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First Half 2023 Earnings Call Transcript

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Corporate Participants

Abdulkareem Al Masabi – *ADNOC L&S – Chief Executive Officer*

Nicholas Gleeson – *ADNOC L&S – Chief Financial Officer*

Neeraj Kumar – *ADNOC L&S – VP Investor Relations*

Operator

Hello, everyone. Welcome to ADNOC L&S results call and thank you for standing by. I would like to inform all participants that this conference call, as well as the Q&A, is being recorded and will be available to clients of JP Morgan. Parts of this conference call may also be reproduced in JP Morgan Research. If you have any objections, you may disconnect at this time. Press participants are not permitted on this call and should disconnect now, unless otherwise permitted by internal JP Morgan policy. Members of JP Morgan Investment and Corporate Banking are not permitted on this call and should disconnect now. At this time, all participants are in listen only mode until the Q&A portion of the call. If you would like to ask a question, please press star, followed by one, on your telephone keypad. If you have joined online, please use the Q&A chat box provided. I will now hand over to your host, Anna Antonova from JP Morgan to begin. Anna please go ahead.

Anna Antonova - *JPMorgan*

Thank you. Good morning and good afternoon, ladies and gentlemen. My name is Anna Antonova from JP Morgan. I cover diversified industrials in MENA and CEEMEA, and I'm pleased to welcome you today to the H1 earnings call of ADNOC Logistics and Services, the first earnings calls since the company became public a few months ago. And without further ado, I'd like to pass the floor to the company's Head of IR, Neeraj Kumar, to introduce the team and begin the presentation. Neeraj, the floor is yours.

Neeraj Kumar – *ADNOC L&S – Vice President, Investor Relations*

Thank you, Anna. Hi. Good afternoon and welcome to the ADNOC L&S earnings call for the first half of 2023. My name is Neeraj Kumar, and I'm the Vice President Investor Relations at ADNOC L&S. Today marks a milestone for our company with this being our first earnings call since our IPO in June. On behalf of the team on this call, we greatly appreciate the level of interest and support, and welcome the continued active engagement of our investor and analyst community. Just for the disclaimer, as a publicly listed company, I need to remind you of our disclaimer on the slide shown, which we encourage you to read. It contains important information, and we advise caution on the interpretation and limitations of the historical data and forward-looking statements. For reference, the presentation slides are available on our investor relations website. Presenting today are Abdulkareem Al Masabi, ADNOC L&S CEO, Nicholas Gleeson, CFO. I will now hand over to our CEO for his opening remarks.

Abdulkareem Al Masabi – *ADNOC L&S – Chief Executive Officer*

Salam Alaikum. A very good afternoon to all. Thank you, Neeraj, and thank you, all, for joining us today. I am pleased to host the first earnings call for ADNOC L&S as an ADX listed company. We all remember that our IPO had the highest level of subscription ever in the UAE with 163 times over subscription. And with that, we greatly appreciate the confidence placed in us by local, regional, and our international investors. And I should also thank the exceptional work of the deal team, who led us through the IPO.

Today, I am very delighted to share our excellent results achieved for the first half of 2023. Following our record-breaking IPO, ADNOC L&S has delivered exceptionally strong financial results for the first half of 2023. And as you've seen, it was 327% growth in net profit over the same period from last year.

This impressive performance is driven by our responsible plans to expand our asset and customer base, and decarbonise our operations, and, enter new verticals in a timely manner, while strategically positioning ADNOC L&S to basically capitalise on ADNOC's ambitious growth strategy. And as part of our smart growth strategy, we remain focused on extending our geographical footprint, exploring new revenue streams, and unlocking further value for our shareholders. If we go to the next slide, please. This just shows you our HSE records. We always say it's 100% HSE, as our slogan within the ADNOC Group of companies, but also, within the ADNOC Logistics and Service. And ADNOC and its values are underpinned by an unwavering focus on the HSE side and the environment, pursuing the goal of zero harm to our people or the community, which has led to our outstanding track record, which is actually one of the best in the industry by any benchmark.

