

Asian Oilfield Services

BSE code: 530355

CMP: Rs 131

Target: Rs 230

BUY

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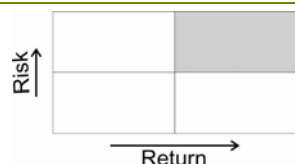
Company data

Particulars	
Market cap (Rs mn / US\$ mn)	875.2/22.1
Outstanding equity shares (mn)	7.0
52-week high/low (Rs)	148/16
3-month average daily volume	71,703

Financial snapshot

Particulars	FY07	FY08E	FY09E
Sales (Rs mn)	274.1	546.6	990.5
Growth (%)	163.7	99.4	81.2
Adj net profit (Rs mn)	43.0	117.2	262.9
Growth (%)	706.4	173.0	124.3
FDEPS (Rs)	7.5	16.7	20.8
Growth (%)	548.7	122.5	24.3
P/E (x)	17.4	7.8	6.3
ROE (%)	44.7	51.6	44.9

Risk-return profile



Shareholding pattern

(%)	Sep-07	Jun-07
Promoters	11.6	11.6
FIs	-	-
Banks & FIs	-	-
Public	88.4	88.4

Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
AOSL	131	(4.2)	20.0	137.6
Sensex	19,838	14.7	27.6	43.0
Oil and Gas	11,658	21.9	43.4	63.4

Drilling for success

Poised for growth on the back of a surge in E&P activities

Investment rationale

- ❖ Provider of seismic survey services (mining of data on the earth's substructure) to upstream oil companies, with a proven track record of successful project execution on challenging terrain.
- ❖ Client roster includes oil majors like ONGC, Jubilant Oil and Gas and Canaro Resources, with several 2D and 3D studies executed for these clients primarily in the rough-terrain northeast regions.
- ❖ Demand for seismic surveys mushrooming due to hectic E&P activity and recent oil discoveries in India. Heavy exploration backlog on blocks awarded under NELP indicates strong future potential for allied services. Business opportunity estimated at Rs 40bn over next three to four years.
- ❖ Shift from labour contracting to 2D and 3D seismic surveys has driven up the EBITDA margin from 12% in FY05 to 31% in FY07. Three new crew acquisitions including a high-end 3D crew planned by December 2007 would expand margins further to 45% by FY09.
- ❖ Robust revenue visibility over the next two years considering the strong order book of over Rs 1.2bn (including two upcoming contracts from Oil India and ONGC) and foray into coal bed methane (CBM) rigs.

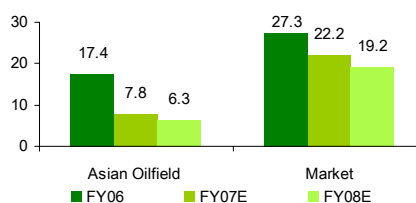
Key concerns

- ❖ Vulnerability to weather conditions and dependence on a large base of unskilled labour for project execution are key risks.

Valuation

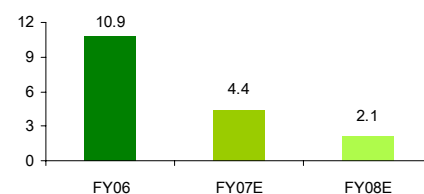
- ❖ Currently trades at a P/E of 6.3x on FY09E which is a steep 50% discount to peers like Alphageo and Shiv-vani. We believe growth visibility validates a P/E of 11x on FY09E which translates to a one-year target price of Rs 230. Buy.

P/E multiple (x)



Source: Religare Research

EV/EBITDA multiple (x)



Source: Religare Research

Company profile

Established in 1992, Gujarat-based Asian Oilfield Services (AOSL) was initially an operator for oilfield work-over rigs. Thereafter, in 1996, the company diversified into shot hole drilling – a component of seismic data acquisition services.

First private sector player to conduct seismic surveys in India's rough northeast terrain

Over the years AOSL has developed rich expertise in a wide range of shot hole drilling activities and has built a reputation for successful project execution in difficult terrain. AOSL was the first private sector player to execute seismic surveys in the geographically complex terrain of Tripura and Nagaland, besides surveying the dry areas of West Bengal, Gujarat and Tamil Nadu. The company has executed projects for clients like ONGC, Jubilant Oil and Gas, Canaro Resources and Premier Oil.

