

Equities

15 August 2011 | 8 pages

Transocean Ltd. (RIG)

Alert: Asserting Itself in the Deepwater Rig Race (Finally)

Company Update

- **RIG Acquires Aker for \$3.1B** – RIG will acquire Aker Drilling AS (AKD-OS) for \$3.13B (including equity of \$1,430M, net debt of \$800M, and future rig construction costs of \$900M). The deal includes two 3,000-meter semis working today in the North Sea and two 3,650-meter drillships to be built in Korea and delivered in 2013.
- **Attractive Forward Multiples** – We like the deal for several reasons. Based on consensus estimates, the forward 12-month multiples are 15.1x P/E and 14.2x EV/EBITDA (see page 2 for comparable transactions). Adding the expected earnings from the two ultra deepwater drillships under construction in Korea gives a pro forma P/E of 6.6x and EV/EBITDA of 7.7x based on consensus 2015 estimates.
- **No Longer on the Sidelines in Rig Race** – RIG, previously with only three high-spec jackups under construction, had been criticized for being overly conservative in expanding/upgrading its fleet. Aker Drilling affords RIG immediate fleet renewal and growth without jeopardizing its current dividend payout policy, in our opinion.
- **Expanded Position in North Sea** – The transaction strengthens its presence in the deepwater/ultra-deepwater North Sea market, adding two existing UDW semis and two more UDW drillships under construction. According to the July 13 fleet status report, Transocean's 17 rigs in the North Sea included only one deepwater rig (the Transocean Leader) along with 13 midwater rigs and three jackups. After acquiring Aker, Transocean will own 7 of the 28 rigs working offshore Norway.
- **Price Reflects New Construction Costs** – Transocean will acquire 6th-generation rigs at close to replacement cost. ODS-Petrodata gives a total initial build cost of \$3.0B (\$900M each for the two existing semis and \$600M each for the two drillships under construction), suggesting that the \$3.13B purchase was at a 4.5% premium to replacement cost. Current construction costs would be closer to \$650M per drillship and more than the \$900 million that Aker spent on each of its harsh environment semis—the Aker Barents and the Aker Spitsbergen.
- **Immediate EPS Accretion is \$0.25-\$0.30** – We estimate annual accretion to EBITDA of \$230M-\$240M (from our baseline \$4,600M estimate for 2012) and annual accretion to EPS of \$0.25-\$0.30. We have not included the potential accretion from the two new build drillships or the two drillship options in this calculation. Our model will be adjusted for these impacts when the deal closes.
- **Bottom Line, We Like This Deal** – We believe the transaction gives RIG a way to expand and renew its rig fleet while strengthening its position in the Norwegian North Sea. The multiples are attractive when considering the earnings contribution from the new builds, and the options have value in and of themselves given the favorable prices (\$600M per unit) and 25%/75% upfront/delivery payment terms.

Buy/High Risk	1H
Price (15 Aug 11)	US\$57.28
Target price	US\$81.00
Expected share price return	41.4%
Expected dividend yield	5.5%
Expected total return	46.9%
Market Cap	US\$18,319M

Price Performance (RIC: RIG.N, BB: RIG US)



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Figure 1. Selected Oil Services Acquisition Comparables