And if you look at the TRIR, you can see that there is a nice downward trajectory, in terms of TRIR percentage. And with this, let me hand over to Nick to update, in detail, on the H1 results. Over to you, Nick.

Nicholas Gleeson – *ADNOC L&S – Chief Financial Officer*

Thanks very much, Captain Abdulkareem, and thanks very much to investors and analysts joining today. We really appreciate your interest in our company, and we really appreciate the participation that we had at the IPO. We're very proud to have delivered strong results against the commitments that we were making at the time of the IPO, and we hope we've made investors happy with these results. You see our revenue up to $1.225 billion, up 62%. Our EBITDA, $417 million, up by 188% half on half, with EBITDA margins at 34.1% now against our 30% guide, driven by the strong efficiencies we've achieved in the business, as well as strong performance in shipping. Our net profit, $307 million is up 327% against the same half last year. So, we've continued strong performance delivery across all three major segments, and as a result, we're positively adjusting our guidance, and I'll speak to that in detail later on.

So, at IPO, we walked our investors through our smart growth strategy, and in essence, there are four elements to this. Growth with and expansion of services to ADNOC, expanding our service offerings to non-ADNOC clients, entering into new verticals, and enlarging our client base to extend our international footprint. And we're moving forward, as you've seen, on all of these fronts. So, the EPC contract award of $975 million, supporting ADNOC's G [unclear] island, artificial island, construction, is a great example of pushing on two of these boundaries. We've also seen that incremental work, for example, in Saudi, we've brought additional ships into the fleet, we've extended our footprint of international energy delivery, so we're moving forward on all growth fronts. We've taken delivery of two of the four market leading environmentally efficient new build VLCCs, which will have their full impact in the second half of 2023, given those two are only recently delivered, and the other two deliver later in the year.

So, on slide seven, we have the summary of financial results, and I've already spoken to these at a high level. But what you can see is that generally, across the board, we've had very strong performance. So, growth in revenue, growth in EBITDA, our margins improving significantly, and as a result of that, delivering that significantly improved net profit I spoke to. So, earnings per share of two US cents, or seven dirham cents. Capital expenditures, you can see, year-to-date, the first half of 2023 at $220 million. Of course, our capital expenditure plan for the year is over $1 billion dollars. And we guided, at IPO, that the vast majority of that would be back end of. You see a positive free cash flow of $82 million.

That's driven, of course, by the higher EBITDA margin performance that we've experienced than initially guided. And as a result of that, we haven't drawn down on debt at all at this stage.

So, we've used free cash flows from operations to fund that CapEx so far. So, our net debt to EBITDA is negative 0.05 times, but we do intend, as we move into the next phase of the CapEx programme, to draw down on that efficiently priced external debt, which is at 85 bps margin. So, in anyone's terms, I think we can regard this as a robust financial performance. Slide eight shows the growth trends that have been achieved in the Group level results. Both revenues and margins trending strongly, driven, in particular, by the Zakher Marine acquisition in November 2022, along with the positive rates that we've achieved in both gas and tankers. Revenues grew by 62% to $1.2 billion for the half, with EBITDA margins expanding towards our midterm, mid-30s target, ahead of schedule, with particular strength from jack-up barges from the other offshore logistics segment, where we've seen market tightening as well, as well as the gas and the tankers' shipping performance.

So, in terms of operational highlights, on slide nine, you can see the important expansion of material handling volume in integrated logistics, which is a part of the driver for that improvement in the offshore logistics performance. So, coupled with the jack-up barge fleet and the DP2s and conventional we acquired with Zakher Marine, you see that very strong growth performance in integrated logistics. On the right hand side of the same page, you can see that we've grown our fleet to 56 vessels, including the six under construction, with utilisation rates continuing in the high 90s. We own and operate one of the largest diversified shipping fleets in the Gulf countries, comprising modern and technologically advanced vessels, with over $2 billion invested, or to be invested, into decarbonisation of our fleet.
On slide ten, you can see quickly the development of rates over time. I won't go into too much detail. We're not talking to specific rates. But in principle, what you can see is that both products and crude tankers have remained relatively strong, and in fact, what we see is quite some potential for growth. Of course, we'd always guide towards using external market analysts for the outlook on rates. Dry bulk has retreated somewhat, and we expect that to remain consistent into the medium term. So, if we move to the next slide, you'll see that in the integrated logistics fleet, we've had exceptional growth from 2022 to 2023. And this, of course, is driven by the acquisition of Zakher Marine, the world's largest owner operator of self-propelled, self-elevated jack-up barges.