Industry overview

Seismic survey – a snapshot

Seismic studies measure the velocity of sound waves travelling through rocks to obtain data on the earth's substructure such as formations, depth and probable soil composition. During a seismic survey, seismic waves are artificially created and these reflect off different layers of the earth. They are then picked up by geophones on the surface which relay them to seismic processors for analysis. The processor uses high-speed and high-capacity computers to convert the raw field data into digital output that displays vertical and horizontal slice views of the earth. This data is then used for 2D or 3D seismic imaging (which provides cross-sectional pictures of the underground rock formation).

Seismic surveys are the primary stage of oil exploration activities since they identify what lies below the rocks. A successful result implies that upstream companies can go ahead with drilling activities. Consequently a scaling up of E&P activities will boost the demand for seismic data acquisition surveys.

Demand for seismic surveys on the rise

Domestic demand for seismic services over the next three to four years is estimated at Rs 80bn. Almost 50% of this business opportunity will be captured by the in-house crews of ONGC and Oil India, which have ~32 and 4 sets of seismic survey equipment respectively. The remaining 50% of the market is expected to be executed by private third party service providers like AOSL, Alphageo and Shiv-vani Oil & Gas Exploration.

Currently, about 15 third party service providers operate in India, estimated to execute projects worth over Rs 3bn in 2006. This is likely to increase significantly to 34 crews fetching revenues of over Rs 10bn by 2010. The onland seismic survey industry is expected to record a CAGR of over 53% till 2010.

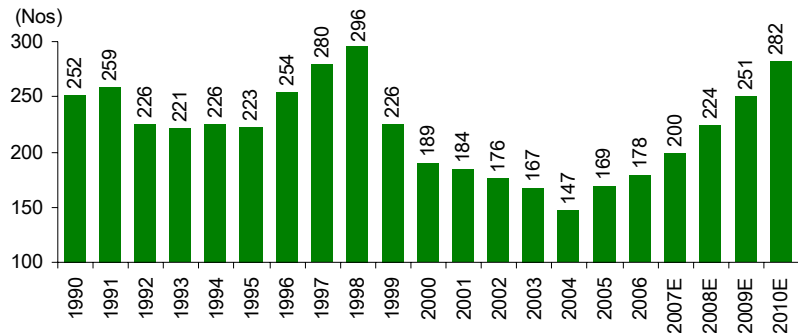
Investment rationale

Strong E&P activity fuelling demand

Spiralling oil prices encourage higher production

Oil prices have risen to over US\$ 90/bbl, inducing upstream companies to ramp up exploration and production (E&P) activities. Recent hydrocarbon discoveries in the KG, Cauvery and Rajasthan basins by upstream players like Reliance Industries, ONGC and Cairn Energy have also served as an impetus to further exploratory efforts. Further, the tremendous success of the New Exploration Licensing Policy (NELP) has attracted global exploration players into the country, which will give an added fillip to the allied seismic survey business.