Date Announced	Target	Acquirer	Sector	Transaction Value (\$ Millions)	Offer Price per Share	Premium One Day	Percent Cash	Forward P/E	Forward EV/EBITDA
8/15/11	Aker Drilling	Transocean	Drillers/Drilling Rigs	\$3,135	NOK 26.50	99%	100%	15.1x	14.2x
7/20/11	Land rig assets (RDC)	Ensign Energy Services	Drillers/Drilling Rigs	\$510	NA	NA	100%	NA	7.1x
7/5/11	Ameron International	National Oilwell Varco	Manufacturers	\$772	\$85.00	28%	100%	29.4x	10.5x
5/16/11	LeTourneau (RDC)	Joy Global Inc.	Manufacturers	\$1,100	NA	NA	100%	NA	7.8x
4/15/11	Bronco Drilling	Chesapeake Energy	Drillers/Drilling Rigs	\$288	\$11.00	6%	100%	44.0x	7.2x
4/7/11	Maritime Industrial	Lamprell plc	Diversified	\$304	NOK 38.00	19%	100%	12.7x	7.5x
3/21/11	TGC Industries Inc	Dawson Geophysical	Geophysical/Reservoir Services	\$146	\$8.00	17%	0%	16.0x	5.9x
2/7/11	Pride International	EnSCO plc	Drillers/Drilling Rigs	\$8,704	\$41.60	21%	38%	22.7x	15.0x
12/13/10	Wellstream Holdings	General Electric	Manufacturers	\$1,156	£7.61	5%	100%	23.4x	11.6x
10/15/10	MAC Services Group	Oil States International	Miscellaneous	\$672	AUS \$3.90	16%	100%	20.3x	10.2x
10/6/10	T-3 Energy Services	Robbins & Myers	Manufacturers	\$422	\$31.80	17%	25%	21.2x	10.8x
8/9/10	Superior Well Services	Nabors Industries Ltd	Production/Well Services	\$802	\$22.12	21%	100%	33.7x	6.0x
5/28/10	Scorpion Offshore Ltd	SeaDrill Ltd	Drillers/Drilling Rigs	\$641	NOK 40.50	1%	100%	8.2x	7.4x
4/12/10	Boots & Coots	Halliburton Company	Production/Well Services	\$230	\$3.00	28%	58%	13.0x	5.3x
2/22/10	Smith International	Schlumberger Ltd	Diversified	\$11,670	\$44.51	18%	0%	37.2x	10.2x
12/11/09	Hallin Marine Subsea	Superior Energy Svcs	Offshore Services/Vessels	\$186	£2.33	87%	100%	9.4x	6.3x
8/31/09	BJ Services Company	Baker Hughes Inc.	Production/Well Services	\$4,956	\$17.94	16%	15%	38.7x	9.5x
6/2/09	NATCO Group Inc	Cameron International	Manufacturers	\$689	\$38.45	24%	0%	21.9x	10.0x
11/10/08	Wavefield Inseis ASA	Compagnie Generale	Geophysical/Reservoir Services	\$397	€ 12.71	31%	0%	18.1x	1.6x
9/19/08	DOF Subsea ASA	First Reserve Corp.	Offshore Services/Vessels	\$528	NOK 36.00	24%	100%	13.8x	6.8x
7/7/08	Awilco Offshore ASA	China Oilfield Services Ltd	Drillers/Drilling Rigs	\$3,791	NOK 85.00	19%	100%	14.4x	11.4x
6/24/08	Grey Wolf Incorporated	Precision Drilling	Drillers/Drilling Rigs	\$1,562	\$10.00	16%	50%	13.4x	4.2x
6/13/08	Expro International	Candover (consortium)	Production/Well Services	\$3,698	£16.15	22%	100%	29.3x	11.3x
6/3/08	W-H Energy Services	Smith International	Production/Well Services	\$2,808	\$93.55	9%	60%	17.5x	7.4x
5/30/08	DeepOcean ASA	Trico Marine Services	Offshore Services/Vessels	\$473	NOK 32.00	28%	100%	13.7x	7.8x
4/22/08	Ocean Rig ASA	Dryships Inc	Drillers/Drilling Rigs	\$1,571	NOK 45.00	5%	100%	11.8x	9.4x
2/22/08	CHC Helicopter Corp	First Reserve Corp	Offshore Services/Vessels	\$2,242	€32.68	49%	100%	18.4x	9.1x
12/19/07	Abbot Group	First Reserve Corp	Drillers/Drilling Rigs	\$2,889	\$3.90	17%	100%	NA	15.2x
12/17/07	Grant Prideco	National Oilwell Varco	Manufacturers	\$7,333	\$58.00	22%	40%	13.1x	8.6x
10/30/07	Tubular assets (GRP)	Valourec Group	Manufacturers	\$800	NA	NA	100%	NA	13.1x
9/3/07	Sondex plc	General Electric	Manufacturers	\$583	460 pence	36%	100%	19.6x	11.6x
8/27/07	Lummus Global	Chicago Bridge & Iron	Miscellaneous	\$950	NA	NA	100%	NA	10.5x
7/23/07	GlobalSantaFe	Transocean ASA	Drillers/Drilling Rigs	\$18,040	\$74.77	0%	30%	9.9x	7.7x
6/12/07	Horizon Offshore	Cal Dive International	Offshore Services/Vessels	\$651	\$19.25	14%	48%	13.2x	6.2x
5/29/07	Washington Group	URS Corp.	Miscellaneous	\$2,325	\$80.00	14%	55%	26.8x	13.5x
5/3/07	IPSCO Inc.	SSAB	Manufacturers	\$8,219	\$160.00	8%	100%	13.1x	7.5x
3/29/07	Lone Star Technologies	United States Steel	Manufacturers	\$1,934	\$67.50	39%	100%	18.0x	8.5x
3/19/07	TODCO	Hercules Offshore	Drillers/Drilling Rigs	\$2,291	\$42.01	28%	38%	9.3x	4.6x
2/12/07	HydriL	Tenaris SA	Manufacturers	\$1,992	\$97.00	17%	100%	19.8x	11.6x
11/20/06	Oregon Steel	Evrar Group S.A.	Manufacturers	\$2,298	\$63.25	7%	100%	10.9x	6.2x
9/25/06	Warrior Energy Svcs	Superior Energy Svcs	Production/Well Services	\$358	\$26.58	85%	49%	11.8x	6.0x
9/11/06	NS Group	IPSCO Inc	Manufacturers	\$1,460	\$66.00	43%	100%	10.8x	6.5x
9/5/06	Veritas DGC Inc.	Compagnie Generale	Geophysical/Reservoir Services	\$3,142	\$75.00	21%	51%	31.8x	11.2x
6/13/06	Maverick Tube	Tenaris SA	Manufacturers	\$3,185	\$65.00	42%	100%	9.7x	6.1x

