financing activities	(397)	1,145	5,250	1,886	(400)	(994)	(1,126)	(2,049)	(2,222)
Change in cash	(214)	(1)	(42)	432	178	(264)	66	(145)	(40)
Ending cash balance	**234**	**233**	**191**	**432**	**611**	**346**	**412**	**268**	**227**
Liquidity ratios									
Current ratio (x)	1.1	1.2	0.8	0.7	0.9	0.9	0.9	1.0	1.1
Quick ratio (x)	0.9	1.0	0.7	0.6	0.8	0.8	0.8	0.8	0.9
Profitability ratios									
Gross profit margin	37.5%	35.6%	36.1%	39.5%	38.6%	38.2%	38.4%	38.8%	39.0%
Operating margin	21.6%	-1.3%	13.6%	29.7%	29.5%	29.1%	29.4%	29.9%	30.1%
EBITDA margin	40.9%	43.4%	42.5%	49.4%	49.5%	49.7%	49.7%	50.2%	50.3%
Net profit margin	4.3%	7.1%	15.8%	10.2%	13.0%	14.9%	17.2%	18.9%	20.1%
Return on assets	1.4%	1.6%	2.7%	2.3%	3.7%	4.6%	5.6%	6.6%	7.5%
Return on equity	4.4%	5.7%	17.6%	7.7%	12.7%	15.2%	18.1%	19.7%	20.0%
Leverage ratio									
Net Debt / equity (x)	1.49	2.04	4.78	1.81	1.83	1.81	1.73	1.53	1.29
Market/valuation ratios									
EV/sales (x)	NM	NM	NM	4.9	5.2	4.8	4.4	4.0	3.7
EV/EBITDA (x)	NM	NM	NM	17.5	10.5	9.6	8.8	8.0	7.3
Market-Cap	NM	NM	NM	27,098	19,894	19,894	19,894	19,894	19,894
P/E ratio (x)	NM	NM	NM	61.3	25.8	20.3	15.9	13.3	11.8
P/BV ratio (x)	NM	NM	NM	4.7	3.3	3.1	2.9	2.6	2.4
DY (%)	NM	NM	NM	0.0%	2.3%	2.8%	4.0%	4.3%	4.3%

Source: Company Reports, AlJazira Capital research, *NM: not meaningful

Arabian Drilling is well poised for a robust growth due to attractive industry growth led by growing O&G demand from emerging Asian economies, intensified gas exploration at Jafurah field, and sustenance of Saudi Aramco's capex program. The gas exploration activities at Jafurah is one of the key reasons for ADC's active rig expansions from 47 in FY23 to 63 by FY28E. This rig expansions could be the backbone of its growth story and enable it to drive revenues at 7.5% CAGR over FY23-28E to reach SAR 5.0bn. Further the order backlog of SAR 11bn as on Q1-24 could be another driver for the revenue growth. However, this expansion could pressurize the margins due to higher OPEX. Further the suspension of 3 offshore rigs, is likely to add onto the margin pressure because of ADC's limited ability to deploy the idle rigs due to its lower exposure to offshore rigs and less significant presence outside KSA. But in the long run operating leverage could aid in net margin expansions, increasing from 17.4% in FY23 to 19.0% by FY28E. Stock currently trades at 8.9x 1-yr forward EV/EBITDA multiple and implying 4.1% revenue growth over FY23-28E. We initiate coverage on Arabian Drilling with an "Neutral" rating and a TP of SAR 166.4 share.

- **Drilling industry to pick-up at the back of attractive industry fundamentals:** Growing demand trends from emerging Asian economies like China and India could bode well for KSA, which is the most competitive oil and gas supplying nation globally. Initiatives undertaken by the KSA government to arrest this growing demand trends is evident from its plans to increase the E&P drilling capex by 13% every year from FY21-25E and intensifying the gas explorations at the Jafurah field. A combination of these could be the key drivers for expansion of onshore and offshore rigs in KSA. ADC could be at the forefront to leverage given its i) six decades of presence in the drilling industry, ii) long standing relationships with some of global behemoths of E&P industry, iii) strong positioning with its largest customer Saudi Aramco, and iv) customer retention through its presence across the entire E&P value chain. The confluence of these could aid ADC to drive a 7.5% revenue CAGR over FY23-28E to reach SAR 5.0bn by FY28E.
- **Contract wins at the Jafurah field to drive onshore revenues over FY23-28E:** The 10 onshore contracts won from Saudi Aramco in 2023 under its unconventional gas program at Jafurah field are expected to be operational by the end of FY25E. These contracts are expected to add incremental SAR 3.0bn (25% of current backlog) over the 5-year duration of the contracts. ADC could command higher pricing for these rigs given 60% of its current fleet is less than 10 years, which will enhance the production levels of the customers. Further additional 3 onshore rigs which ADC recently won in February 2024 are expected to be operational by Q1-25E and could be additional growth levers for the onshore drilling business. We expect the active onshore rigs to increase at a CAGR of 8.0% over FY23-28E, thereby increasing the active rigs from 35 in FY23 to 52 by FY28E. This capacity expansion should aid the onshore revenues to outpace offshore revenues by growing at 10.0% over FY23-28E (versus 3.5% for offshore) and drive the overall revenue growth.
- **Suspension of 3 offshore rigs by Saudi Aramco to be a near term headwind and pressurize the gross margins:** Saudi Aramco accounts for 68% of ADC's revenues and 85% of the overall bookings, thereby increasing the risk of customer concentration. Although ADC maintains a high REI score with Saudi Aramco, which justifies its reputation and relationships, but the high dependency on a single customer makes the topline and future earnings at risk. This is evident from the recent news wherein Aramco suspended 3 offshore rigs deployed by ADC for a period of 12 months. This followed Aramco's earlier announcement to suspend the plan of raising MSC from 12 mbpd to 13 mbpd. This suspension is likely to put pressure on the gross margins in the near term, which we believe could fall from 28.1% in FY23 to 25.8% in FY24E, as offshore rigs generally derive a higher margin. ADC is likely to face more brunt than ADES because of its lower exposure to offshore rigs and also less significant presence outside KSA, thereby limiting ADC's ability to deploy the idle offshore rigs, unlike ADES whose business is more skewed to offshore revenues. We have factored this in our model by lowering the total offshore rigs from 12 in FY23 to 9 by FY24E.

Recommendation	**Neutral**
Target Price (SAR)	**166.4**
Upside/(Downside)	**16.2%**

Source: Tadawul *prices as of 14th of May 2024

Key Financials

(in SAR mn, unless specified)	FY23	FY24E	FY25E	FY26E
Revenues	3,477	3,757	4,422	4,737
Growth %	28.59%	8.07%	17.69%	7.13%
Gross Profit	976	971	1,162	1,291
EBITDA	1,485	1,539	1,796	1,955
Net Income	605	557	731	847
Growth %	8.4%	-7.84%	31.10%	15.97%
EPS	6.8	6.3	8.2	9.5
DPS	5.1	4.0	4.2	5.3

Source: Company, AlJazira Capital

Key Ratios

	FY23	FY24E	FY25E	FY26E
Gross Margin	28.1%	25.8%	26.3%	27.3%
EBITDA Margin	42.7%	41.0%	40.6%	41.3%
Net Margin	17.4%	14.8%	16.5%	17.9%
ROE	10.5%	9.2%	11.5%	12.6%
ROA	6.0%	5.2%	6.7%	7.7%
PE	22.1	22.9	17.5	15.0
PB	2.2	2.1	2.0	1.8
EV/EBITDA	9.7	10.1	8.4	7.4
Dividend Yield	3.3%	2.8%	2.9%	3.7%