World land seismic crew count

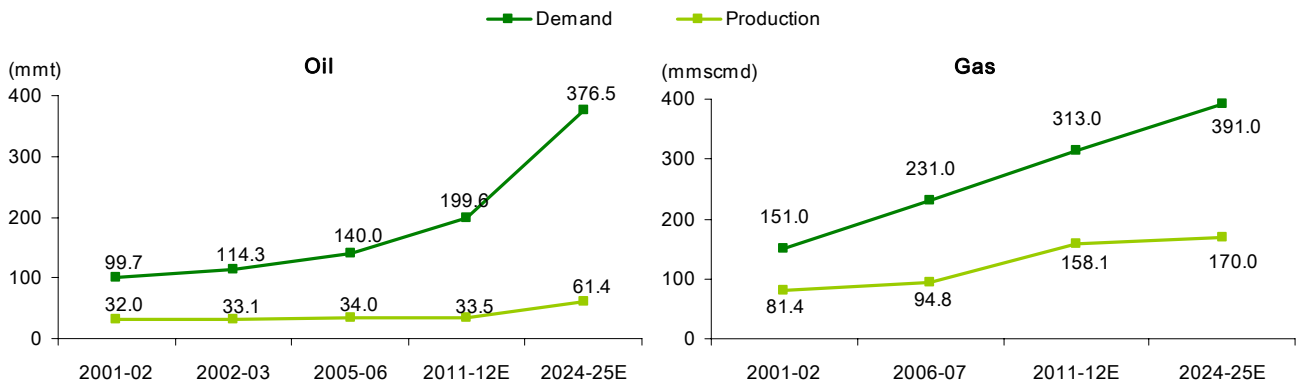


Source: World Geophysical News

Demand for petroleum products continues to rise

The demand for hydrocarbon products is directly related to a nation's economic growth. The consumption of hydrocarbon products the world over has increased at a modest pace of 2% per annum, while emerging countries like India are recording demand growth of over 4%. According to the Directorate General of Hydrocarbons (DGH), crude oil demand will grow from 140mn tonnes (mmt) in FY06 to 199.6mmt by FY12 and 376.5mmt by FY25. This huge upside in demand will drive further E&P activities and hence growth in the seismic survey business.

Petroleum products

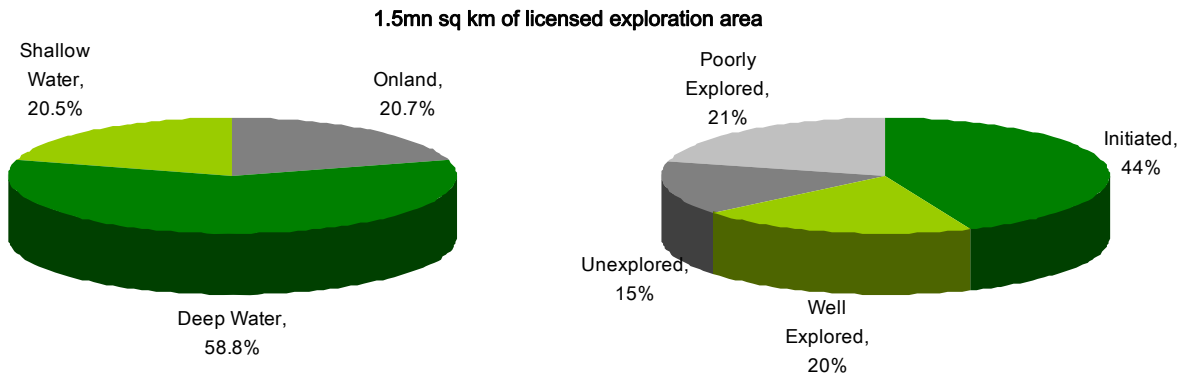


Source: DGH Presentation, Religare Research

Huge growth opportunity for seismic surveyors

In India, close to 3.1mn sq km of land has been identified as sedimentary area for hydrocarbon exploration activities (1.5mn sq km under license) distributed over nearly 26 sedimentary basins. In addition, nearly 35,400sq km has been identified as having a coal bed methane (CBM) energy base. The licensed area of 1.5mn sq km comprises 59% deep water, 20% shallow water and 21% of onland area. Just 20% of the total area has been extensively explored and only with a low drilling density.