So, this acquisition has proven to be very well timed. We've seen that market tightening, and so the rates achieved on those jack-up barges have been very strong. We've had strong and improving utilisation rates across the jack-up barges, which we see continuing to improve today. And in general, strong performance in offshore margins, with a tight market across the Gulf countries. Net profit has increased tenfold half on half, as a result of that acquisition, along with the May 2022 inception of the ILSP model, as well as other works that we've been carrying out through the offshore logistics and the integrated logistics segment. We see growth on all fronts ILSP, jack-up barges onshore, along with the new EPC contract coming into the P&L from the end of this year.

On slide 12, when you look at the breakdown across shipping, you'll see that on the dry bulk side, revenue and profit contributions have reduced with declining rates, as we anticipated coming into this part of the year. Tankers have held firm, delivering strong profitability. We did see the rates dipped somewhat, but actually, the outlook remains reasonable on tankers. We have two new build VLCCs delivered and two more coming in the second half, which will contribute to further revenue and EBITDA growth in the half. The gas shipping outlook remains strong long term, with dry bulk anticipated to steady around current levels. And tankers could steady or come off somewhat on the rates side, but overall, will grow, as a result of the incremental fleet.

On slide 13, you can see the growth in revenues in the marine fleet, with the benefit of a one-off equipment installation project, supporting revenues and profitability. And we have new projects, which have been renewed that we'll see strengthen into the back half of the year. And I'll guide to what that means for the profit outlook later in the presentation. If we move to slide 14, you can see our cash flow position. And what's most notable here, I think, is very strong EBITDA, the $417 million for half, which has been delivered, which puts us in a very positive position. So, we have $113 million change in working capital, which is simply related to the growth of the business overall. And that leaves us with operating free cash flows of $302 million. With CapEx of $220 million, we're left with $82 million positive free cash flow for the half. And that position does really well, coming into the second half, when we get into this stronger level of CapEx spend and growth investment.

So, on the net debt side, we've left ourselves unlevered. We're at negative 0.05 times net debt to EBITDA, and we're very well positioned for the next phase of the smart growth strategy. Moving on to the next slide. I think it's important to mention that while we're doing all of this, we've continually improved our carbon intensity since 2020, and we anticipate showing further progress for 2023. As I mentioned before, we’re investing $2 billion in vessels with dual fuel capability and retrofitting vessels, with air lubrication systems, along with using projects, such as coal binding [unclear] to increase the use of shore power in place of diesel, and all of these things are reducing our carbon footprint, and helping us to move towards those decarbonisation plans that we have in place.

We're very proud that ADNOC has brought forward its net zero ambitions from 2050 to 2045, and will be an active contributor to that achievement, having already reduced our carbon intensity by over 17% since 2019. So, we have a collaboration underway with Khalifa University to pilot testing low carbon alternative fuels for marine use, on top of all that spending that we have in place on our fleet, to make sure that we're operating as technologically advanced carbon efficiently. On the next slide, I mentioned earlier positive adjustments to our outlook, and I think this is probably the part of the presentation many people are waiting for. So, slide 16, we run through our segmental medium term targets. On integrated logistics, we see strong double digit year-on-year growth in 2023 and 2024, including that new EPC project. Thereafter, we see growth in line with UAE inflation.