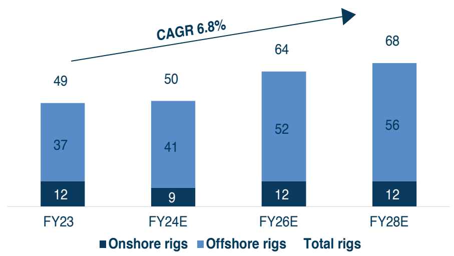
Source: Company, AlJazira Capital

Key Market Data

Current market price (SAR per share)	143.2
Market Cap (SAR bn)	12.74
Share Outstanding (mn)	89.0

Source: Company reports, Aljazira Capital

Total rig capacity



Source: Company, AlJazira Capital research

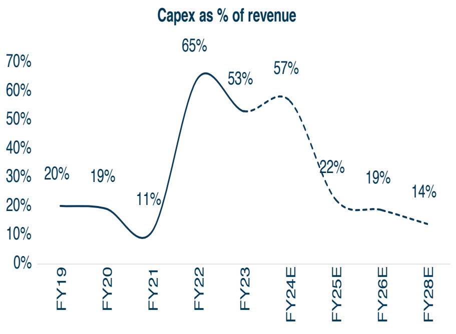
- **Capex cycle to peak out in FY24E, before normalizing to historic levels:** The capex cycle intensified from 20% of revenues in FY19 to 53% in FY23 due to increase in offshore rig capacity. The contract for 13 onshore rigs (10 and 3) is expected to peak out in FY24E, for which the company has already started incurring capex since Q3-23. We expect the capex intensity to remain elevated in FY24E at 57%, before normalizing to historical levels of 14% by FY28E.
- **Net profit margins to be pressured by rig expansions in the ST, but to stay resilient in the LT:** ADC's net profit margins expanded from 8.2% in FY19 to 17.4% in FY23 on the back of better pricing and demand pick-up in the offshore rigs. We believe these levels are sustainable and incremental expansion likely in the long run, due to i) revenue growth by multiple rigs being operational in the near term; ii) higher chances of commanding premium pricing for onshore rigs, 60% of which are less than 10 years, and iii) operating leverage at play. However, we expect the net profit margins to be impacted in the near term due to the start-up costs to be incurred for multiple rigs which are operational in the near term, but over FY23-28E we expect them to expand from 17.4% levels in FY23 to 19.0% by FY28E.
- **Strong positioning in its largest customer, Saudi Aramco, benefits in longer term contracts and revenue visibility:** Saudi Aramco's Rig Efficiency Index (REI) is a tool which dictates a drilling contractor's eligibility to participate in Saudi Aramco's tenders, as well as the scope to negotiate contract extensions and/or renewals. ADC has consistently maintained a high REI score above 90% within Saudi Aramco's internal tool which dictates a drilling contractor's eligibility to participate in the tenders, as well as the scope to negotiate contract extensions and/or renewals. This has benefited it in the form of longer-term contracts, and timely extensions and renewals. A testament of maintaining superior REI score is evident from the increase in the company's revenues from Aramco from SAR 1.2bn in FY21 to SAR 2.4bn in FY23 (0.4x growth) and a stellar 1.5x increase in order backlog over FY21-23.
- **Investment Thesis and Valuation:** The rig expansions from 47 active rigs in FY23 to 63 by FY28E could be the backbone of ADC's growth story. The expansion plan is supported by the i) growing demand for O&G from emerging Asian economies, ii) changing demand patterns to unconventional gas, and iii) government's plans to expand the E&P drilling CAPEX. These rig expansions will aid ADC to close its gap with ADES and enhance its market position. We expect the overall active rigs to expand at 5.9% CAGR over FY23-28E and the blended revenue per rig to expand from ~SAR 203,000 per day in FY23 to ~SAR 218,000 per day by FY28E. This robust growth in the rigs and the revenue per rig could aid in delivering a revenue CAGR of 7.5% over FY23-28E to reach SAR 5.0bn by FY28E. The gross margins are likely to be pressurized in the near term due to the suspension of 3 offshore rigs by Saudi Aramco and the start-up of multiple rigs. Thus, we expect the EBITDA margins to contract from 42.7% in FY23 to 42.1% by FY28E. However, we expect the net income to grow at 9.4% CAGR over the same period. We value the stock with 50% weightage to DCF (WACC=8.6%, terminal growth rate=2.50%) and 50% weight to EV/EBITDA to arrive at a TP of **SAR 166.4/share**, implying 16.2% upside.

Rig capacity expansion

Active rigs	FY23	FY24	FY25	FY26	FY27	FY28
Total	47	47	58	60	61	63
Onshore	35	38	47	49	50	52
Offshore	12	9	11	11	11	11

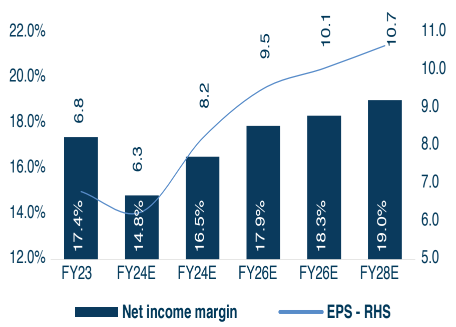
Source: Company, AlJazira Capital research

Capex intensity



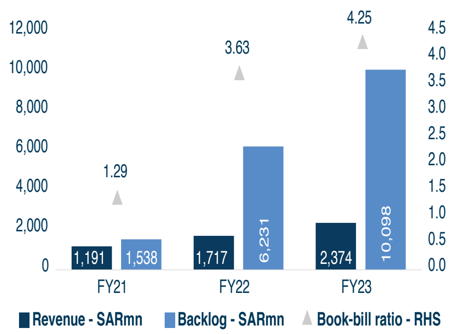
Source: Company, AlJazira Capital research

Net income margin and EPS trends



Source: Company, AlJazira Capital research

Revenues from Aramco and backlog trajectory



Source: Company, AlJazira Capital research

Company Overview

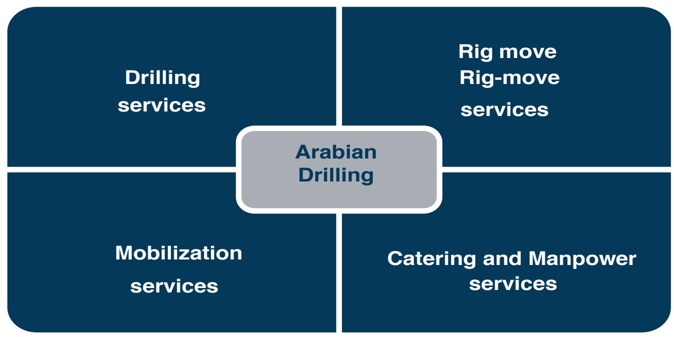
Having started operations with just 1 offshore rig, **Arabian Drilling Company (ADC)** has expanded its rig capacity at 6.9% CAGR, over its 60 years of presence in KSA's drilling industry. By reaching a fleet size of 49 rigs (onshore: 37, offshore:12), it has commanded a whooping ~19% market share. By developing its forte in the drilling industry, ADC has laid its focus on the entire exploration & production (E&P) value chain as this is where drilling of oil and gas wells and enhancing production from the existing wells is conducted. It is present across the exploration phase of oil & gas (O&G), the development phase, the production phase and the abandonment phase. By having a presence across the entire value chain, ADC has expanded its revenues to SAR 3.5bn in FY23, at a 5.4% CAGR over FY19-23.