Exploration opportunity

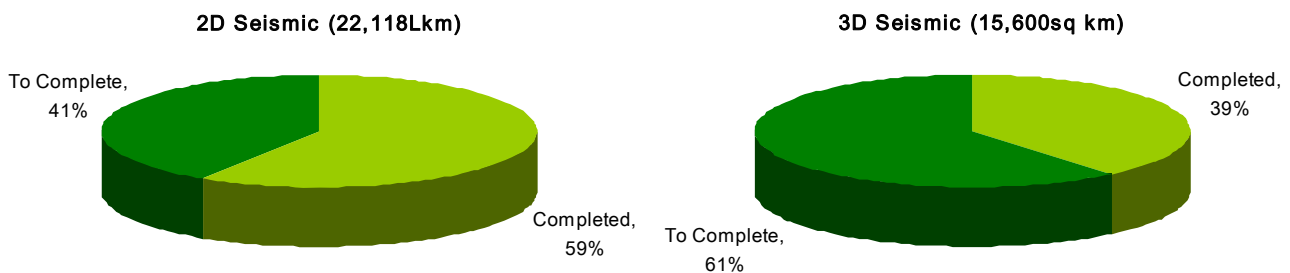


Source: DGH Presentation, Religare Research

Six rounds of competitive bidding under the NELP have already been completed in which 185 blocks have been awarded for exploration. The seventh round is likely to be held in December 2007 which will further distribute close to 85 blocks among E&P players. The minimum work commitment pending for the awarded blocks totals 9,129 line km (Lkm) for 2D seismic surveys and 9,359sq km for 3D seismic surveys, to be completed within the next five years.

With NELP-VII, another 72,000Lkm and 50,000sq km would be added to the 2D and 3D survey pipeline respectively. This huge pile-up of projects will generate strong revenue streams for service providers like AOSL over the next five years.

Onland work commitment



Source: DGH Presentation, Religare Research

Minimum work commitment for next 5 years

Particulars	2D (lkm)	3D (sq km)	Wells
Onland	9,129	9,359	126
Offshore	97,055	50,941	125
Expected in NELP VII	72,000	50,000	160

Source: DGH Presentation, Religare Research

Established expertise in seismic survey services

AOSL has wide-ranging expertise in shot hole drilling activities and is recognised for successful project execution on challenging terrain. Drawing on strategic technical partnerships, the company has successfully conducted seismic surveys in the northeast states of Tripura, Arunachal Pradesh, Nagaland and Assam which are characterised by difficult hilly terrain.

Technical partnership with GII, Israel has enhanced the company's project skills

Technical collaboration with GII, Israel

In 2003, AOSL entered into a technical collaboration with the Geophysical Institute of Israel (GII) for seismic data processing and interpretation services. GII helped to upgrade the company's capabilities in seismic surveying through its globally benchmarked technology and quality practices. AOSL has undertaken 2D surveys covering nearly 600Lkm in association with GII. We believe this technological partnership will help the company to move up the value chain and expand its footprint in new segments.

Complex project execution within tight deadlines

AOSL's client roster comprises large E&P players like ONGC, Jubilant Oil and Gas, Canaro Resources and Premier Oil. The company has ramped up its capabilities in FY07, executing five large projects during the fiscal. This includes seismic surveys in Assam and Nagaland undertaken for Canaro Resources. The surveys commenced in January 2007 with a six-month timeline. Despite the harsh terrain of the northeast region, AOSL completed the project in a record four months and also became the first private sector player to successfully conduct a seismic study in Nagaland.

The company has also executed a project awarded by Jubilant Oil and Gas across inhospitable terrain in Tripura within a tight deadline. This enabled AOSL to garner an extension of 10% of the project size, enhancing overall project revenues.

Selected as L1 bidder by ONGC and Oil India

AOSL has an order book of over Rs 1.4bn including two upcoming contracts from ONGC and Oil India, where AOSL has been selected as the L1 bidder. A strong order book with an execution timeline of less than two years provides revenue visibility for the company.

Higher capex to meet the growing demand

Acquiring two new 2D crews by November

AOSL currently owns one set of 2D seismic data acquisition equipment and one more 2D set on lease. It now plans to invest ~Rs 350mn in FY08 to acquire three new crews in order to cater to the growing demand for seismic survey activities. The company has placed an order for two sets of 2D equipment with a Canada-based equipment supplier (2D set costs vary from Rs 60mn-120mn depending on the number of channels). Both sets are expected to join its fleet from November 2007. We believe the owned crews will enhance its margins significantly in the future.

3D crew will fetch higher revenues

In addition to the two new 2D crews, AOSL is planning to invest Rs 180mn-200mn to acquire a new 3D crew. These crews are complex in nature and in high demand in the market. We thus expect the company to garner higher revenues on the new crew which would expand its profitability considerably going forward.

