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Aug 12, 2020

Transocean Ltd. (RIG)

$2.33 (As of 08/11/20)

Price Target (6-12 Months): **$2.50**

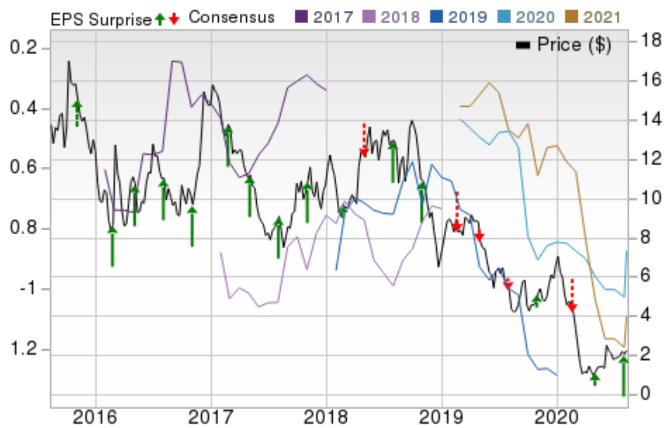
Long Term: 6-12 Months | **Zacks Recommendation:** **Neutral**
(Since: 10/02/18)
Prior Recommendation: Outperform

Short Term: 1-3 Months | **Zacks Rank:** (1-5) **3-Hold**
Zacks Style Scores: VGM:A
Value: B | Growth: B | Momentum: A

Summary

Being the largest provider offshore contract drilling services, Transocean's unrivalled backlog of $8.9 billion offers cash flow visibility. As it is, the company's technologically advanced and versatile drilling fleet differentiates it from competitors and provides it with an edge. Transocean is also taking necessary steps to enhance its fleet with modern and competitive rigs, while scrapping off old and incompetent drillships, which is expected to make its operations more technically effective and efficient. However, the Ocean Rig acquisition has impacted the financials of RIG, leading to stock issuance, debt addition along with cash reduction. To add to the negatives, things are looking bleak for the offshore drilling sector on account of the virus-induced slump. Hence, investors are advised to wait for a better entry point.

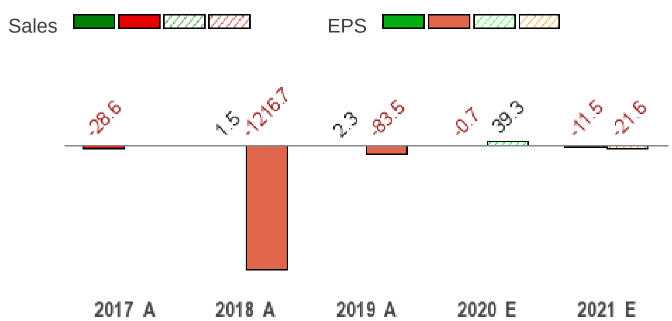
Price, Consensus & Surprise



Data Overview

52 Week High-Low	$7.28 - $0.76
20 Day Average Volume (sh)	18,119,244
Market Cap	$1.4 B
YTD Price Change	-66.1%
Beta	2.46
Dividend / Div Yld	$0.00 / 0.0%
Industry	Oil and Gas - Drilling
Zacks Industry Rank	Bottom 23% (196 out of 253)
Last EPS Surprise	100.0%
Last Sales Surprise	22.9%
EPS F1 Est- 4 week change	13.8%
Expected Report Date	10/26/2020
Earnings ESP	0.0%
P/E TTM	NA
P/E F1	NA
PEG F1	NA
P/S TTM	0.4

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021	685 E	710 E	726 E	691 E	2,712 E
2020	759 A	930 A	766 E	687 E	3,066 E
2019	754 A	758 A	784 A	792 A	3,088 A

EPS Estimates

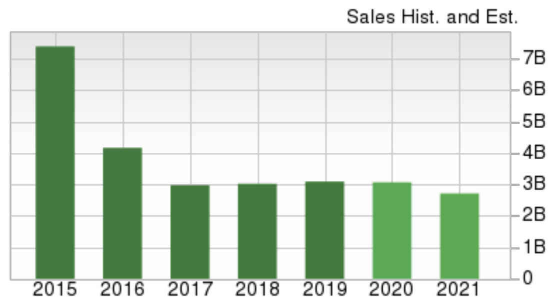
	Q1	Q2	Q3	Q4	Annual*
2021	-$0.26 E	-$0.25 E	-$0.26 E	-$0.30 E	-$1.07 E
2020	-$0.30 A	$0.00 A	-$0.17 E	-$0.27 E	-$0.88 E
2019	-$0.30 A	-$0.34 A	-$0.38 A	-$0.43 A	-$1.45 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 08/11/2020. The reports text is as of 08/12/2020.

