

Tear Sheet:

Odfjell Drilling Ltd.

July 3, 2024

We believe offshore activity over the next 24 months will sustain utilization and day rates in the drilling markets. We expect current commodity prices, supply and demand fundamentals for crude oil, and a focus on global energy security will support 2%-7% in offshore drilling spending and activity. As such, we anticipate day rates will remain at current level, or be up to 10% higher for the next 24 months. For Odfjell Drilling, this will translate into EBITDA of \$350 million in 2024 and above \$400 million from 2025, with S&P Global Ratings-adjusted debt to EBITDA remaining below 2x during this period. In our view, a firm backlog of about \$1.9 billion, and contracts in place throughout 2025 greatly limit volatility risks for the next 18 months.

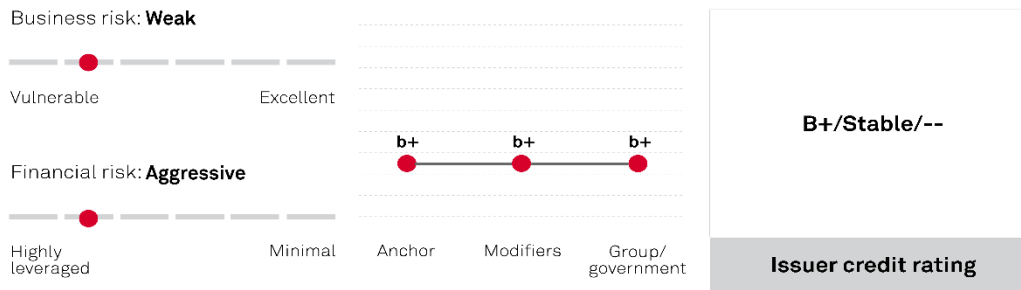
Above-average operating efficiency and profitability will continue to support the rating. While Odfjell Drilling's fleet is small, in terms of number of units owned, we believe it is very well managed, with an overall utilization rate of 95%-100% over the past few years. This, combined with its rigs' high technological specifications, allows the company to contract its rigs more often and at higher day rates than peers, given quicker delivery and hence lower cost for the customer. This supports Odfjell Drilling's superior profitability, with EBITDA margins over 45% on average, an advantage we anticipate will be sustained.

We believe Odfjell Drilling's credit metrics are commensurate with the rating, and are supported by a prudent approach to the balance sheet, despite dividend introduction. Despite drilling being a boom-and-bust cycle type of industry, in our view, Odfjell Drilling is less prone to large EBITDA variations thanks to its long-term contracts with clients, as well as the harsh environmental conditions in Norway, which limit the number of rigs that can work there. Odfjell Drilling went through the previous industry downturn without experiencing a default or distressed exchange. We therefore believe that its prudent leverage target of net debt to EBITDA of 1x-2x over the cycle, and the absence of dividend payments if debt to EBITDA is above 3x, support the rating. We note dividend payments could rise as EBITDA increases.

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Ratings Score Snapshot



Company Description

Founded in 1973 but with roots dating back to 1914 and headquartered in Aberdeen, Scotland, Odfjell Drilling owns and operates mobile offshore drilling units predominantly in Norway. As of Dec. 31, 2022, the company employed 1,358 people. Through its various subsidiaries, Odfjell Drilling has eight rigs in total, four that it owns and four that it operates under management contracts.

The company operates through two main segments: Own fleet and External fleet. The drilling operations and management of Odfjell Drilling's own rigs reflect contracted day rates and additional incentives. Odfjell Drilling only offers operational management to the owners of the rigs in the external fleet, for which it receives a management fee. Although limited, the customer base mostly consists of tier 1 exploration and production companies such as Equinor, Aker BP, Exxon, and Shell.

Odfjell Drilling is a publicly traded company with all its ordinary shares listed on the Oslo Stock Exchange. Its majority owner is Helene Odfjell, who holds 59.6% of the publicly traded shares through Odfjell Partners Holding Ltd. No other shareholder owns more than 2.5% of the shares.