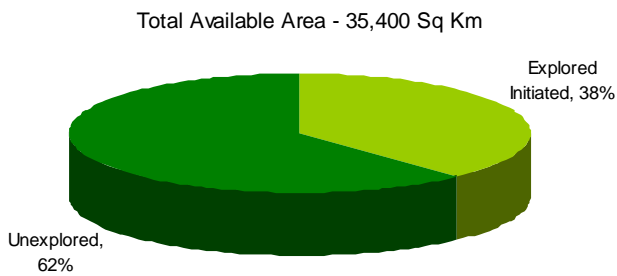
To invest Rs 180mn-200mn on a 3D crew which will enhance revenues significantly

Entering a new business line of CBM rigs

Enormous opportunity in CBM drilling services

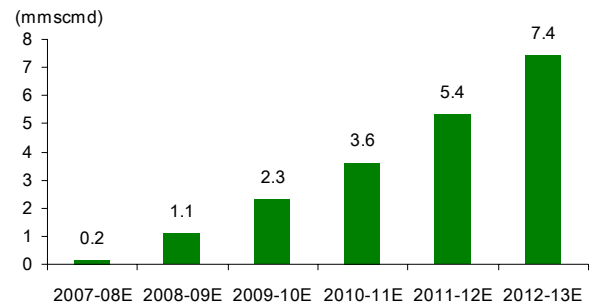
In India, ~35,400sq km of land has been identified as CBM gas bearing areas. Of this, almost 38% of the area remains unexplored. Several government and private upstream companies are focused on the development of CBM fields. As per DGH estimates, the total production from CBM fields would increase to 7.4mmscmd by FY13 from 0.15mmscmd expected in FY08.

Opportunity in CBM



Source: DGH Presentation, Religare Research

CBM field production profile



Source: DGH Presentation, Religare Research

Plans to acquire a CBM rig, to start operation from September 2008

Plans to acquire a CBM rig

AOSL is proactively responding to the growth opportunity by working to improve its capabilities. The company is planning to acquire a CBM rig for ~Rs 150mn which will be deployed at the client's field for drilling purposes. The company expects the rig to join its fleet from September 2008.

Key concerns

Vulnerable to climate vagaries

The seismic survey business is highly seasonal in nature and operations typically peak during October to May. Timely project completion is a direct function of good climatic conditions, particularly in the northeast region. In order to mitigate the risk, the company is venturing into offshore seismic surveys and CBM drilling.

Availability of unskilled labour

Each seismic survey typically requires about 15 skilled personnel and 800–1,000 unskilled labourers depending on the use of 2D or 3D crews. AOSL subcontracts all the unskilled labour to a third party but managing such a large floating workforce presents challenges and can affect project deadlines.

Financial performance

Robust topline growth over the past three years

AOSL's net sales have registered an 87.3% CAGR over FY05-FY07 to Rs 273.3mn. The strong revenue growth over the past three years has been driven by rising demand for seismic surveys paired with AOSL's expertise in the country's northeast region.

Sharp margin improvement enhances profitability

AOSL has gradually built up its capabilities from contracting labour to companies like ONGC (which then utilise in-house equipment) to deploying its own skilled crew and equipment for full-fledged 2D and 3D seismic surveys. This offers higher revenues and margins to the company. Further, it employs only skilled personnel while most of the labour requirements are fulfilled through sub-contracting in 2D and 3D seismic services which yield cost efficiencies. As a result, AOSL's EBITDA margin has improved significantly to 31.1% in FY07 from 12.3% in FY05. Consequently, the company's net profit increased at a CAGR of 267% over FY05-FY07 to Rs 43.0mn.

EBITDA margin has risen from 12% in FY05 to 31% in FY07, leading to a tripling of net profits

Financial outlook

Strong order book will drive revenues

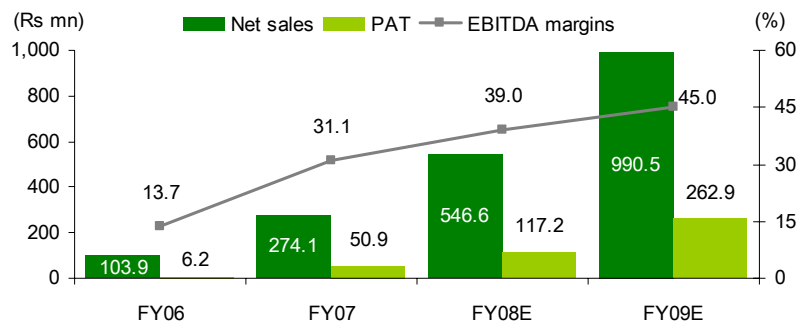
The company has been selected as a L1-bidder for the two new contracts from Oil India and ONGC, which led to sharp increase in its order book of over Rs 140cr with less than two years of execution period. Further, we expect the growing pace of E&P activity to throw open immense opportunities for allied service providers like AOSL. The company's plans to foray into CBM drilling rigs will add a new dimension to growth. We thus expect AOSL's revenues to clock a CAGR of 90.1% over the next two years to Rs 990.5mn in FY09.