Source: John S. Herold, Inc., Thomson, Factset, Citi Investment Research and Analysis

(BHI.N; US\$64.12; 2H); (CAM.N; US\$49.47; 2H); (ESV.N; US\$47.49; 2H); (HAL.N; US\$47.64; 1H); (HERO.O; US\$3.97; 2S); (NBR.N; US\$19.99; 1H); (NOV.N; US\$70.09; 1H); (RDC.N; US\$35.52; 2S); (RIG.N; US\$57.28; 1H); (SLB.N; US\$79.62; 1M); (SPN.N; US\$35.49; 1H)

Transocean Ltd.

Valuation

We derive our \$81 RIG price target by averaging P/E and EV/EBITDA methodologies. Our target is based on historical analysis of RIG and group multiples.

Our P/E derivation generates a price target of \$81 by applying an 13.0x multiple to our *forward 12-month EPS estimate of \$6.25. The multiple is below the 28.2x peak RIG multiple reached in the most recent downturn and is above the 3.4x trough reached at the peak of the last upturn. The multiple is based on historical analysis of RIG and relative market multiples and is within the 4.5x–47.0x historical range where the average of offshore driller stocks traded over the past ten years. The median group P/E multiple was 13.1x in the most recent cycle.

Our EV/EBITDA derivation generates a price target of \$81 by applying a 6.6x EV/EBITDA multiple to our *forward-12-month adjusted EBITDA of \$4.78 billion. The multiple is below the 17.1x peak RIG multiple reached in the most recent downturn and is above the 3.8x trough reached at the peak of the last upturn. The multiple is based on historical analysis of RIG and relative market multiples and is within the 2.9x–15.6x historical range where the average of offshore driller stocks traded over the past ten years. The median group EV/EBITDA multiple was 7.6x in the most recent cycle.

* Our forward-12-month estimate reflects the four quarters earnings stream beginning 12 months from the most recently reported quarter.