Outlook

The stable outlook reflects our expectation that Odfjell Drilling will reduce its leverage amid supportive market conditions, providing it with the scope to face headwinds at lower points in the cycle. We believe that Odfjell Drilling's fleet of rigs will continue to achieve above-average utilization and efficiency rates. We anticipate debt to EBITDA in the 2x-3x range, which is commensurate with the 'B+' rating.

Downside scenario

We could lower our rating on Odfjell Drilling if we anticipate weaker credit metrics, such as debt to EBITDA consistently above 3.0x or funds from operations to debt below 30%. This could occur if:

- Weaker commodity prices impair demand for offshore drilling services, making it more challenging for the company to re-contract its rigs at favorable day rates; and
- Odfjell Drilling adopts a more aggressive financial policy on dividends and capital spending.

Upside scenario

We view rating upside as limited in light of Odfjell Drilling's asset and geographic concentration. Such upside is linked to increased scale and cash flow generation, with less dependence on individual assets. Rating upside could also arise if the company's financial policy targets were to become much more stringent, for example with a capital structure that was close to being free of net debt so that debt to EBITDA would be below 1.5x at all points of the cycle.

Key Metrics

Odfjell Drilling Ltd.--Forecast summary

Period ending	Dec-31-2022	Dec-31-2023	Dec-31-2024	Dec-31-2025	Dec-31-2026	Dec-31-2027
(Mil. \$)	2022a	2023a	2024e	2025f	2026f	2027f
Revenue	650	733	770	904	972	1,045
Gross profit	650	733	342	450	510	548
EBITDA (reported)	308	329	335	443	503	541
EBITDA	308	329	336	443	504	542
Less: Cash interest paid	(45)	(56)	(39)	(23)	(14)	(11)
Less: Cash taxes paid	(2)	(6)	(13)	(27)	(36)	(41)
Funds from operations (FFO)	261	267	284	393	454	489
EBIT	139	148	145	252	315	357
Interest expense	56	75	40	23	14	12
Cash flow from operations (CFO)	275	265	264	373	437	495
Capital expenditure (capex)	67	66	144	95	28	28
Free operating cash flow (FOCF)	209	199	120	278	409	467
Dividends	2	28	60	60	60	60
Share repurchases (reported)	75	--	--	--	--	--
Discretionary cash flow (DCF)	131	170	60	218	349	407
Debt (reported)	843	711	595	542	542	542
Plus: Lease liabilities debt	68	63	39	14	(14)	(43)
Plus: Pension and other postretirement debt	0	1	1	1	1	1
Debt	911	775	635	556	529	500
Equity	1,209	1,394	1,427	1,569	1,774	2,018
FOCF (adjusted for lease capex)	150	179	120	278	409	467
Interest expense (reported)	55	75	40	23	14	12
Capex (reported)	67	66	144	95	28	28
Cash and short-term investments (reported)	157	131	50	190	511	889
Adjusted ratios						
Debt/EBITDA (x)	3.0	2.4	1.9	1.3	1.0	0.9
FFO/debt (%)	28.7	34.4	44.7	70.7	85.9	97.9
FFO cash interest coverage (x)	6.8	5.7	8.3	18.4	34.4	43.9
EBITDA interest coverage (x)	5.6	4.4	8.4	18.9	34.8	43.9

Odfjell Drilling Ltd.

Odfjell Drilling Ltd.--Forecast summary

CFO/debt (%)	30.2	34.1	41.6	67.2	82.6	99.1
FOCF/debt (%)	22.9	25.6	18.9	50.1	77.3	93.5
DCF/debt (%)	14.4	21.9	9.5	39.3	66.0	81.5
Lease capex-adjusted FOCF/debt (%)	16.5	23.1	18.9	50.1	77.3	93.5
Annual revenue growth (%)	13.5	12.8	5.1	17.3	7.5	7.5
Gross margin (%)	100.0	100.0	44.4	49.8	52.5	52.5
EBITDA margin (%)	47.5	44.9	43.6	49.0	51.9	51.9
Return on capital (%)	6.2	6.9	6.9	12.0	14.2	14.8
Return on total assets (%)	5.9	6.6	6.4	11.3	13.4	14.0
EBITDA/cash interest (x)	6.9	5.9	8.6	19.6	37.1	47.5
EBIT interest coverage (x)	2.5	2.0	3.7	10.8	21.8	28.9
Debt/debt and equity (%)	43.0	35.7	30.8	26.2	23.0	19.8
Debt fixed-charge coverage (x)	5.6	4.4	0.5	5.8	34.8	43.9
Debt/debt and undepreciated equity (%)	43.0	35.7	30.8	26.2	23.0	19.8