Brief overview of business segments

ADC's core business activity lies in drilling oil and gas rigs, wherein it focuses on the land drilling (onshore) and water depth drilling (offshore). Historically its revenues were skewed towards onshore drilling, however limited availability of natural resources in the onshore space, led the company to lay its focus on offshore drilling as well. This bodes well for ADC as offshore drilling is a more premium business due to the drilling characteristics, which makes it a higher margin business.

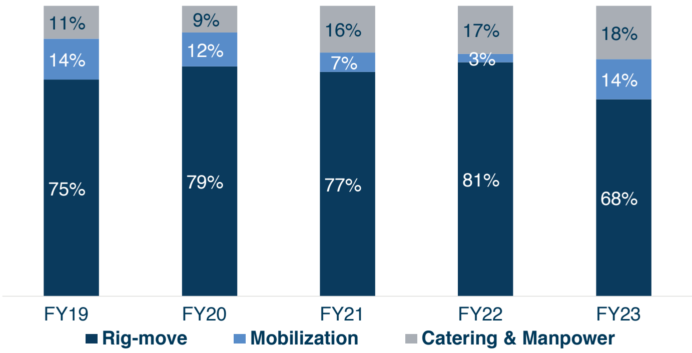
Apart from the drilling services, ADC also provides additional customized services such as i) rig-move services, ii) mobilization service, and iii) manpower sub-contracting and catering service. These services form an integral part of drilling services and hence are offered as complementary services.

Fig 59. ADC is present across the entire value chain of E&P industry



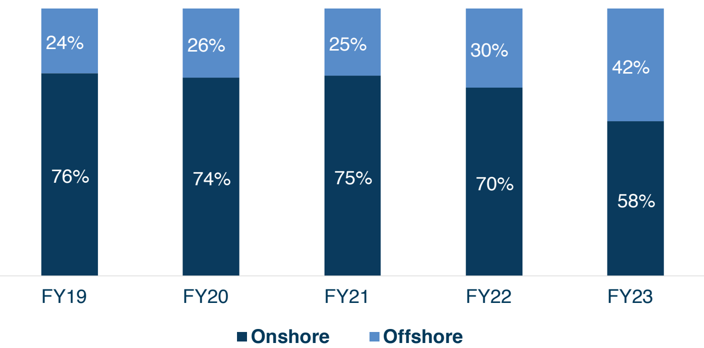
Source: Company, AlJazira Capital research

Fig 60. Focus has always been on drilling business, which has been its forte since 60 years



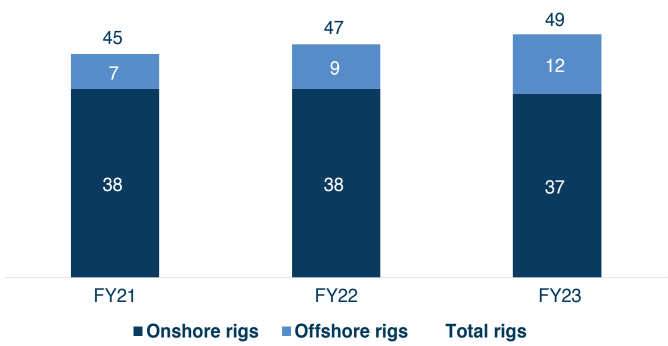
Source: Company, AlJazira Capital research

Fig 61. Revenue mix skew shifting to offshore business which is more premium than onshore



Source: Company, AlJazira Capital research

Fig 62. ADC's total 49 rigs enables a leadership-like position in the industry



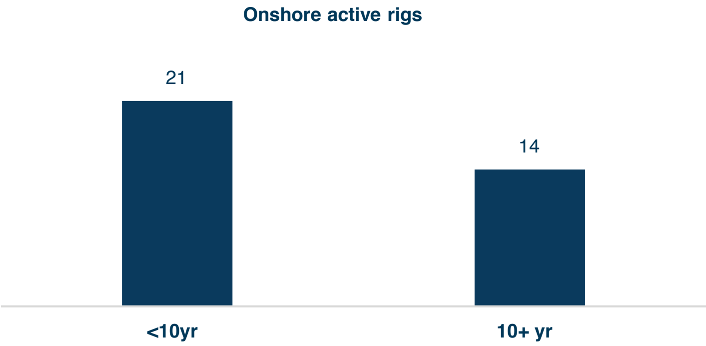
Source: Company, AlJazira Capital research

1. Onshore drilling business

Onshore drilling is a mechanical process used to extract oil or gas from the land surface. In this an oil or gas well is drilled on the land through the bedrock, by using a stationery rig. To handle the complicated drilling operations through the bedrock, ADC has equipped itself with 37 medium-to-ultra heavy rigs, which operate at a 95% utilization as on FY23. Around 60% of these rigs are less than 10 years-old which provides increased efficiency to the customers and can permit ADC to command higher ask rate from its customers.

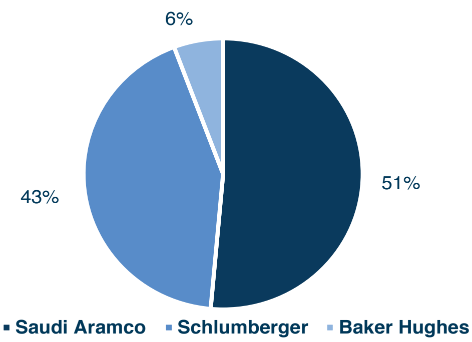
ADC generates revenues from 3 customers, which have been the cornerstone for the company. Saudi Aramco is the largest customer, which operates 18 rigs and accounts for 51% of the total active rigs as on FY23. Schlumberger Middle East is the second most important customer which operates 15 rigs and accounts for 43% of the total active rigs. ADC also supplies 2 rigs to Baker Hughes which accounts for 6% of total active rigs.

Fig 63. 60% rigs less than 10 years-old aiding in enhanced efficiency in production levels for the client



Source: Company, AlJazira Capital research

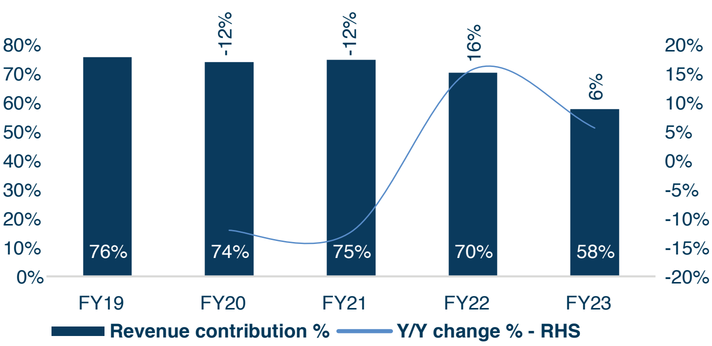
Fig 64. Dominates its business around the behemoths of the oil and gas industry



Source: Company, AlJazira Capital research

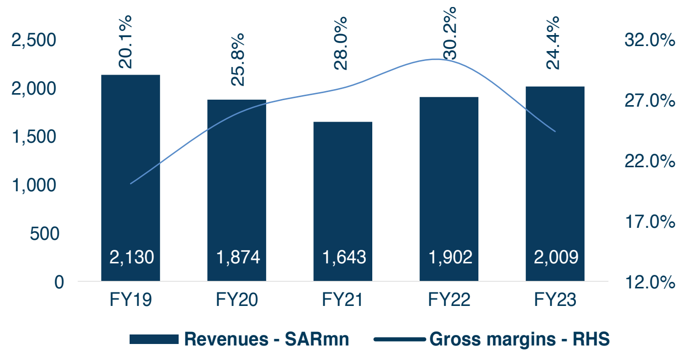
COVID-19 and the aftermath adversely affected ADC's onshore drilling revenues as there was a global slowdown in the oil and gas demand. This made two of its core customers suspend the drilling activities and seek steep discounts in the day rates, thereby adversely impacting the onshore revenues. Over FY19-23 the onshore revenues declined at 1.5% CAGR to reach SAR 2.0bn revenues in FY23. This global demand crisis declined the revenue contribution of onshore segment from 76% in FY19 to 58% in FY23. However, the suspension of business enabled the company to incur less operational cost which enabled ADC to expand the gross margins of onshore business by 430bps to 24.4% over FY19-23. However, the gross margins fell from 30.2% in FY22 to 24.4% in FY23 due to the start-up cost of the 10 unconventional rigs and higher employee related costs.

