

ADNOC Logistics & Services Plc

Healthy charter rates and strategic acquisition boosted the bottom-line

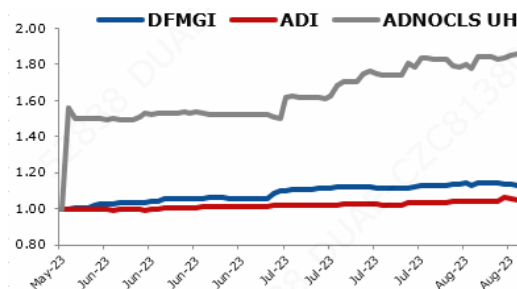
Current Price
AED 3.74

Target Price
AED 4.00

Upside/Downside (%)
+7.0%

Rating
HOLD

- ADNOC L&S secured a USD 975 Mn contract from ADNOC Offshore for the construction of an artificial island. ADNOC will offer Engineering, Procurement, and Construction (EPC) services
- ADNOC L&S added to its fleet two very large crude carriers (VLCC) which feature dual-engine that also that can also run on liquified natural gas (LNG), which is cost-efficient fuel for the company.
- The Company affirmed its commitment to declare its first dividend in 4Q23 for 1H23 of USD 65 Mn and USD 130 Mn for 2H23 in 2Q24
- ADNOCLS recorded robust growth in material handling volume, which rose 15% YOY in 1H23, mainly attributed to ILSP contract benefitting top-line of the Company



Stock Information

Market Cap (AED, mm)	27,744.37
Share Outstanding (mm)	7,398.5
52 Week High	3.77
52 Week Low	2.90
3M Avg. daily value (AED)	N/A

2Q23 Result Review (USD, mm)

Total Assets	4,959
Total Liabilities	801
Total Equity	4,158
EBITDA	219
Net Profit	162

Financial Ratios

Dividend Yield (12m)	N/A
Dividend Pay-out (%)	0.00
Price-Earnings Ratio(x)	N/A
Price-to-Book Ratio (x)	1.82
Book Value (AED)	2.064
AnnReturn-on-Equity(%)	15.67

Stock Performance

5 Days	4.47%
1 Months	15.74%
3 Months	N/A
6 Months	N/A
1 Year	N/A
Month to Date (MTD%)	4.17%
Quarter to Date (QTD%)	22.55%
Year to Date (YTD%)	N/A

2Q23 Net Profit higher than our estimate

ADNOC Logistics & Services (ADNOCLS/the Company) net profit rose significantly to USD 162 Mn in 2Q23 as compared to USD 56 Mn in 2Q22, higher than our estimate of USD 144 Mn. The increase in net profit is mainly driven by solid performance across all three segments. In addition, the performance also benefitted from the ZMI acquisition, an increase in integrated logistics offering, and healthy charter rates resulting in robust revenue growth partially offset by an increase in operating expenses.

P&L Highlights

ADNOCLS revenue increased 42.8% YOY to USD 632 Mn in 2Q23 mainly driven by the acquisition of Zakher Marine International (ZMI), an increase in integrated logistics offerings along with healthy charter rates for tankers and gas carriers. Revenue from the integrated logistics business more than doubled from USD 182 Mn in 2Q22 to USD 378 Mn in 2Q23 mainly driven by acquisition of ZMI, higher volumes due to the deployment of the Integrated Logistics Services Platform (ILSP) and start of the work at Hail and Ghasha project. ADNOCLS shipping segment owned 56 vessels as of 2Q23 while the utilization rate stood more than 95% during 1H23. Integrated logistics material handling volume rose more than 15% YOY during 1H23. ZMI acquisition and ILSP positively benefitted the tanker and gas carriers' revenue in 2Q23. Revenue from Gas carriers rose 22.6% YOY to USD 38 Mn in 2Q23 owing to addition of two vessels and higher charter rates partially offset by the seasonality in the spot contracts. Likewise, revenue from tankers rose 19.5% YOY to USD 98 Mn in 2Q23 owing to higher charter rates. Dry-bulk shipping revenue declined 35.5% YOY to USD 71 Mn in 2Q23 due to the lower spot rates, the Russia-Ukraine war, unfavorable macroeconomic conditions, and weak Chinese economic performance. Marine business revenue increased 23.7% YOY to USD 47 Mn in 2Q23 driven by equipment supply, install-