With important gains already made, we target EBITDA margins above 30% in 2023, and remaining in the mid-30s thereafter. On shipping, we see low single digit growth on gas carriers near term, with increases of 50% year-on-year in 2025, 26, which is driven by that large newbuild fleet coming in onto long-term contracts, predominantly, with ADNOC Gas. On tankers, we see the new VLCC additions driving growth in 2023, and having full year impact in 2024. And thereafter, that growth of UAE inflation levels. On dry bulk, we anticipate rates continuing at the lower levels, compared to 2022 in the medium term, and from 2025, we anticipate growth in line with UAE inflation. On EBITDA, we see mid-single digit margin expansion in 2023 to levels, which we think are sustainable over the medium term.

On marine services, we see mid to high single digit year-on-year growth in 2023, with growth in line with UAE inflation thereafter. And we see EBITDA margins continuing to grow to beyond 20%, having already grown to 19%, and remaining at those levels in the medium term in that marine services segment. So, what does this mean at Group level? If we move to the next slide, 17, you'll see that we're targeting mid to high single digit consolidated revenue growth year-on-year over the medium term. We see consolidated EBITDA in 2023 above 30%, likely to remain in the mid-30s mid-term thereafter. We continue to target organic growth CapEx of $4 billion to $5 billion in the medium term, and we see opportunities to expand accretive beyond that. We continue to target low double-digit IRRs on investments, and to keep a watch for value accretive M&A.

You can imagine that now we're delivering such strong positive cash flows for that margin improvement, which has already been achieved, that positions us even better, financially, to be able to continue to grow the business at and beyond the pace that we've talked about. And then finally, of course, we have the opportunity to participate in value accretive M&A. And given the industries we operate in, the capabilities that we have, and the margins that we're able to generate using our unique business model, leveraging scale, we see a significant range of opportunities that could be interesting in the mid to long term. We target a mean leverage of two to 2.5 times over the medium term, although we don't see that as a cap on our leverage. And we can move beyond that, if it makes sense to take advantage of value accretive opportunities. And with that, I'll pass back to Captain Abdulkareem.

Abdulkareem Al Masabi – *ADNOC L&S – Chief Executive Officer*

Thank you very much, Nick. We all enjoyed the session, and it has been helpful [unclear] to look at the numbers. And at the same time, I'm very proud, actually, of what ADNOC L&S has achieved over the last year and the last quarters. And very strong value, actually, when it comes to delivering our shareholders' expectations, who have placed their trust in us, since the listing of ADNOC L&S. ADNOC L&S, with these impressive results, delivering over 327 growth in net profit, is a remarkable milestone for us that we have promised that we've delivered. So, this is what we plan to continue, basically, growing in size and profitability through the smart and well time value accretive investments that will take advantage of our capabilities, our existing asset platform, and our extensive international network of business partners in the international energy sector.

And we are continuing to deliver on our smart growth strategy with two environmentally friendly VLCCs that you have seen being delivered, and two more to be delivered later this year. And our highly capable team took those new deliveries straight to work at very good rates. ADNOC L&S, as highlighted by Nick, has won a $970 million EPC contract with ADNOC Offshore, which represents our capabilities to leverage our skillsets and relationship to intel and to new business areas, generating fresh needed revenue streams for L&S. On the back of the excellent results, we have still been able to adjust our guidance positively. And lastly, on dividends, let me reiterate our view on position. The board has adopted a dividend policy aimed at maximising shareholder value, while reflecting the company's strong earnings potential and cash flow generation.

The company intends to pay a dividend in Q [unclear] for 2023, for the first half of 2023, with the specific dividend amounts to be determined by the board. At the time of listing, the company indicated an H1 2023 dividend of $65 million. The final dividend is anticipated to be paid in Q2 2024 for the second half of 2023. At the time of listing, the company indicated a half two 2023 dividend of $130 million. Thank you again for joining us today. We prize our investors, as we do our team, our clients, suppliers, and business partners. And we'll be glad to answer any questions you may have. And I will now hand the call back to Neeraj to moderate the questions. Thank you.