Owning of equipment will boost profits

The company is acquiring two new 2D crews by November and one 3D crew by December which will be directly deployed at its customer locations. We expect this to expand margins by a massive 1,389bps over the next two years to 45% in FY09. Consequently, AOSL's net profit is expected to log a 127.2% CAGR over FY07-FY09 to Rs 262.9mn.

New crew acquisitions to expand EBITDA margin by 1,389bps over FY07-FY09 to 45%

Sales and profit growth forecast



Source: Company, Religare Research

Valuation

Comparative P/E-based valuation yields target of Rs 230; Buy

AOSL currently trades at a P/E multiple of 6.3x on FY09E which is a steep 50% discount to peers like Alphageo and Shiv-vani Oil and Gas Explorations. We believe AOSL's strategy of acquiring rather than leasing equipment together with its foray into CBM drilling will drive business growth and narrow the discount to peer valuations.

In our view, the company merits a P/E multiple of 11x on FY09E. This gives us a one-year target price of Rs 230, signifying a potential upside of 76% from current levels; we initiate coverage with a Buy recommendation.

Comparative valuation

Company	CMP* (Rs)	FY07		FY08E		FY09E	
		EPS (Rs)	P/E (x)	EPS (Rs)	P/E (x)	EPS (Rs)	P/E (x)
Asian Oilfield Services	131	7.5	17.4	16.7	7.8	20.8	6.3
Alphageo	493	15.2	32.5	34.0	14.5	N.A.	N.A.
Shiv-vani Oil and Gas Explorations (Y/E Dec)	385	11.6	33.2	17.4	22.2	30.5	12.6

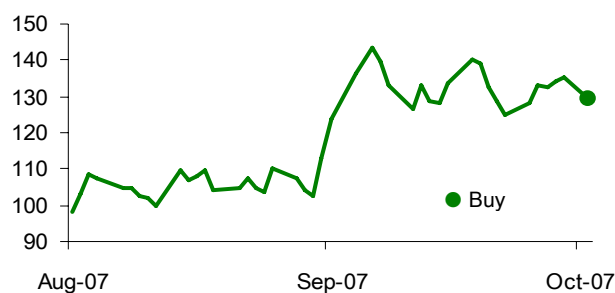
Source: Bloomberg, Religare research *Closing price of 31 October 2007

Recommendation history

Date	Event	Reco price	Tgt price	Reco
01-Nov-07	Initiating Coverage	131	230	Buy

Source: Religare Research

Stock performance



Source: Religare Research

Consolidated financials

Profit and Loss statement

(Rs mn)	FY06	FY07	FY08E	FY09E
Revenues	103.9	274.1	546.6	990.5
Growth (%)	32.3	163.7	99.4	81.2
EBITDA	14.2	85.4	213.0	446.0
Growth (%)	46.6	501.1	149.6	109.4
Depreciation	(3.4)	(6.6)	(18.8)	(20.0)
EBIT	12.3	80.7	195.0	426.8
Growth (%)	88.6	556.9	141.7	118.8
Interest	(2.3)	(5.0)	(18.3)	(30.4)
Other income	1.4	0.8	0.8	0.8
EBT	10.0	75.7	176.7	396.3
Growth (%)	98.8	656.0	133.4	124.3
Tax	(3.8)	(24.8)	(59.5)	(133.4)
Effective tax rate (%)	34.9	29.7	33.7	33.7
Adj net income	5.3	43.0	117.2	262.9
Growth (%)	67.0	706.4	173.0	124.3
Shares outstanding (mn)	5.4	7.0	7.0	12.6
FDEPS (Rs)	1.2	7.5	16.7	20.8
DPS (Rs)	-	-	-	-
CEPS (Rs)	1.8	8.2	19.4	22.4