All figures are adjusted by S&P Global Ratings, unless stated as reported. a--Actual. e--Estimate. f--Forecast. \$--U.S. dollar.

Financial Summary

Odfjell Drilling Ltd.--Financial Summary

Period ending	Dec-31-2022	Dec-31-2023
Reporting period	2022a	2023a
Display currency (mil.)	\$	\$
Revenues	650	733
EBITDA	308	329
Funds from operations (FFO)	261	267
Interest expense	56	75
Cash interest paid	45	56
Operating cash flow (OCF)	275	265
Capital expenditure	67	66
Free operating cash flow (FOCF)	209	199
Discretionary cash flow (DCF)	131	170
Cash and short-term investments	149	113
Gross available cash	149	113
Debt	911	775
Common equity	1,209	1,394
Adjusted ratios		
EBITDA margin (%)	47.5	44.9
Return on capital (%)	6.2	6.9
EBITDA interest coverage (x)	5.6	4.4

Odfjell Drilling Ltd.--Financial Summary

FFO cash interest coverage (x)	6.8	5.7
Debt/EBITDA (x)	3.0	2.4
FFO/debt (%)	28.7	34.4
OCF/debt (%)	30.2	34.1
FOCF/debt (%)	22.9	25.6
DCF/debt (%)	14.4	21.9

Peer Comparison

Odfjell Drilling Ltd.--Peer Comparisons

	Odfjell Drilling Ltd.	Seadrill Ltd.	Valaris Ltd	Noble Corp. PLC
Foreign currency issuer credit rating	B+/Stable/--	B+/Stable/--	B+/Stable/--	BB-/Stable/--
Local currency issuer credit rating	B+/Stable/--	B+/Stable/--	B+/Stable/--	BB-/Stable/--
Period	Annual	Annual	Annual	Annual
Period ending	2023-12-31	2023-12-31	2023-12-31	2023-12-31
Mil.	\$	\$	\$	\$
Revenue	733	1,502	1,784	2,589
EBITDA	329	483	193	907
Funds from operations (FFO)	267	391	119	720
Interest	75	55	80	63
Cash interest paid	56	68	82	81
Operating cash flow (OCF)	265	259	242	558
Capital expenditure	66	101	354	410
Free operating cash flow (FOCF)	199	158	(111)	149
Discretionary cash flow (DCF)	170	(105)	(315)	(53)
Cash and short-term investments	113	697	621	361
Gross available cash	113	697	621	361
Debt	775	612	1,292	622
Equity	1,394	2,983	1,997	3,921
EBITDA margin (%)	44.9	32.2	10.8	35.0
Return on capital (%)	6.9	13.3	6.1	13.0
EBITDA interest coverage (x)	4.4	8.8	2.4	14.5
FFO cash interest coverage (x)	5.7	6.8	2.4	9.9
Debt/EBITDA (x)	2.4	1.3	6.7	0.7
FFO/debt (%)	34.4	63.9	9.2	115.9
OCF/debt (%)	34.1	42.4	18.7	89.8
FOCF/debt (%)	25.6	25.9	(8.6)	24.0
DCF/debt (%)	21.9	(17.1)	(24.4)	(8.6)

Rating Component Scores

Foreign currency issuer credit rating	B+/Stable/--
Local currency issuer credit rating	B+/Stable/--
Business risk	Weak
Country risk	Very Low
Industry risk	Moderately High
Competitive position	Weak
Financial risk	Aggressive
Cash flow/leverage	Aggressive
Anchor	b+
Diversification/portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Neutral (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile	b+

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria | Corporates | Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

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