Neeraj Kumar – *ADNOC L&S – Vice President, Investor Relations*

Thank you very much. This concludes our presentation. Now we are open for the question and answer. So, either you can put the questions in the chat, or you can raise your hand and we can do live questions as well. I'll take a pause for a few seconds to look at the questions.

Operator

As a reminder, if you would like to ask a question, please press star, followed by one, on your telephone keypad. If you have joined online, please use the Q&A chat box provided. I'll hand back to you, Neeraj.

Nicholas Gleeson – *ADNOC L&S – Chief Financial Officer*

Thanks very much. So, we have a question already. I'll mention the questions without names, obviously. So, as of June 23rd, the company had capital commitments of 1.4 billion, and earlier, you indicated 2023 estimate CapEx of 1.1 to 1.2 billion, versus only 223 million, year-to-date, I'm assuming that means, so around 20% of target in the first half. Can we still expect Group CapEx to accelerate in half two, or may we see downward revisions to your FY CapEx guidance? All right, let me give a little bit of colour around how we do our CapEx planning. So, typically, we look at the work opportunities that are in the market for our business, the requirements to increase the size of our fleet to meet the growth in our client based needs, and then we project asset acquisitions along those lines. We also look at oncoming projects and make sure that we'll have the right budget in place to acquire assets to meet those projects.

So, at the time of the IPO, we mentioned already that the first half spend on CapEx was relatively low, compared to the full year plan. So, it shouldn't be a great surprise that year-to-date, June, it's only $220 million. We still have a plan to spend more than a billion dollars at the full year, so we do expect CapEx to accelerate substantially in the second half. What's driving that? We have, in offshore logistics, for example, moved to a level of utilisation, which is so high that you want to make sure that your fleet underpinning that is starting to grow, so that we can meet new opportunities as they come in. We have still the next two VLCCs to be delivered in the second half of the year. We've actually managed to push back some of our instalment payments on certain vessels, which reduces our CapEx plan in 2023. But all of our growth CapEx is still targeted for this year, and that $4 billion to $5 billion plan that we talked about at IPO remains relevant. So, no, there's no downward guidance on growth CapEx plan, medium or long term.

There's another question here. How would you hedge the improbable risk of ADNOC not following through with their oil expansion of five million barrels per day? There seems to be a conflicting oil production strategy between KSA and UAE currently. Well, I can't speak to the strategies of the two nations, but what I can say is that our oil tanker fleet at the moment is plying international waters and working for a range of international companies. So, we're not heavily exposed to the oil expansion in terms of the international transportation. In terms of the domestic work that we carry out in our integrated logistics segment of the business, we've been re-contracting assets recently, as strong rates on multiyear periods. We have ILSP in place, which is a very long term contract. So, we have very strong underpinning of our outlook for both revenues and EBITDA.

And how we improve our EBITDA is by operating more efficiently than originally planned against those contracts. So, no, we don't feel like we're very exposed to the risk of any reduction in that oil expansion outlook. There's a couple of audio queries. Would the moderator please bring those through to the call?

Operator

Of course. Our first question goes to Sathish Sivakumar of Citigroup. Sathish, please go ahead, your line is open.

Sathish Sivakumar - *Citibank*

Thanks again for the presentation. I’ve got two questions here. So, firstly, within the integrated logistics, in terms of contract repricing, could you just give us an update on where we are on that side? Because during the IPO, you did mention that you're going to be repricing some of those legacy contracts, both at Zakher Marine, as well as your standalone [unclear] contracts. So, any colour on where we are on the jack-up portfolios being repriced, and what will be the impact on the functional pricing alone for this year and into next year. And then the second one on the…

Nicholas Gleeson – *ADNOC L&S – Chief Financial Officer*

So, for the ILSP, the ILSP kicked off in May 2022. So, the re-contracting is typically a five year provision, and it's really meant to address any significant shift in underlying fundamentals. But there's no repricing anticipated before that. In terms of the other work that we have in place, we've seen quite a few of the jack-up barges re-contracted, which is good news for us. It was good timing. And that's because the market had firmed up quite significantly. So, that should see a boost in our utilisation in the jack-up barge fleet, as well as improving rates in the second half of the year and going forward over the next couple of years. So, the other projects that we're carrying out in integrated logistics, again, where any of those contracts are being written at the moment, the market has tightened up quite substantially. So, in general, that will be good news for us, where we have assets coming off contract and being delivered on to new contracts. Sorry, please go ahead with your second question.