Source: Company, Religare Research

Cash flow statement

(Rs mn)	FY06	FY07	FY08E	FY09E
Net income	6.2	50.9	117.2	262.9
Depreciation	3.4	6.6	18.8	20.0
Other adjustments	2.2	8.5	0.0	0.0
Changes in WC	(11.1)	(53.1)	(46.6)	(43.0)
Operating cash flow	0.7	12.8	89.5	240.0
Capital expenditure	(1.9)	(48.9)	(290.0)	(25.0)
Investments	1.4	0.0	0.0	0.0
Other investing inc/(exp)	0.6	33.9	0.0	0.0
Investing cash flow	0.1	(15.0)	(290.0)	(25.0)
Free cash flow	0.8	(2.2)	(200.5)	215.0
Issue of equity	0.0	16.5	30.3	306.9
Issue/repay debt	6.3	20.4	200.0	20.0
Dividends paid	0.0	0.0	0.0	0.0
Others	(2.3)	(21.5)	0.0	0.0
Financing cash flow	4.1	15.4	230.3	326.9
Beg. cash & cash eq	4.0	8.9	22.1	51.8
Chg in cash & cash eq	4.9	13.2	29.7	541.9
Closing cash & cash eq	8.9	22.1	51.8	593.7

Source: Company, Religare Research

Balance sheet

(Rs mn)	FY06	FY07	FY08E	FY09E
Cash and cash eq	8.9	22.1	51.8	593.7
Accounts receivable	63.1	183.5	304.7	522.4
Inventories	0.1	0.9	1.1	1.9
Others current assets	8.3	13.8	37.4	48.0
Current assets	80.3	220.3	395.0	1,166.0
LT investments	1.1	0.1	0.1	0.1
Net fixed assets	34.0	67.4	338.6	343.6
CWIP	0.0	0.0	0.0	0.0
Total assets	115.3	287.8	733.6	1,509.6
Payables	5.7	43.1	91.4	166.7
Others	16.1	52.6	102.7	213.6
Current liabilities	21.8	95.7	194.1	380.3
LT debt	17.1	37.5	237.5	257.5
Other liabilities	1.9	1.3	1.3	1.3
Equity capital	53.6	70.1	70.1	126.4
Reserves	20.9	83.2	230.7	744.2
Net Worth	74.5	153.2	300.8	870.6
Total liabilities	115.3	287.8	733.6	1,509.6
BVPS (Rs)	13.9	21.9	42.9	68.9

Source: Company, Religare Research

Financial ratios

	FY06	FY07	FY08E	FY09E
EBITDA margin (%)	13.7	31.1	39.0	45.0
EBIT margin (%)	11.8	29.4	35.7	43.1
Net profit margin (%)	5.1	15.7	21.5	26.5
FDEPS growth (%)	94.7	548.7	122.5	24.3
Receivables (days)	221.5	244.4	203.5	192.5
Inventory (days)	0.2	1.2	0.7	0.7
Payables (days)	19.9	57.4	61.0	61.4
Current ratio (x)	3.7	2.3	2.0	3.1
Interest coverage (x)	5.4	16.2	10.7	14.0
Debt/equity ratio (x)	0.2	0.2	0.8	0.3
ROE (%)	8.7	44.7	51.6	44.9
ROCE (%)	9.4	40.2	35.5	34.0
ROAE (%)	10.8	25.3	23.0	23.4
EV/Sales (x)	9.0	3.4	1.7	0.9
EV/EBITDA (x)	65.7	10.9	4.4	2.1
P/E (x)	113.0	17.4	7.8	6.3
P/BV (x)	9.4	6.0	3.1	1.9
P/CEPS (x)	73.0	16.0	6.7	5.9

Source: Company, Religare Research

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Recommendation parameters

Large-caps*	> 10%	< - 5%	Returns	Absolute
	BUY	SELL		
Mid-caps**	> 25%	< 10%		

*Market cap over US\$ 1bn **Market cap less than US\$ 1bn

Religare Securities

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