Overview

Switzerland-based Transocean, Inc. is the world's largest offshore drilling contractor and leading provider of drilling management services. The company provide rigs on a contractual basis to explore and develop oil and gas. Transocean offers offshore drilling rigs, equipment, services and manpower (with particular emphasis on ultra-deepwater and harsh environment drilling services) to exploration and production companies worldwide.



Transocean's fleet is considered one of the most modern and versatile in the world due to its emphasis on technically demanding segments of the offshore drilling business. Transocean's fleet can be broadly divided into three distinct groups based on drilling capabilities: ultra-deepwater floaters, harsh environment floaters and midwater floaters, which accounted for 63.4%, 35.1% and 1.5%, respectively, of its total revenue for 2019.

Transocean's 31 ultra-deepwater floaters are capable of drilling in water depths of 4,500 feet and more. The company's 14 harsh environment floaters are capable of drilling in harsh environment at water depths between 1,500 and 10,000 feet with greater displacement. The four mid-water floaters operate at water depth of less than 4,500 feet.

Moreover, four ultra-deepwater drillships and one harsh environment semisubmersible are currently under construction. Transocean's fleet is considered one of the most modern and versatile in the world due to its emphasis on technically demanding segments of the offshore drilling business.

Recent Acquisitions: Songa & Ocean Rig

In early 2018, Transocean acquired Norway-based drilling contractor Songa Offshore for $3.4 billion. As a result of the transaction, the company got seven mobile offshore drilling units, including five harsh environment floaters and two midwater floaters.

In December 2018, Transocean snapped up smaller rival Ocean Rig UDW for $2.7-billion. The deal further strengthened its portfolio, in turn expanding fleet size and quality. Notably, the acquisition gave Transocean 11 mobile offshore drilling units, including nine ultra-deepwater floaters and two harsh environment floaters.

Reasons To Buy:

▲ Despite the struggles with coronavirus-induced price and demand slump, Transocean's backlog of $8.9 billion as of Jul 15 reflects steady demand from the customers and offers earnings and cash flow visibility.

Transocean's robust backlog of $8.9 billion offers earnings and cash flow visibility.

▲ Transocean completed two big buyouts in 2018 which has bolstered the offshore game of the company to a considerable extent. The acquisition of Songa and Ocean Rig has not just boosted the Transocean's fleet size, it also provided the company with significant commercial and operational synergies along with boosting long-term growth prospects.

▲ With U.S. offshore industry witnessing early signs of revival, as evidenced by the increasing project sanctions, Transocean is poised to capitalize on trend effectively, given its technologically advanced and versatile drilling fleet. Further, as the drilling fundamentals improve with the rebound in oil price, demand for rigs is likely to improve, benefiting the offshore drilling giant. As it is, the company has been taking necessary steps to enhance its fleet with modern and competitive rigs, while scrapping off old and incompetent drillships, which is expected to make its operations more technically effective and efficient.

Reasons To Sell:

- For most E&P operators, the current oil price in the low-$40s is not enough to support profitable operations, forcing them scrambling to cut costs and stay afloat. As customers drill fewer wells, the demand for contracting work has taken a hit. This puts a great deal of pressure on drilling margins and utilization. In particular, things are looking bleak for the offshore drilling sector, which was among the hardest hit by the 2014 downturn as well. Their sharp price sell-offs reflect their inability to get sufficient daily rates in the current situation. Many oil producers — including biggies Chevron, ExxonMobil and Royal Dutch Shell — have withdrawn from endeavors that require oil to be pegged at $60 per barrel to make a profit and this could consume enough time before they can actually achieve that price again. Such has been the extent of the downturn offshore drillers like Diamond Offshore Drilling, Noble Corporation, Seadrill Limited and Valaris either sought protection from creditors under chapter 11 or already began debt-restructuring discussions to avoid insolvency.

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- While Transocean's acquisition of Ocean Rig in a stock-cash deal worth $2.7 billion bodes well for long term growth, it has adversely affected the financial position of the company. The transaction has led to stock issuance, debt addition along with cash reduction. Transocean's total debt is currently more than $9 billion with less than $2 billion in cash and cash equivalents, which continues to fall over the past many quarters. Moreover, the company's debt-to-capitalization as of the end of second quarter was 45.2%, deteriorating from the prior quarter's 44.4%.

- Notably, Transocean has sold couple of Ocean Rig's drillships including Paros and Eirik Raude owing to high reactivation costs. Also many of the Ocean Rig's drillships are currently stacked, involving stacking costs. Moreover, charges related to the reactivation of such drillships along with the technical challenges to make them operational after such long breaks remain a concern. Rig reactivation and impairment charges amid retirement of drillships are likely to weigh down on the company's margins in the coming periods as well.