Sathish Sivakumar - *Citibank*

The second one is actually on the tanker rate normalisation. I'm just curious as to what will be the lag from the point that it starts to come off? And, actually, you are seeing it within your portfolio, I believe, even just the spot driven market, do you still have some short term contracts there? Any colour on that would be appreciated, too.

Nicholas Gleeson – *ADNOC L&S – Chief Financial Officer*

Our VLCC fleet is operating on the spot market, and that means the lag is unpredictable, because it's dispersed, based on the timing of contracts starting and running off. So, on average, it should broadly follow the market, but from time to time, you'll see us operating above or below the market, just depending on the individual timing of contracts. Typically, if we're behind, we'll catch up. If we're ahead, we'll come back down to get closer to the market in the next reporting period. Actually, if you look at external market analysis, at the moment, you're seeing quite a bit of bullishness, again, in the tanker space, driven by ton mile demand, accompanied by the fleet type and the lack of fleet renewal. So, in general, the market feels a bit more bullish on the tanker segment that we felt some months ago.

Sathish Sivakumar - *Citibank*

Thank you.

Operator

Thank you. As a reminder, if you would like to ask a question, please press star, followed by one, on your telephone keypad. If you have joined online, please use the Q&A chat box provided. Our next question goes to Ashish Khetan of Citi Group. Ashish, please go ahead, your line is open.

Ashish Khetan - *Citibank*

Hello, everyone. Thanks for taking my question. I just wanted to understand on the margin profile of the gas segment, the margin was very strong in H1 at around 74%. So, is this a benchmark going forward? And since the new vessels that will be coming up in 25, 26 are more advanced, do we expect those to have a similar rate of margin? Thank you.

Nicholas Gleeson – *ADNOC L&S – Chief Financial Officer*

It's a good question, because for the LNG carrier segment, we've really seen particular unique strength in LNG carrier margins recently. And that's anticipated to continue for at least several years into the future. And the reason for that is we've seen much higher demand, in terms of ton miles with significant restrictions on supply. So, it's very hard to buy a new LNG carrier at the moment, because the yard spaces are fully booked. And there's just a dearth of supply to meet the demand that's there in the market. And as a result of that, yes, we see strong rates on LNG carriers, and we anticipate those to continue for some years into the future. And I'd highlight that we've already contracted five of the six incoming LNG carriers that have been delivered in 2025 and 26. We acquired those assets below the peak of prices in the market, and it will have to be below the peak, because it's still peaking, as we speak.

But the rates were contracted some time after those acquisitions, which normally means that the rate environment the time of contracting was better than the new build price environment at the time of buying. So, yes, in general, we expect margins to stay strong in LNG carriers for several years into the future.

Ashish Khetan - *Citibank*

Got it. Thank you.

Operator

Thank you. And the next question goes to Guillaume Delaby or Société Générale. Guillaume, please go ahead, your line is open.

Guillaume Delaby - *Societe Generale*

Good afternoon. A very basic, candid, and maybe naïve question, if I may. So, you increased your 2023, 2024 revenue guidance. That's correct. Why don't you also increase your EBITDA guidance? Is there an extra cost for growth, or is it just for the nice sake of being conservative? Thank you.

Nicholas Gleeson – *ADNOC L&S – Chief Financial Officer*

Hi, Guillaume, thanks for your question. What we've done is we've actually slightly upgraded our guidance on EBITDA. So, we were originally guiding towards 30%, and now we're guiding above 30% at the same point in time. And what I can tell you, if you look across the business, typically, we don't see any retracement in EBITDA margins in the integrated logistics space. We have to be aware that large contracts, such as the EPC contract, will be on typical margins for that EPC type of business. On the shipping business at the moment, if anything, we see EBITDA margins moving slightly ahead of where we thought they would be at the time of the IPO.

