

18 February 2014 | 8 pages

Oil & Gas Equipment & Services  
**CEEMEA | Russian Federation**

## Eurasia Drilling (EDCLq.L)

**Alert:** Jan 2014 drilling meters down 12.6%, wells off 21% y/y, but average depth jumped

**January 2014 drilling volumes dropped 12.6% y/y:** Eurasia Drilling operational statistics for January are now available on the company's website. Total drilling volumes declined by 12.6% y-o-y in January 2014 to 405.9km, compared to 464.3km in January of last year (Figure 1). The significant volume drop is possibly attributable to the decline in the level of activity with Rosneft, which EDC flagged in the most recent guidance update ([2014 Outlook: First Take Negative](#)).

**The number of wells drilled was 21% off y/y:** The number of wells drilled in January declined by 21% to 113 from 143 wells drilled last year. Of those 30 fewer wells, 24 were attributable to the main subsidiary BKE, while the remaining 6 wells were apparently attributable to SGK, where Rosneft's Yuganskneftegas accounted for c65% of drilling volume in 2012.

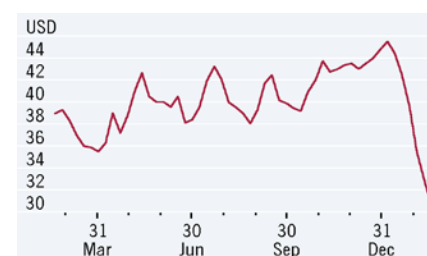
**Average well depth appears to have jumped 10.6% y/y:** If one divides meters drilled by the number of wells, EDC's average well depth increased by 10.6% in Jan 2014 to 3,593 meters/well from 3,247 in the corresponding period of last year. However, we note this metric may be somewhat distorted by sidetracking volumes, as those meters are now being included but, perhaps, they are not being counted as wells. Still, the trend clearly indicates the increasing share of horizontal drilling, and we think the average well is indeed getting deeper.

**We still remain cautious:** As we wrote recently ([Eurasia Drilling \(EDCLq.L\) - Three Reasons to Curb Your Enthusiasm – Too Early to Step In](#)), we see reasons to believe that Russian drilling market may be going through a phase change. In our view, EDC's ability to capitalize on the new trends yet remains uncertain and will largely depend on the management's efforts on the way of adjusting business to the new market realities. Meanwhile, as Eurasia Drilling pointed in the outlook, 2014 EBITDA margin may be back-loaded due to the higher than average inter-customer rig moves this winter. As drilling statistics indicated, the company's next quarterly results are unlikely to be strong, which could weigh on the share price.

**Where we could be wrong?:** Any progress with Rosneft negotiations and/or meaningful increase of activity with other customers, substituting the potential volumes lost with Rosneft, could be a catalyst capable of sparking a relief rally in the share price. In addition, if the cannibalization theory outlined in our recent note is not borne out in the field, and the visibility of EDC's earnings growth therefore improves, our earnings growth projections for the company may prove too conservative.

Neutral	2
Price (17 Feb 14)	US\$30.72
Target price	US\$35.40
Expected share price return	15.2%
Expected dividend yield	3.1%
Expected total return	18.4%
Market Cap	US\$4,509M

Price Performance  
(RIC: EDCLq.L, BB: EDCL LI)



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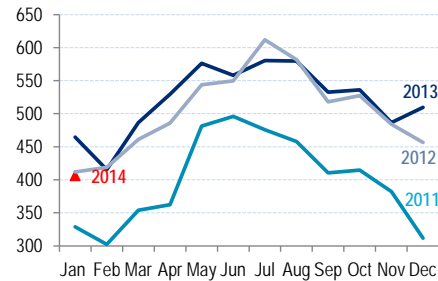
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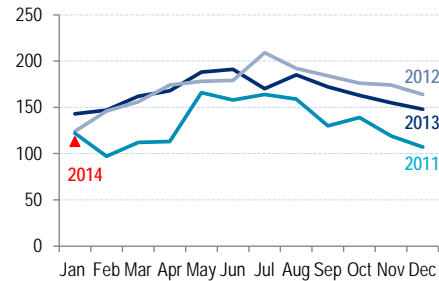


Figure 1. EDC's drilling volumes, km



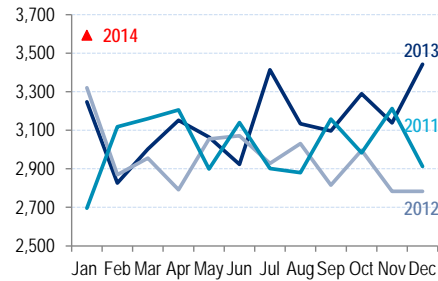
Source: Company data, Citi Research

Figure 2. Wells drilled by EDC, units



Source: Company data, Citi Research

Figure 3. Average well depth, m/well



Source: Company data, Citi Research



## Eurasia Drilling

### Valuation

Our target price of \$35.4/GDR is based three methodologies: 1) DCF valuation of \$35.4 based on a WACC of 10.11% and terminal growth of 4.0% with a 50% weighting, 2) Near-term multiple valuations (25% weighting each) include an implied target price of \$32.9 on a P/E basis (2013-14E) and \$37.6 on an EV/EBITDA basis.

### Risks

The key risks to our investment case are: on the downside: 1) lower-than-expected oil price, 2) regulatory and fiscal risk affecting level of upstream investments, 3) competition risks, 4) customer credit risk, 5) risk of a loss of a large customer; 6) local currency depreciation. On the upside: 1) Operational growth above market level, 2) Value-accretive M&A, 3) International expansion (i.e. Iraq), 4) Stronger than expected demand for drilling services due to the tight oil reserves development acceleration in Russia.

## Appendix A-1

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#### Ratings and Target Price History

#### Fundamental Research

Analyst: Alexander Beshpalov, CFA

Covered since August 31 2012



	Date	Rating	Target Price	Closing Price
1	5-May-11	*1M	*40.00	28.76
2	7-Oct-11	Stock rating system changed		
3	7-Oct-11	*1	40.00	18.00

\* Indicates change

	Date	Rating	Target Price	Closing Price
4	28-Oct-11	1	*35.00	24.68
5	3-May-12	1	*37.00	28.31
6	3-Sep-13	*2	*41.70	39.50

	Date	Rating	Target Price	Closing Price
7	6-Feb-14	2	*35.40	33.20

Rating/target price changes above reflect Eastern Standard Time



## Eurasia Drilling (EDCLq.L)

### Ratings and Target Price History

#### Best Ideas Research

#### Relative Call (3 Month)

Analyst: Alexander Bespalov, CFA

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#### Data current as of 31 Dec 2013

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12 Month Rating			Relative Rating		
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49%	40%	12%	6%	88%	6%
55%	52%	44%	62%	52%	49%

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