ation and higher volumes managed through oil spill services. Furthermore, the Integrated logistics business EBITDA increased significantly from USD 15 Mn in 2Q22 to USD 131 Mn in 2Q23 with an EBITDA margin of 34.7%. Shipping business EBITDA grew 44.3% YOY to USD 85 Mn in 2Q23 while the EBITDA margin stood at 40.9%. Similarly, the Marine business recorded a 37.3% YOY growth in EBITDA to USD 9 Mn in 2Q23 with an EBITDA margin of 19.8%. As a result, operating profit rose from USD 59 Mn in 2Q22 to USD 147 Mn in 2Q23. Likewise, total EBITDA increased significantly to USD 219 Mn in 2Q23, up from USD 94 Mn in 2Q22. Total EBITDA margin rose 1,322 bps YOY to 34.4% in 2Q23. Furthermore, net finance cost stood at USD 0.4 Mn in 2Q23 as compared to USD 2.7 Mn in 2Q22. Additionally, income tax expense stood at USD 2 Mn in 2Q23.

Balance Sheet Highlights

ADNOCLS's cash and cash equivalents stood at USD 234 Mn in 2Q23. The Company remained debt-free in 2Q23. ADNOCLS incurred a capex of USD 177 Mn in 2Q23 as compared to USD 43 Mn in 1Q23 which is towards the final payment of new carriers and other ongoing offshore projects. Moreover, the Company's free cash flow stood negative at USD 101 Mn in 2Q23, down from USD 183 Mn in 1Q23 mainly due to the high capital expenditure and negative working capital. In addition, the Company entered into USD 350 Mn revolving credit facility and a USD 1,500 Mn term loan facility with ADNOC for a period of two years in 2Q23 however the facility remains unutilized in 2Q23.

Target Price and Rating

We revise our rating on ADNOC Logistics & Services from BUY to HOLD with a target price of AED 4.00. The Company's share price rose 14.4% since our last rating (i.e., 6 July 2023). The Company's financials positively benefited from the ZMI acquisition as it capitalizes on the ILSP launch. Likewise, higher charter rates and increased vessel days also contributed to ADNOCLS' bottom-line growth. The company took delivery of two Very Large Crude Carriers (VLCC) in 2Q23. These vessels feature a dual-fuel engine that can also run on liquified natural gas (LNG) saving cost and reducing exhaust emissions. The Company committed around USD 2 Bn to build more environment-efficient vessels. ADNOCLS secured USD 975 Mn engineering, procurement, and construction (EPC) contract from ADNOC offshore for the construction artificial island during 2Q23. ADNOCLS' more than 65% of total long-term revenue is contracted, while 70% of the revenue is contracted with ADNOC, ensuring strong cash flow visibility in the forthcoming period. This leads the Company to generate robust free cash flow which is consumed internally to fund its capex requirements. ADNOCLS entered into a USD 350 Mn revolving credit facility and USD 1,500 Mn term loan facility with ADNOC in 2Q23, however, it remained unutilized until 2Q23. ZMI acquisition and increased integrated logistics offering resulted in margin expansion in all segments whereas the strong support from acquisition will further improve ADNOCLS' margins in the forthcoming period. Additionally, the company strategy aims to expand into new business verticals and increase its fleet. The Company intends to pay USD 195 Mn dividend in 2023 and expects to pay on a progressive basis in the upcoming year with a minimum growth of 5% per annum. Thus, based on our analysis we assign a HOLD rating on the stock.