Guillaume Delaby - *Societe Generale*

Thank you, but I'm a little bit puzzled. Where do you say that you also increased your EBITDA guidance? Because I have the IPO guidance…

Nicholas Gleeson – *ADNOC L&S – Chief Financial Officer*

So, the idea, at the Group reporting level, the IPO guidance was towards an EBITDA margin of 30%. And it's now above 30%.

Guillaume Delaby - *Societe Generale*

Okay. Sorry, I missed that. Too many results. Sorry about that. It's a very naïve question, indeed.

Nicholas Gleeson – *ADNOC L&S – Chief Financial Officer*

No, issue at all. All questions are good. Thanks. We've got one more written question here. In note 20 for the H1 IFRS statements, you've commented that introduction of UAE corporate income tax in 2024 will require you to record deferred taxes. And as of June 23rd, you already recognised $3 million of deferred tax assets. Can you shed more light on how these developments may impact your effective tax payments in 2024, if any? It's a really good question. So, the funny thing is, because there's a new tax regime coming in place in the UAE, we have a benefit in our financial statements, which would be against most people's expectations. The reason we have a benefit, is because we have an end of service benefit payable to employees, which attracts a tax offset that will be able to be applied in the future. So, because we've got this tax asset, we then have to record it on our balance sheet, which results in a positive impact of a tax asset coming on the balance sheet.

Going forward, of course, the new tax is not positive news for us, although it's probably very sensible, in terms of the UAE. And essentially, we guide to an effective tax rate of mid-single digits going forward, and a tax impact in the UAE of around 9%.

Operator

Thank you. And as another reminder, if you would like to ask a question, please press star, followed by one, on your telephone keypad. If you have joined online, please use the Q&A chat box provided. We'll pause for just a moment. And we have a follow-up question from Ashish Khetan of Citigroup. Ashish, please go ahead, your line is open.

Ashish Khetan - *Citibank*

Hi. Thank you, everyone, once again. I just have a quick question on SG&A. In Q1, it was around 31 million, and now, again, it was around 32 in Q2. So, do we expect this as a normal ballpark figure going forward, or do you expect a wage hike or something?

Nicholas Gleeson – *ADNOC L&S – Chief Financial Officer*

No. I think that's a reasonable expectation going forward. The only thing is to look at the extreme growth of the business over the next five years, which could drive SG&A upwards. We're continually working towards an environment where we can do more with the same. So, at the moment, I think in the short and medium term, you can look at that as a reasonable quarterly expectation for SG&A.

Ashish Khetan - *Citibank*

Okay, thank you.

Operator

Thank you. I'll hand back to the team for the written questions.

Nicholas Gleeson – *ADNOC L&S – Chief Financial Officer*

Okay, great. We've got a question. The EBITDA margin for integrated logistics was 35% in Q2 23 and 32% for half one 23. However, the guidance suggests a target and EBITDA margin of 30% for integrated logistics in 2023. Are you expecting lower margins in the second half of 23? Second, can you talk about your EBITDA margins on EPC contract, and how it differs from EBITDA margins on jack-up barges and ILSP contracts? Is it high or low, or about 35%? I'm just trying to understand if the higher margin in Q2 23 was because of some EPC contract. This is a very insightful question. So, typically, in the market, EPC contracts deliver mid-single digit types of margins, so they have much higher headline numbers, but delivering margins in what's called the 5% to 8% range, typically in the market. And we think that's a reasonable way of looking at the EPC contracts that we'll be working on going forward.

You can imagine that when you look at the size of the headline number, that if we delivered 34% on that, that would be a $300 million plus EBITDA increment, which, of course, as much as we'd love to do it, you can't make those margins on these types of contracts. So, I think that's probably what you're getting at in your question, and indeed, one of the reasons that you see a slight retracement in the EBITDA margin in the second half of the year is the implementation of that very valuable, but lower, EBITDA margin EPC work. There haven't been works so far on the EPC side. That's kicking off in Q4 of this year. We've got another question, which has come up. Considering the extent of EBITDA to be $290 million in Q2 23 versus an IPO expectation of $720 million for FY 23, can you be more clear about the extent of EBITDA guidance upgrade? Are Q2 margins sustainable?