Fig 65. Onshore revenues were impacted due to suspension of drilling activities on COVID led global demand slowdown



Source: Company, AlJazira Capital research

Fig 66. Suspension of onshore activities led to lower operational costs, thereby aiding the gross margins



Source: Company, AlJazira Capital research

2. Offshore drilling business

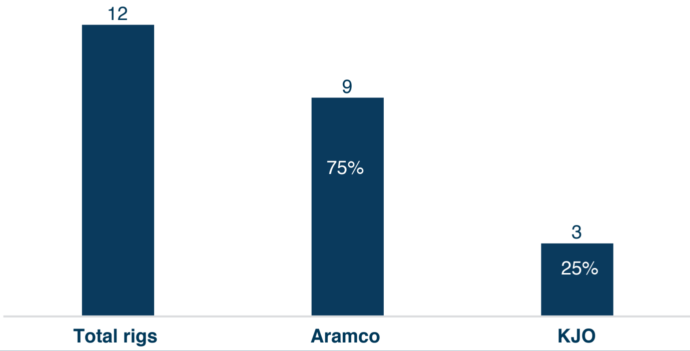
Offshore drilling is a more complex, costly activity and the rigs are to be operated in complex geological and climatic conditions, thereby necessitating the use of high specification equipments like jack-up rigs. These technical specifications and complexity in drilling makes offshore drilling more premium service than onshore drilling.

By starting off with just 1 offshore rig in 1964, ADC expanded its fleet to 12 rigs. Heavy demand due to depletion of avenues to extract oil and gas from the land surface, enabled the company to maintain its utilization levels at 100% as on FY23. ADC equipped itself with heavy-duty jack-up rigs with high specification equipment. With these rigs it is capable of drilling in water-depth of 375 feet. ADC relies heavily on Saudi Aramco, which operates 9 rigs and accounts for 75% of the total fleet. Al-Khafji Joint Operations (KJO) is another key customer for ADC, which operates 3 rigs and accounts for 25% of the total fleet.

Fig 67. Self-elevating jack-up rigs form a part of 12 rigs fleet

Source: Company, AlJazira Capital research

Fig 68. Major dependency on Saudi Aramco, followed by KJO

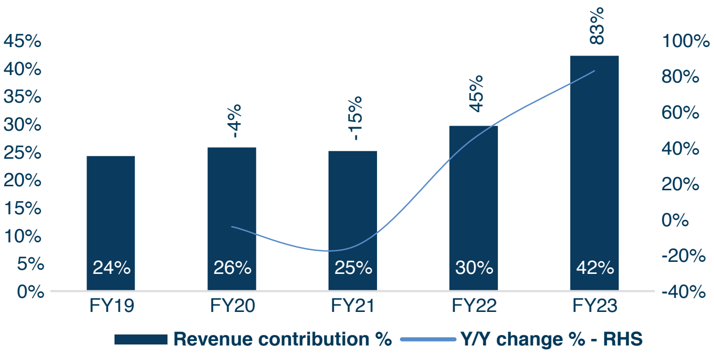


Source: Company, AlJazira Capital research

Offshore drilling revenues remained impacted over FY20 and FY21 due to COVID-19 led global slowdown in the oil and gas demand. The customers resorted to suspending the drilling activities and seek discount on day rates for the existing rigs in operations. Over FY19-21 the offshore drilling revenues declined from SAR 681mn to SAR 553mn. However, as the global demand picked post FY22, ADC witnessed a host of offshore contracts thereby aiding its revenues to inch up to SAR 1.5bn in FY23.

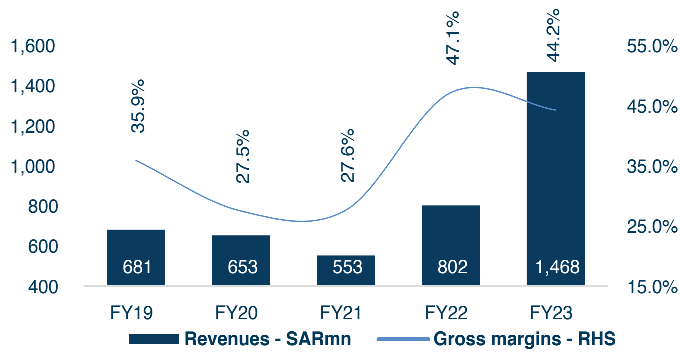
Unlike onshore drilling's gross margins which benefitted from the suspension activities, the offshore drilling's gross margins were adversely impacted due to high maintenance cost for offshore rigs. Over FY19-21 the gross margins contracted by 830bps to 27.6%. However, the demand pick-up boosted the day rates thereby aiding recoup of margins to 44.2% levels by FY23.

Fig 69. Pick-up in global demand aided offshore drilling revenues to expand at 21.2% CAGR over FY19-23



Source: Company, AlJazira Capital research

Fig 70. Improved ask rates in offshore operations enabled ADC to offset margin contraction over FY19-21



Source: Company, AlJazira Capital research

Modus operandi

Operational Presence:

ADC follows a strategic but concentrated approach in terms of its operational presence. Although it provides drilling services from 5 locations within the kingdom, its main focus area lies in the oil and gas rich eastern province and the neutral zone. As on FY21 ADC had 42 rigs (93%) operating in the eastern province and Khafji.

Fig 71. ADC's operational presence is concentrated in the eastern province of Saudi Arabia

City	Province	Nature of business	Branches
Al-Khobar	Eastern	Head office and two compounds	1
Dhahran	Eastern	Operational base and training centres	1
Riyadh Road	Central	Yard	1
Khafji	Eastern	Operational base and compound	1
Abqiq	Eastern	Operational base and yard	1

Source: Company, AlJazira Capital research

Fig 72. Majority rigs installed in the Eastern province to benefit from abundance of natural resource

Source: Company, AlJazira Capital research

Contracting and Pricing:

Participation in the tender process is the most prevalent method of sourcing contracts, which are awarded on multi-year basis (typically 3-5 years) with an extension clause of 1-2 years. ADC's primarily secures long-term contracts as it ensures i) locking up of rigs at maintains the capacity utilization, ii) security of cash flows, and iii) provides revenue visibility. In terms of pricing, ADC has adopted a flexible pricing strategy which can be adjusted depending on the customers' demands and the macro environment. ADC provides drilling and ancillary services on a day rate contract basis, under which it provides the rig along with the crew for operating it and receives fixed remuneration per day of drilling. These day rates are influenced by factors such as i) Market supply and demand outlook, ii) Operating performance of the service provider / rig, iii) Track record of safety, iv) Operating uptime and v) Prior experience with customer.