Last Earnings Report

Transocean Reports Break-Even Q2 Earnings

Quarter Ending	06/2020
Report Date	Jul 29, 2020
Sales Surprise	22.89%
EPS Surprise	100.00%
Quarterly EPS	0.00
Annual EPS (TTM)	-1.11

Transocean reported break-even earnings for second-quarter 2020. The Zacks Consensus Estimate was pegged at a loss of 27 cents per share. Also, in the year-ago quarter, the company incurred a loss of 34 cents per share. This outperformance reflects improving utilization and higher revenue efficiency.

Meanwhile, the offshore drilling powerhouse generated total revenues of $930 million, beating the Zacks Consensus Estimate of $757 million and also the prior-year figure of $758 million, primarily on proceeds from a legal settlement with a customer.

Segmental Revenue Break-Up

Transocean's Ultra-deepwater floaters contributed to 68.4% of total contract drilling revenues while Harsh Environment floaters and Midwater floaters accounted for the remainder. In the quarter under review, revenues from Ultra-deepwater and Harsh Environment floaters totalled $636 million and $293 million each, indicating a respective 31% and 16.7% improvement from the year-ago reported figures of $486 million and $251 million, respectively.

Revenue efficiency was 97.2%, higher than 94.4% reported sequentially. The figure, however, declined from the year-ago value of 97.8%.

Dayrates and Utilization

Average dayrate in the quarter fell to $307,800 from the year-ago level of $314,900. The company witnessed weak year-over-year average revenues per day from both Midwater floaters and Harsh environment floaters. Overall, fleet utilization was 66% during the quarter, up from the prior-year utilization rate of 56%.

Backlog

Transocean's backlog record at $8.9 billion as of July reflects a decline of $2.5 billion from the year-ago figure.

Costs, Capex & Balance Sheet

Operating and maintenance costs increased to $525 million from $510 million a year ago. The company spent $46 million as capital investment in the second quarter. Cash provided by operating activities totalled $87 million. The company had cash and cash equivalents worth $1.51 billion on Jun 30, 2020. Long-term debt was $8.48 billion with debt-to-capitalization of 43.6% as of the same date.

Guidance

For the third quarter, the company expects adjusted contract drilling revenues to be $800 million with a revenue efficiency of 95%.

Third-quarter operating and maintenance expense is projected to be approximately $500 million. Further, the company projects its G&A expense for the current quarter to be approximately $45 million.

Meanwhile, capital spending for the third quarter comprising capitalized interest is predicted to be almost $80 million, consisting of roughly $50 million for the newbuild drillships under construction and the remaining $30 million for maintenance. Further, management added that it eliminated certain onshore positions — expecting lower activity for this year and the next — to save $80 million in annual costs.

Recent News

Transocean Fleet Status: Backlog at $8.9B

On **Jul 15**, Transocean Ltd. issued its monthly Fleet Update Summary according to which the contract backlog was stated at $8.9 billion. Further, Transocean said that a contract for its Paul B. Loyd Jr. semi-submersible rig in the U.K. was terminated.

Valuation

Transocean shares are down 66.1% in the year-to-date period and 45.9% over the trailing 12-month period. Stocks in the Zacks subindustry and the Zacks Oil-Energy sector are down 56.6% and 34.3% in the year-to-date period, respectively. Over the past year, the Zacks subindustry and sector are down 44.8% and 30.6%, respectively.

Transocean shares are down 71.3% in the year-to-date period and 66.4% over the trailing 12-month period. Stocks in the Zacks subindustry and the Zacks Oil-Energy sector are down 68.7% and 37.5% in the year-to-date period, respectively. Over the past year, the Zacks subindustry and sector are down 68.8% and 39.6%, respectively.

The S&P 500 index is up 4.2% and 15% in the year-to-date period and in the past year, respectively.

The stock is currently trading at 8.95X trailing 12-month EV/EBITDA, which compares to 10.53X for the Zacks sub-industry, 4.73X for the Zacks sector and 12.66X for the S&P 500 index.

Over the past five years, the stock has traded as high as 16.35 and as low as 2.79X, with a 5-year median of 6.12X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our $2.50 price target reflects 0.54X F12M sales.