So, I think that goes to really, exactly the same question. We've given specific guidance, actually, on where we expect margins to be. And so, I would just look at that. If we can go to the second to last page of the presentation, next one back, we see EBITDA margins in 2023 above 30%. And moving upwards, in the low teens towards a long term average of 35%. That's the guidance. So, I really shouldn't speak outside of that. And I think that good question that we had on EPC helps to bring that to bear on why we're not saying 35% by the end of the year, and why we're leaving ourselves some room for retracement in the integrated logistics segment. Okay, next question says could you please comment on what developments push the expected financials above your pre-IPO assumptions? It's a good question. So, there were a few things that happened.

I think the first one in integrated logistics was the acquisition of Zakher Marine turned out to be particularly well timed. And we've seen the rate environment firm up substantially, and a lot of work has been put in by the ZMI team, making sure that they found opportunities to re-contract at good value, and re-contract long term at good value. So, three year plus free contracting on assets, which are earning very good margins. On top of that, you have the efficiency improvements in the other offshore logistics works that we carry out. So, essentially, carrying more with the same number of assets. And we've seen really strong improvements in the utilisation of the offshore logistics assets, which no doubt means that we need to invest more going forward to make sure that we maintain the relevant size of fleet for the work that is out there. But really, it's that combination of strong performance of ZMI investment, along with the improving utilisation of assets in the integrated logistics space.

Next question. Can you please provide some more details on the new EPC contract? What will be timeline for and rough margins? Are you bidding for more such contracts? So, I have to be a little cagey on this question, because this is so material to our results that I can't announce something on this call that we are not yet putting out to the market. And we will announce to the market, as we see more happening, but it's certainly in our ambition set to look for more contracts, and to really build ourselves out into the EPC space. It just seems to take good advantage of the end-to-end logistics capabilities that we have, the project management capabilities, and the extensive relationships we have across the region, that we should go out and take a lead on EPC contracts, and deliver that type of value. All right, there's one more question there.

You have met your midterm EBITDA percentage guidance for integrated logistics 35%. So, yes, indeed, we've met that ahead of time. How should one think about this going forward? Should we expect margins to be volatile and attract lower, depending on EPC volume at a particular period? Or is it simply contracted, and the management was able to accelerate the margin realisation earlier than anticipated? Good question. There are a few components. So, essentially, yes. Management was able to accelerate knowledge and realisation earlier than anticipated for the reasons that I've mentioned, strengthening jack-ups, DP2s, conventional from the ZMI acquisition, strengthening performance of ILSPs, strengthening performance of other projects in the offshore logistics and integrated logistics space. In terms of the impact of EPC going forward, EPC work is likely to be at a different margin level than the rest of the integrated logistics segment.

And so, it will bring us to a point where we'll have to make a decision on how we report on that going forward. But at the moment, yes, I would expect if you see these large headline numbers on EPC projects, you should be applying something more in that mid-single digit margin range for that component of the work to get to the right number. Hopefully, that gives you enough to move forward right now, and we'll let you know as we see more EPC contracts ready to be signed.

Operator

Thank you. And as a final reminder, if you would like to ask a question, please press star, followed by one, on a telephone keypad. If you have joined online, please use the Q&A chat box provided. We'll pause for just a moment. Thank you. It appears we have no further questions. I'll now hand back to Anna for any closing comments.

Anna Antonova - *JPMorgan*

Thank you. With that, I guess we will conclude this earnings call. Thank you, everyone, for your attention and time, and have a very nice and productive day and week ahead. Thank you.

Abdulkareem Al Masabi – *ADNOC L&S – Chief Executive Officer*

Thank you, everyone.

Nicholas Gleeson – *ADNOC L&S – Chief Financial Officer*

Thank you.