Business Analysis

Attractive industry fundamentals with growing market

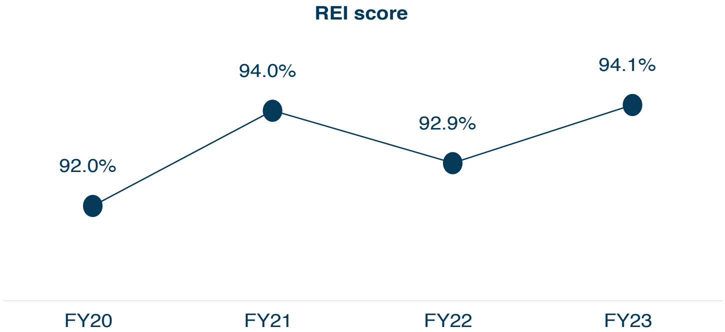
KSA's status of being one of the lowest cost producers for hydrocarbons, enables it to be the leading oil-producing country. In contrast to other geographies where the cost of production is high, KSA's drilling intensive legacy fields have supported its production levels and utilization rates. This insulates KSA from being sensitive to swings in oil prices, as witnessed by other countries.

The total hydrocarbon production in KSA stands at 12.0mn barrels of oil equivalent per day in FY21, and which is expected to expand to 13.3mn by FY25E, implying a 3.0% CAGR. This growth will be driven by i) KSA's plans to increase the E&P drilling capex by 13% per year from FY21 to FY25E, and ii) rising demand orders for gas, which KSA is trying to capture by intensifying its gas explorations at its Jafurah field. A combination of these factors could be the key growth drivers for onshore and offshore rigs in the region.

Strong positioning in Aramco enables longer term contracts and revenue visibility

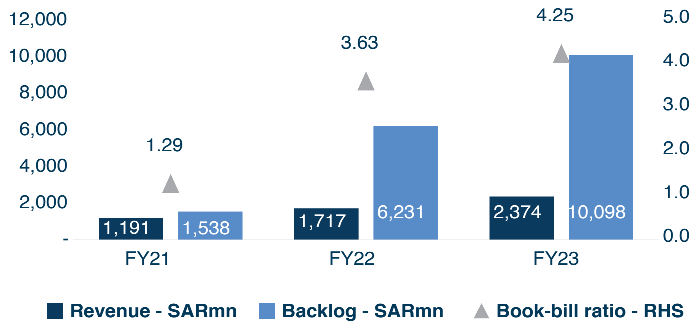
Saudi Aramco's Rig Efficiency Index (REI) is a tool which dictates a drilling contractor's eligibility to participate in Saudi Aramco's tenders, as well as the scope to negotiate contract extensions and/or renewals. ADC has consistently maintained a high REI score above 90% and thus been able to benefit from longer term contract extensions and renewals with KSA's market leader. Its superior operational performance has continuously supported its ability to consistently renew existing contracts, generally at a premium day rate compared to its peers. A testament of maintaining superior REI score is evident from the increase in revenues from Aramco from SAR 1.2bn in FY21 to SAR 2.4bn in FY23 (0.4x growth) and a stellar 1.5x increase in order backlog over FY21-23. This backlog forms a meaningful contributor to the company's total order backlog of SAR 11.0bn as on Q1-24, which is likely to be one of the key revenue drivers.

Fig 73. ADC has been consistent in maintaining higher REI score and benefitting from longer term contracts



Source: Company, AlJazira Capital research

Fig 74. Strong positioning with Aramco is evident from the book-bill ratio which increased from 1.29x to 4.25x

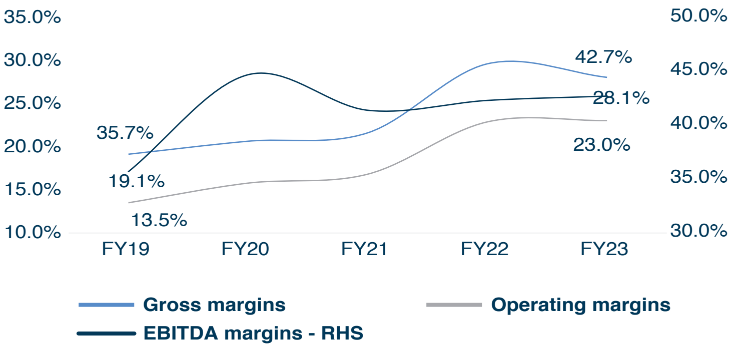


Source: Company, AlJazira Capital research

Solid financial profile with strong track record of resilient profitability margins

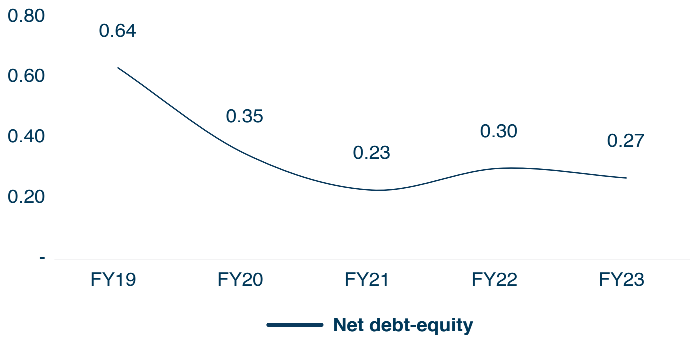
Lean cost structure has enabled ADC to recover quickly from shocks of COVID pandemic. Its in-house maintenance and technical team (unlike ADES who relies on third party providers), provides it the leeway to maintain a lean cost structure. Over the years ADC has introduced various initiatives to optimize its cost structure such as i) adjusting employee incentive schemes; ii) re-negotiating contracts with existing vendors; iii) finding alternate sourcing of spare parts at competitive prices; and iv) improving utilization of internal assets. ADC's focus on cost optimization has supported steady profitability, which is evident from its operating margins which expanded by 950bps over FY19-23 to reach 23.0% levels. Further ADC acquires new rigs only after securing contracts and ensuring the outperformance to thresholds of internal rate of return (IRR). This disciplined approach in capex helps it to maintain a strong balance sheet with healthy leverage levels.

Fig 75. Lean cost structure aided in margin expansion over FY19-23, despite COVID led global demand slowdown



Source: Company, AlJazira Capital research

Fig 76. Acquiring rigs only after securing contracts and attractive IRR enables to keep a check on leverage



Source: Company, AlJazira Capital research

Limited exposure to offshore rigs and less significant presence outside KSA could limit ADC's ability to deploy the 3 idle rigs, suspend by Aramco, thereby posing a risk of uncertainty in the near-term

Saudi Aramco recently announced to scrap its plans to expand MSC to 13.0 mbpd from 12.0 mbpd. This was followed by Aramco suspending contracts for selected rigs with several drillers including ADC. A total of 3 offshore rigs from ADC's fleet were suspended for a period of up to 12 months. Of the 3 rigs, 2 rigs are leased and one is owned by ADC. Given the current situation with Aramco and lower exposure to offshore business as a whole with lack of significant presence outside KSA, it would limit ADC's ability to deploy the idle offshore rigs, unlike ADES which has already been able to deploy 3 rigs of its 5 suspended rigs. Hence, it is possible that ADC might not renew the 2 leased rigs after the contract expiration. We expect this suspension to pressurize the gross margins in the near term and believe it would drop from 28.1% in FY23 to 25.8% in FY24E. Due to limited ability to deploy the idle rigs, we have accordingly lowered our total offshore rigs from 12 in FY23 to 9 by FY24E.