The table below shows summary valuation data for RIG

Valuation Multiples - RIG

		Stock	Sub-Industry	Sector	S&P 500
EV/EBITDA TTM	Current	8.95	10.53	4.73	12.66
	5-Year High	16.35	15.3	10.47	12.84
	5-Year Low	2.79	4	3.04	8.24
	5-Year Median	6.12	9.12	6.49	10.9
P/S F12M	Current	0.5	0.83	0.73	3.67
	5-Year High	2.28	3.43	1.46	3.67
	5-Year Low	0.17	0.37	0.59	2.53
	5-Year Median	1.21	1.9	0.99	3.05
P/B TTM	Current	0.13	0.25	0.93	4.68
	5-Year High	0.55	0.89	1.54	4.68
	5-Year Low	0.05	0.11	0.52	2.83
	5-Year Median	0.3	0.61	1.31	3.74

As of 08/11/2020

Industry Analysis **Zacks Industry Rank:** Bottom 23% (196 out of 253)

Top Peers

Company (Ticker)	Rec	Rank
KONINKLIJKE VPK **(VOPKY)**	Outperform	3
HelmerichPayne, Inc. **(HP)**	Neutral	3
Independence Contract Drilling, Inc. **(ICD)**	Neutral	3
Nabors Industries Ltd. **(NBR)**	Neutral	3
Noble Corporation **(NE)**	Neutral	4
Precision Drilling Corporation **(PDS)**	Neutral	3
PattersonUTI Energy, Inc. **(PTEN)**	Neutral	3
SAIPEM SPA SAN **(SAPMF)**	Neutral	4

Industry Comparison Industry: Oil And Gas - Drilling

	RIG	X Industry	S&P 500	HP	NE	SAPMF
				Industry Peers		
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	3	4	4
VGM Score	A	-	-	A	-	A
Market Cap	1.43 B	138.91 M	23.61 B	2.09 B	NA	2.12 B
# of Analysts	4	1	14	4	3	2
Dividend Yield	0.00%	0.00%	1.69%	14.62%	%	0.00%
Value Score	B	-	-	B	C	A
Cash/Price	1.41	1.14	0.07	0.25	NA	NA
EV/EBITDA	15.80	2.79	13.32	3.85	NA	NA
PEG Ratio	NA	NA	2.95	NA	NA	NA
Price/Book (P/B)	0.13	0.16	3.22	0.61	NA	0.48
Price/Cash Flow (P/CF)	9.20	1.06	12.79	2.80	NA	3.73
P/E (F1)	NA	9.34	22.02	NA	NA	NA
Price/Sales (P/S)	0.44	0.19	2.57	0.94	NA	NA
Earnings Yield	-37.77%	-42.57%	4.29%	-20.34%	NA%	-0.94%
Debt/Equity	0.77	0.58	0.77	0.14	0.00	NA
Cash Flow ($/share)	0.25	0.38	6.94	6.94	0.25	0.57
Growth Score	B	-	-	B	B	C
Hist. EPS Growth (3-5 yrs)	NA%	-23.30%	10.41%	-3.35%	NA	NA
Proj. EPS Growth (F1/F0)	39.66%	-38.78%	-6.51%	-325.57%	-11.40%	-112.90%
Curr. Cash Flow Growth	-72.37%	-21.95%	5.22%	25.65%	85.52%	NA
Hist. Cash Flow Growth (3-5 yrs)	-44.46%	-14.88%	8.55%	-8.86%	-46.50%	NA
Current Ratio	2.07	1.90	1.34	4.09	0.14	NA
Debt/Capital	43.56%	36.88%	44.59%	12.39%	0.00%	NA
Net Margin	-54.06%	-53.13%	10.13%	-17.81%	-126.73%	NA
Return on Equity	-5.92%	-13.37%	14.59%	0.61%	-11.87%	NA
Sales/Assets	0.14	0.23	0.51	0.41	0.16	NA
Proj. Sales Growth (F1/F0)	-0.70%	-0.52%	-1.45%	-37.67%	-27.46%	-0.34%
Momentum Score	A	-	-	B	-	C
Daily Price Chg	-2.10%	0.00%	-0.17%	0.00%	0.00%	0.00%
1 Week Price Chg	9.80%	0.86%	2.30%	3.42%	NA%	0.00%
4 Week Price Chg	20.10%	0.32%	6.41%	2.43%	NA%	-16.47%
12 Week Price Chg	65.25%	3.80%	15.42%	3.02%	NA	-5.33%
52 Week Price Chg	-45.81%	-52.04%	2.88%	-52.04%	NA	-58.64%
20 Day Average Volume	18,119,244	237,568	2,007,486	1,949,305	6,403,073	554
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	11.39%	0.00%	0.00%
(F1) EPS Est 4 week change	13.79%	0.00%	1.84%	23.25%	4.33%	-300.00%
(F1) EPS Est 12 week change	13.88%	1.43%	2.40%	16.19%	5.72%	-130.77%
(Q1) EPS Est Mthly Chg	18.12%	1.53%	0.72%	-4.49%	2.65%	0.00%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	B
Growth Score	B
Momentum Score	A
VGM Score	A

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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