ADNOC L&S - Relative valuation

(at CMP)	2022	2023F
PE (x)	NA	15.00
PB (x)	NA	1.82
EV/EBITDA	NA	9.94
Dividend yield (%)	NA	2.6%

FABS Estimates & Co Data

Note – ADNOC Logistics & Services listed on ADX in 2023. Thus, the financial multiple for the prior period is unavailable.

ADNOC L&S – P&L

AED mm	2Q22	1Q23	2Q23	2Q23F	Var.	YOY Ch	QOQ Ch	2022	2023F	Change
Revenue	443	592	632	613	3.2%	42.8%	6.8%	1,952	2,448	25.4%
Direct cost	-363	-426	-440	-435	1.2%	21.2%	3.2%	-1,537	-1,779	15.8%
Gross profit	80	166	192	178	7.9%	141.1%	16.1%	409	668	63.4%
G&A expenses	-19	-31	-32	-32	0.2%	66.5%	2.5%	-106	-122	15.7%
Other expenses	-1	0	0	0	NM	NM	NM	-4	0	NM
Other income	0	3	4	1	NM	NM	25.5%	1	0	NM
EBITDA	94	199	219	203	7.7%	133.0%	10.3%	453	735	62.1%
EBIT	59	137	164	147	11.2%	176.6%	19.4%	301	546	81.7%
Provision for ECL, net	0	4	-6	-2	NM	NM	NM	-6	-5	-17.0%
Share of profit from JVs	1	4	3	4	-	NM	-25.1%	2	13	NM
Finance income	0	1	3	2	70.1%	NM	84.1%	4	4	2.4%
Finance costs	-3	-1	-3	-3	-2.0%	-5.5%	NM	-39	-29	-24.9%
Profit before tax	56	145	160	148	8.5%	187.4%	10.4%	262	529	101.8%
Income tax expense	0	0	2	-4	NM	NM	NM	-1	-26	NM
Net Profit	56	145	162	144	12.7%	NM	12.0%	261	502	92.7%

FABS estimate & Co Data
ADNOC L&S - Margins

	2Q22	1Q23	2Q23	YOY Ch	QOQ Ch	2022	2023F	YOY Ch
Gross margin	18.0%	28.0%	30.4%	1,241	244	21.0%	27.3%	635
EBITDA margin	21.2%	33.5%	34.4%	1,322	91	23.2%	30.0%	679
Operating margin	13.4%	23.2%	25.9%	1,254	274	15.4%	22.3%	691
Net profit margin	12.6%	24.5%	25.7%	1,308	120	13.3%	20.5%	717

FABS estimate & Co Data

Valuation:

We use Discounted Free Cash Flow (DCF), Relative Valuation (RV), and Discounted Dividend Method (DDM) to value ADNOC Logistics & Services. We have assigned 70% weight to DCF, 30% to RV, and 10% to DDM.

Valuation Method	Target	Weight	Weighted Value
DCF Method	4.15	70.0%	2.91
Relative Valuation (RV)	4.43	20.0%	0.89
DDM Method	2.08	10.0%	0.21
Weighted Average Valuation (AED)			4.00
Current market price (AED)			3.74
Upside/Downside (%)			+7.0%

1) DCF Method:

ADNOC Logistics & Services is valued using free cash flow to firm. We have discounted the cash flow using the weighted average cost of capital of 8.2%. It is arrived after using cost of equity of 9.3% and cost of debt of 5.4%. Cost of equity is calculated by using 10-year government bond yield of 4.5%, beta of 1.15 and equity risk premium of 4.1%. Government bond yield is calculated after adding Abu Dhabi 10-year spread over 10-year US risk free rate. Also, assumed a terminal growth rate of 2.0%.