Risk Factors

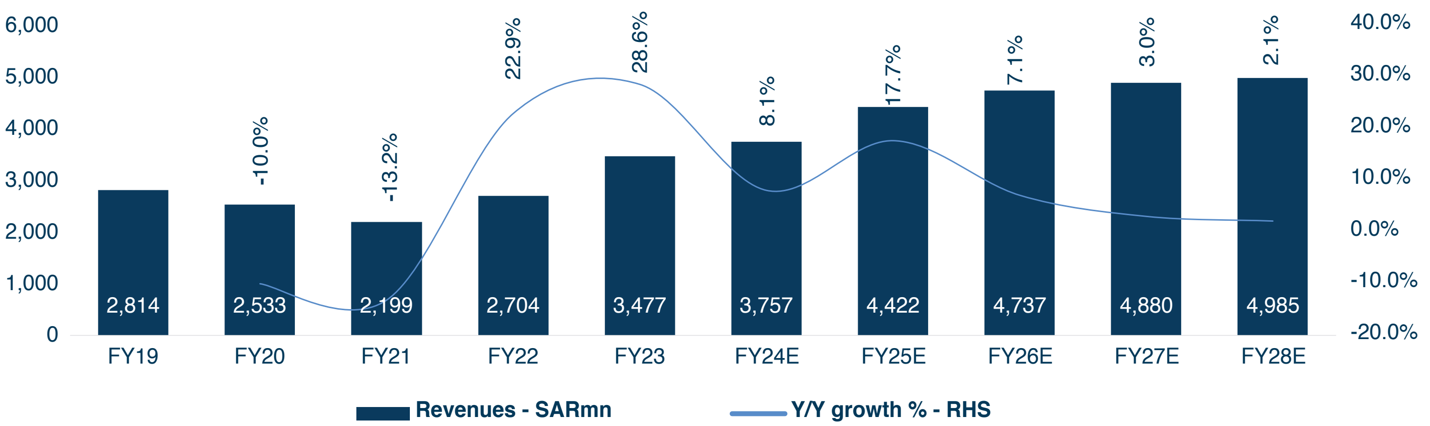
- **Aramco's suspension of 3 offshore rigs:** Saudi Aramco's recent announcement of suspending 3 offshore rigs deployed by ADC for a period of 12 months is likely to pressurize gross margins in the near term. Limited exposure to offshore rigs and less significant presence outside KSA could limit its ability to deploy the idle offshore rigs.
- **Global economic slowdown or recession is an inevitable risk:** The geopolitical tensions in the Middle East, Red Sea attack and Russia-Ukraine war has severely impacted the global supply chains. This coupled with fiscal policies to tackle the economic impact from COVID-19 has created inflationary pressures. Central banks of the work have resorted to it with continuous rise in the benchmark interest rates, thereby driving the concerns of recession. Such macroeconomic environment could result in decline in the crude oil demand and destabilize the oil prices. Any uncertainty could impact the company's day rates, thereby impacting the revenue's growth trajectory.
- **Customer concentration is a key risk:** ADC's revenues are concentrated around Saudi Aramco, which accounts for 68% of overall revenues and 85% of overall backlogs. Although the high REI score justifies ADC's reputation and relationships with Aramco, the high dependency on single customer makes the topline and future earnings at risk.
- **Adoption of alternative energy around globe:** Economies around the globe are attempting to adopt alternative energy sources and reduce their dependency on oil and gas resources. Although the shift is expected to remain slow, any faster-than-expected change in pace in the current energy mix would be a major hindrance for ADC's services.

Financial Analysis

Attractive industry fundamentals to drive drilling revenues in the near to medium term

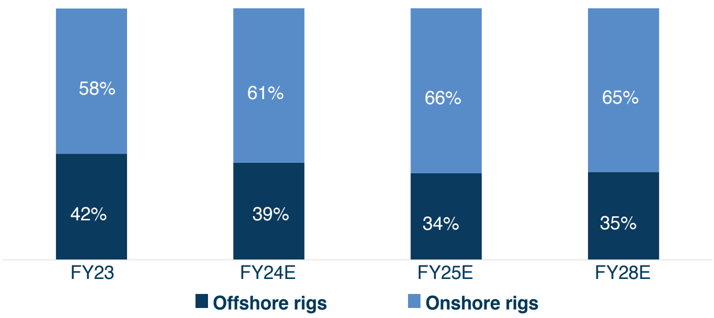
O&G industry is poised to benefit from increasing demand from emerging Asian economies and intensified gas exploration at Jafurah field. ADC is likely to be one of the key beneficiaries of KSA's E&P growth trajectory, given i) technical know-how and capabilities gained over its 6 decades of presence, ii) Marquee customers with long standing relationships, iii) Strong positioning with largest global O&G company, Saudi Aramco, and iv) customer retention through presence across the entire EP& value chain. Accordingly, over FY23-28E, we forecast a 10.0% and 3.5% revenue CAGR for onshore and offshore business, respectively. It will be driven by i) rising demand trends from emerging Asian economies, ii) book-bill of 12.2x and 12.0x for onshore and offshore respectively, iii) increased investments for E&P drilling capex by the government, and iv) onshore rigs benefitting from rising demand orders from unconventional gas programs. Overall, we expect ADC's revenues to grow at 7.5%.

Fig 77. Historical revenue growth driven by offshore rigs, however going forward onshore rigs to drive the overall revenue growth due to unconventional gas contracts



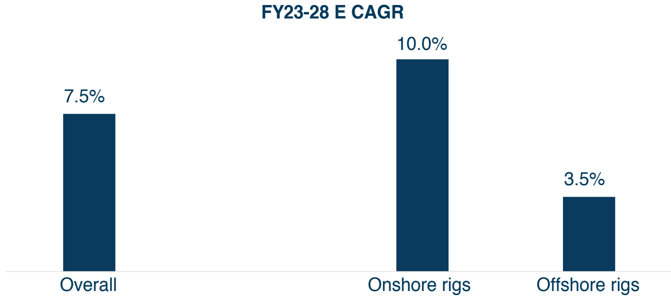
Source: Company, AlJazira Capital research

Fig 78. Demand trends shifting to gas based drilling to skew the business mix to onshore drilling yet again



Source: Company, AlJazira Capital research

Fig 79. Increase in unconventional gas contracts to drive onshore rigs demand and aid in higher growth

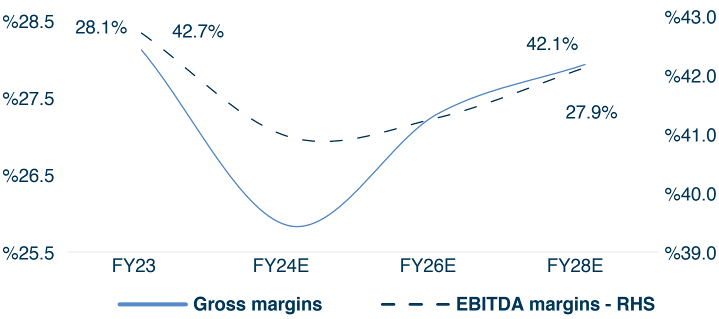


Source: Company, AlJazira Capital research

Suspension of offshore rigs and start-up of multiple rigs to keep OPEX elevated and contract margins

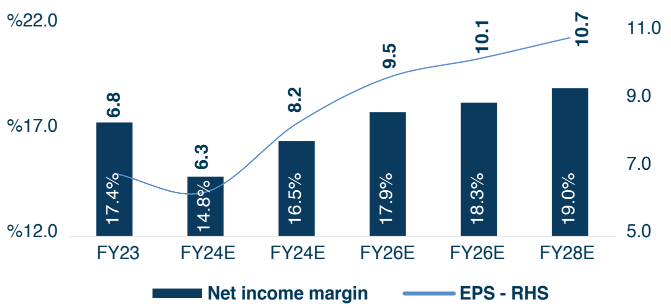
ADC's EBITDA margins expanded from 35.7% in FY19 to 42.7% in due to better pricing and demand pick-up in offshore rigs. However, going forward we believe that the margins would be pressured, despite 13 onshore rigs being operational by the end of FY25E. The suspension of 3 offshore rigs is likely to be the key factor for margin contraction in the near term, as generally offshore rigs possess the ability to generate 2x greater margins than onshore rigs. Furthermore, the start-up costs for the planned rig expansions is likely to keep the OPEX elevated. Accordingly, we forecast EBITDA margins to contract from 42.7% in FY23 to 42.1% in FY28E. However, we expect the net income margin to grow from 17.4% in FY23 to 19.0% in FY28E, as the debt levels are reduced and interest rate cuts are witnessed.