Risks

Our High Risk rating on Transocean is based on projected financial performance, which is highly dependent on the level of oil and natural gas exploration and production (E&P) activity. E&P activity, in turn, can be significantly impacted by rising and falling oil and natural gas prices. Transocean's financial performance is particularly sensitive to both rig demand and day rates. We estimate that under conditions of strong rig demand and full utilization of its fleet, Transocean's earnings per share would change by \$0.13 for every \$1,000 change in its average daily revenue per rig. If the impact on the company from any of these factors proves to be greater/less than we anticipate, we believe the stock will likely have difficulty achieving our target price or could outperform it.

Appendix A-1

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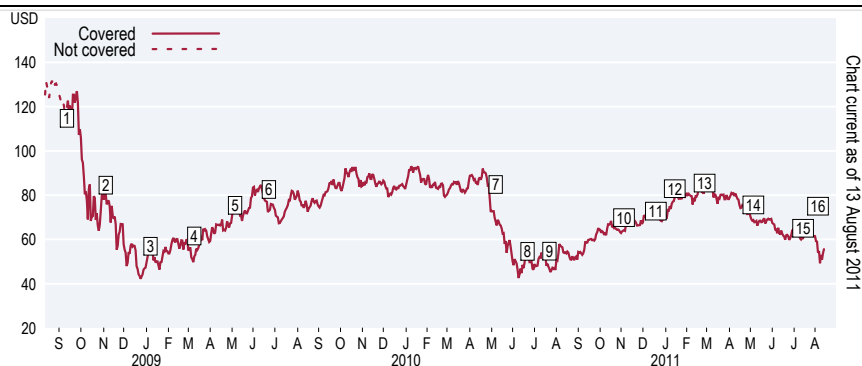
IMPORTANT DISCLOSURES

Transocean Ltd. (RIG)

Ratings and Target Price History Fundamental Research

Analyst: Robin Shoemaker

Covered since September 12 2008



Date	Rating	Target Price	Closing Price
1 11-Sep-08	1H	*159.00	119.92
2 5-Nov-08	1H	*137.00	80.35
3 7-Jan-09	1H	*107.00	54.91
4 10-Mar-09	1H	*98.00	52.30
5 6-May-09	1H	*102.00	74.59
6 23-Jun-09	1H	*100.00	72.98

* Indicates change

Date	Rating	Target Price	Closing Price
7 7-May-10	1H	*98.00	68.01
8 22-Jun-10	1H	*72.00	52.49
9 22-Jul-10	1H	*69.00	46.67
10 4-Nov-10	1H	*80.00	64.21
11 19-Dec-10	1H	*90.00	69.34
12 14-Jan-11	1H	*88.00	79.01

Date	Rating	Target Price	Closing Price
13 25-Feb-11	1H	*97.00	82.80
14 5-May-11	1H	*90.00	68.77
15 14-Jul-11	1H	*87.00	60.59
16 4-Aug-11	1H	*81.00	53.98

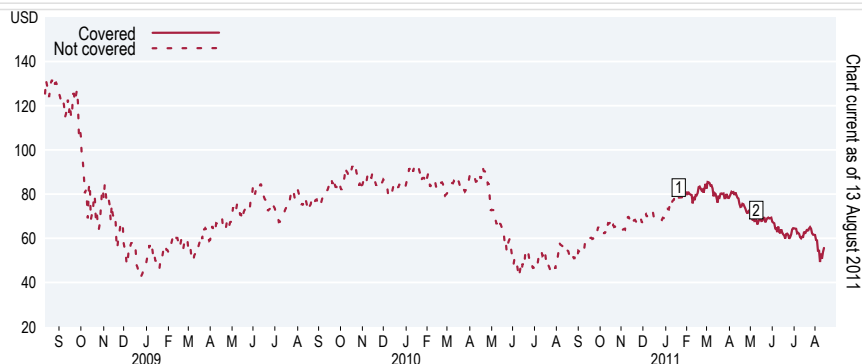
Rating/target price changes above reflect Eastern Standard Time

Transocean Ltd. (RIG)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Robin Shoemaker

Covered since September 12 2008



Date	Rating	Target Price	Closing Price
1 20-Jan-11	*ADD MP	-	78.37

* Indicates change

Date	Rating	Target Price	Closing Price
2 10-May-11	*REM MP	-	68.36

Rating/target price changes above reflect Eastern Standard Time

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