Sum of PV (USD, Mn)	-237
Terminal value (USD, Mn)	8,367
FV to Common shareholders (USD, Mn)	8,364
No. of share (Mn)	7,398
Current Market Price (AED)	3.74
Fair Value per share (AED)	4.15

DCF Method

(All Figures in USD Mn)	FY 2023E	FY 2024E	FY 2025E	FY 2026E	FY 2027E	FY 2028E
NOPAT	594	615	662	723	743	763
Depreciation & Amortization	174	212	233	253	279	287
Capex	-1,325	-750	-900	-1,450	-700	-250
Change in Working Capital	-57	-34	-24	-30	-16	-15
Free Cash Flow to Firm (FCFF)	-613	44	-29	-505	306	785
Discounting Factor	0.97	0.90	0.83	0.76	0.71	0.65
Discounted FCFF	-595	39	-24	-386	216	512

Source: FAB Securities

2) Relative Valuation:

We have used local as well as international peers to value ADNOC Logistics & Services and it is valued using the EV/EBITDA multiple. The Integrated & Marine business is valued at EV/EBITDA multiple of 13.4x and the Shipping business is valued at EV/EBITDA multiple of 6.3x in line with peers.

Company	Market	EV/EBITDA (x)		P/E (x)	
	(USD Mn)	2023F	2024F	2023F	2024F
<u>Integrated & Marine peers</u>					
ADNOC DRILLING CO PJSC	17,118	13.1	11.2	18.5	16.2
EMIRATES CENTRAL COOLING SYS	5,065	15.0	13.8	19.4	19.7
DUBAI ELECTRICITY & WATER AU	35,533	11.3	10.8	16.7	17.7
SALIK CO PJSC	6,392	19.9	18.4	22.5	21.7
ABU DHABI PORTS CO PJSC	9,272	13.4	12.3	22.0	21.0
Average		14.5x	13.3x	19.8x	19.3x
Median		13.4x	12.3x	19.4x	19.7x
Max		15.0x	13.8x	22.0x	21.0x
Min		13.1x	11.2x	18.5x	17.7x

Source: FAB Securities

Company	Market	EV/EBITDA (x)		P/E (x)	
	(USD Mn)	2023F	2024F	2023F	2024F
<u>Shipping peers</u>					
QATAR GAS TRANSPORT(NAKILAT)	5,982	10.9	10.4	13.9	12.9
EURONAV NV	3,509	5.5	5.3	5.5	5.4
STAR BULK CARRIERS CORP	1,880	6.3	4.5	8.2	4.3
DORIAN LPG LTD	1,146	6.0	8.4	7.1	16.1
GOLAR LNG LTD	2,593	10.6	6.4	45.7	9.2
FLEX LNG LTD	1,742	10.7	10.4	NA	NA
FRONTLINE PLC	3,847	5.6	6.5	5.8	6.5
Average		7.9x	7.4x	14.3x	9.1x
Median		6.3x	6.5x	7.6x	7.8x
Max		10.7x	9.4x	12.5x	12.0x
Min		5.8x	5.8x	6.1x	5.7x

Source: FAB Securities

2) DDM Method:

ADNOC Logistics and Services plans to pay USD 195 Mn dividend in 2023 and expects to pay on a progressive basis in the forthcoming period with a minimum growth of 5% per annum. The dividend is discounted at the cost of equity of 9.3%.

Sum of PV (USD, Mn)	1,305
Terminal value (USD, Mn)	2,889
FV to Common shareholders (USD, Mn)	4,194
No. of share (Mn)	7,398
Current Market Price (AED)	3.74
Fair Value per share (AED)	2.08

(All Figures in AED Mn)	FY 2023E	FY 2024E	FY 2025E	FY 2026E	FY 2027E	FY 2028E
Dividend Paid						
H1	65	137	143	150	158	166
H2	130	137	143	150	158	166
Total Dividend	195	273	287	301	316	332
Discounting Factor	0.97	0.88	0.81	0.74	0.68	0.62
Present Value of Dividend	188	241	232	223	214	206

Source: FAB Securities

Research Rating Methodology:

Rating	Upside/Downside potential
BUY	Higher than +15%
ACCUMULATE	Between +10% to +15%
HOLD	Lower than +10% to -5%
REDUCE	Between -5% to -15%
SELL	Lower than -15%

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