Fig 80. Start-up costs for multiple rigs to pressurize Gross and EBITDA margins in near term



Source: Company, AlJazira Capital research

Fig 81. Operating leverage, debt repayment and lower financing cost to drive net margin expansion

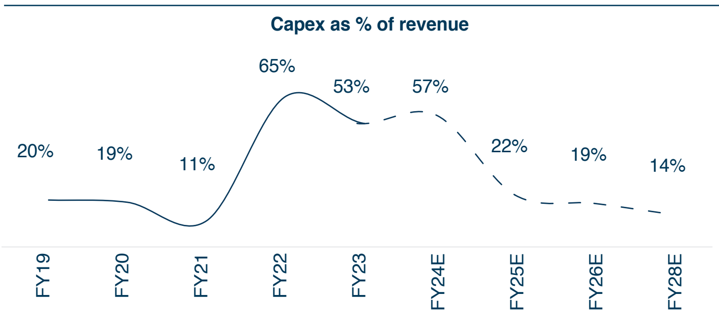


Source: Company, AlJazira Capital research

Capex to peak out in near term, but to normalize to historic levels over the longer term

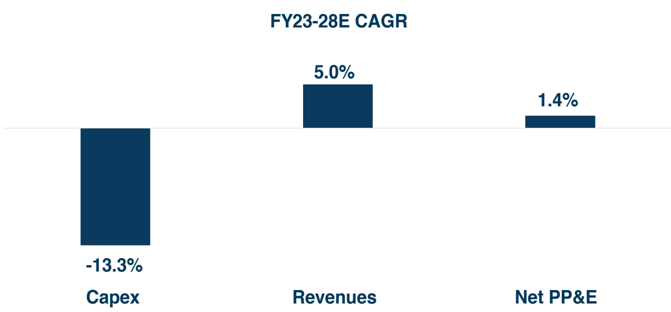
Over FY19-23 the capex intensity increased from 20% to 53%, driven by commencement of multiple offshore rigs, whose average capex per rig is 5x that of onshore rigs. The 13 onshore rigs contracts won in 2023 from Aramco for its unconventional gas program is likely to keep the capex intensity elevated in near term. ADC started the capex cycle for these rigs in Q3-23. Since these rigs are expected to be operational by the end of FY24E, we believe the capex to peak by then. Further the 3 additional onshore rig contracts won from Aramco to also drive the capex partially. We expect capex intensity to increase from 53% in FY23 to 57% in FY24E, before normalizing to 14% by FY28E.

Fig 82. Rig expansion to drive capex intensity



Source: Company, AlJazira Capital research

Fig 83. Capex cycle to boost revenue and PP&E growth



Source: Company, AlJazira Capital research

Investment Thesis and Valuation

The rig expansions from 47 active rigs in FY23 to 63 active rigs by FY28E could be the backbone of ADC's growth story. The expansion plan is supported by the i) growing demand from emerging Asian economies, ii) changing demand patterns to unconventional gas, and iii) government's plans to expand the E&P drilling capex. These rig expansions will aid ADC to close its gap with ADES and enhance its market position. We expect the overall active rigs to expand at 5.9% CAGR over FY23-28E and the blended revenue per rig to expand from ~SAR 203,000 per day in FY23 to ~SAR 218,000 per day by FY28E. This robust growth in the rigs and the revenue per rig could aid in delivering a revenue CAGR of 7.5% over FY23-28E to reach SAR 5.0bn by FY28E. The gross margins are likely to be pressurized in the near term due to the suspension of 3 offshore rigs by Saudi Aramco and the start-up of multiple rigs. Hence, accordingly we expect the EBITDA margins to contract from 42.7% in FY23 to 42.1% by FY28E. However, we expect the net income to grow at 9.4% over the same period, as the debt levels are reduced and interest rate cuts are witnessed.

We have performed 50% DCF and 50% EV/EBITDA based valuation based on our forecasts for the next seven years. We assumed risk free rate of 3.5%, market risk premium of 6.3% and beta of 1.0 to arrive at WACC of 8.6%. Terminal growth rate is assumed at 2.5%. Our valuation of ADC based on DCF yielded an enterprise value of SAR 16.70bn and fair value to equity shareholders of SAR 15.08bn, which translated into a value of SAR 169.5 per share. We also have valued ADC using a relative valuation method based on 12-month forward EV/EBITDA multiple for domestic peers (ADES). Based on the EV/EBITDA based valuation our value is SAR 163.3 per share. Further assigning 50% weightage to DCF and 50% to EV/EBITDA based valuation methodology, we have arrived at a weighted target price of **SAR 166.4 per share**.

Fig 84. Discounted Cash Flow model

	FY23	FY24E	FY25E	FY26E	FY27E	FY28E
NOPAT	**704.2**	**672.7**	**834.4**	**944.4**	**968.3**	**997.2**
Depreciation & Amortization	684.1	771.6	844.8	878.3	912.8	927.7
Change in working capital	(235.3)	2.9	(143.3)	(23.2)	(8.9)	(15.5)
Capex	(1,846.7)	(2,132.5)	(988.0)	(888.0)	(681.2)	(578.0)
FCFF	**(693.8)**	**(685.3)**	**547.9**	**911.6**	**1,190.9**	**1,331.5**
Discounting factor	1.0	0.9	0.9	0.8	0.7	0.7
Present value of FCFF	**(693.8)**	**(650.4)**	**479.3**	**733.6**	**878.9**	**897.1**
Sum of present value						**2,338.6**
Terminal Value						21,320.4
Enterprise value						**16,703.9**
Equity value to shareholders						15,085.2
No of outstanding shares (mn)						89.0
Fair value per share						**169.5**

Source: AlJazira Capital research

Fig 85. DCF key assumptions

Terminal growth rate		Risk premium				
		5.30%	5.80%	6.30%	6.80%	7.30%
	2.00%	185.1	170.1	157.1	145.5	135.3
	2.25%	193.1	177.0	163.1	150.8	139.9
	2.50%	201.9	184.5	169.5	156.4	144.8
	2.75%	211.5	192.7	176.5	162.4	150.0
	3.00%	222.0	201.5	184.0	168.9	155.7

Source: AlJazira Capital research

Above is an illustration of sensitivity of our DCF based target price to the changes in terminal growth rate (range: 2.00%-3.00%) and risk premium (range: 5.2%-7.2%). The sensitivity analysis indicates valuation in the range between a minimum of SAR 135.3 (at terminal growth rate of 2.00% and risk premium of 7.20%) and a maximum of SAR 222.0 per share (at terminal growth rate of 3.00% and risk premium of 5.20%).

Fig 86. Relative valuation using EV/EBITDA multiple

EV/EBITDA ratio (x)	10.5
Cash (SAR mn)	1,435
Debt (SAR mn)	3,054
Enterprise value (SAR mn)	14,538
TP	**163.3**

Source: AlJazira Capital research

Fig 87. Weighted valuation summary

	TP (SAR)	Weight	Weighted TP
DCF	169.5	50%	84.7
EV/EBITDA	163.3	50%	81.6
Total			**166.4**

Source: AlJazira Capital research

Fig 88. Key upside risks

- Currently we have assumed only 4 out of 10 onshore rigs from Saudi Aramco to be operational by FY24E. Higher than expected rigs turn operational can drive valuations upwards.
- Our assumption of moderating offshore rigs to 9 in FY24 (vs 12 in FY23) is because Aramco suspended 3 offshore rigs. If ADC can deploy the idle rigs, the valuations could be benefitted.
- Better than expected economic growth.
- Higher than expected utilization or revenue per rig.

Source: AlJazira Capital research

Fig 89. Key downside risks

- Failure to deploy idle offshore rigs could be a key driver for valuation downgrades.
- Inefficiency in getting the 13 onshore rigs operational by the end of FY25E.
- Increasing intensity of geopolitical tensions in Middle East affecting overall economic growth.
- Lower than expected utilization or revenue per rig.

Source: AlJazira Capital research

Key Financial Data

Amount in SAR mn, unless otherwise specified	FY21	FY22	FY23	FY24E	FY25E	FY26E	FY27E	FY28E
Income statement								
Revenues	2,199	2,704	3,477	3,757	4,422	4,737	4,880	4,985
Y/Y	**-13.17%**	**22.95%**	**28.59%**	**8.07%**	**17.69%**	**7.13%**	**3.03%**	**2.13%**
Cost of revenue	(1,723)	(1,902)	(2,501)	(2,786)	(3,259)	(3,446)	(3,545)	(3,594)
Gross profit	**476**	**801**	**976**	**971**	**1,162**	**1,291**	**1,336**	**1,390**
General & administration expense	(105)	(180)	(181)	(211)	(220)	(223)	(225)	(228)
Operating profit	**370**	**619**	**801**	**767**	**951**	**1,077**	**1,120**	**1,172**
Y/Y	**-7.45%**	**67.28%**	**29.42%**	**-4.26%**	**24.03%**	**13.19%**	**4.03%**	**4.64%**
Financial charges	(38)	(94)	(161)	(170)	(154)	(135)	(97)	(67)
EBITDA	**910**	**1,144**	**1,485**	**1,539**	**1,796**	**1,955**	**2,033**	**2,100**
Y/Y	**-19.58%**	**25.66%**	**29.81%**	**3.62%**	**16.74%**	**8.85%**	**3.98%**	**3.29%**
Income before zakat	**333**	**552**	**688**	**635**	**833**	**966**	**1,036**	**1,115**
Zakat	(53)	5	(83)	(78)	(102)	(119)	(140)	(166)
Net income	**280**	**558**	**605**	**557**	**731**	**847**	**895**	**948**
Y/Y	**-4.69%**	**98.98%**	**8.41%**	**-7.84%**	**31.10%**	**15.97%**	**5.66%**	**5.95%**
EPS (SAR)	3.1	6.3	6.8	6.3	8.2	9.5	10.1	10.7
DPS (SAR)	0.0	0.2	5.1	4.0	4.2	5.3	5.7	6.8
Balance sheet								
Assets								
Cash & equivalent	412	832	1,435	169	563	543	646	763
Other current assets	864	2,017	1,365	1,265	1,554	1,601	1,633	1,664
Total current assets	**1,275**	**2,849**	**2,801**	**1,434**	**2,118**	**2,144**	**2,278**	**2,427**
Property plant & equipment	5,259	6,491	7,738	9,107	8,830	8,703	8,480	8,191
Right of use assets	2	199	132	124	115	107	99	91
Total assets	**6,544**	**9,554**	**10,686**	**10,681**	**11,079**	**10,970**	**10,873**	**10,725**
Liabilities & owners' equity								
Trade payables	457	585	729	632	778	802	824	841
Other current liabilities	576	225	362	358	354	350	346	342
Total current liabilities	**1,033**	**809**	**1,091**	**990**	**1,132**	**1,151**	**1,170**	**1,182**
Lease liabilities – non-current	-	136	68	64	60	56	51	47
Long term loans	836	2,481	2,886	2,786	2,686	2,186	1,686	1,186
Total non-current liabilities	**1,320**	**3,155**	**3,634**	**3,529**	**3,425**	**2,921**	**2,417**	**1,913**
Share capital	23	890	890	890	890	890	890	890
Reserves	4,169	4,700	5,071	5,271	5,632	6,008	6,396	6,740
Total owners' equity	**4,192**	**5,590**	**5,961**	**6,161**	**6,522**	**6,898**	**7,286**	**7,630**
Total equity & liabilities	**6,544**	**9,554**	**10,686**	**10,681**	**11,079**	**10,970**	**10,873**	**10,725**
Cashflow statement								
Operating activities	676	1,242	1,360	1,463	1,550	1,813	1,884	1,918
Investing activities	(227)	(2,724)	(789)	(2,094)	(953)	(864)	(669)	(568)
Financing activities	(677)	1,903	33	(635)	(632)	(1,114)	(1,112)	(1,180)
Change in cash	(228)	420	603	(1,266)	(34)	(165)	103	170
Ending cash balance	**412**	**832**	**1,435**	**169**	**563**	**543**	**646**	**763**
Liquidity ratios								
Current ratio (x)	1.2	3.5	2.6	1.4	1.9	1.9	1.9	2.1
Quick ratio (x)	0.8	2.5	1.3	1.3	1.4	1.4	1.4	1.4
Profitability ratios								
Gross profit margin	21.6%	29.6%	28.1%	25.8%	26.3%	27.3%	27.4%	27.9%
Operating margin	16.8%	22.9%	23.0%	20.4%	21.5%	22.7%	23.0%	23.5%
EBITDA margin	41.4%	42.3%	42.7%	41.0%	40.6%	41.3%	41.7%	42.1%
Net profit margin	12.7%	20.6%	17.4%	14.8%	16.5%	17.9%	18.3%	19.0%
Return on assets	4.2%	6.9%	6.0%	5.2%	6.7%	7.7%	8.2%	8.8%
Return on equity	6.9%	11.4%	10.5%	9.2%	11.5%	12.6%	12.6%	12.7%
Leverage ratio								
Net Debt / equity (x)	0.23	0.30	0.27	0.45	0.35	0.26	0.17	0.08
Market/valuation ratios								
EV/sales (x)	6.2	5.3	4.1	4.1	3.4	3.1	2.9	2.7
EV/EBITDA (x)	15.1	12.6	9.7	10.1	8.4	7.4	6.9	6.4
Market-Cap	12,745	12,745	12,745	12,748	12,748	12,748	12,748	12,748
P/E ratio (x)	45.5	22.9	21.1	22.9	17.5	15.0	14.2	13.4
P/BV ratio (x)	3.0	2.3	2.1	2.1	2.0	1.8	1.7	1.7
DY (%)	0.0%	0.2%	3.5%	2.8%	2.9%	3.7%	4.0%	4.7%

Source: Company, AlJazira Capital research

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RESEARCH DIVISION

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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.

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