



December 20, 2023

THE LONG PULL: Borr Drilling (BORR)

Borr Drilling (BORR) is a pure-play jackup operator with 24 modern, high-spec jackup rigs. The company contracts with large E&Ps like Aramco, Total, E.ON, and Shell to drill in shallow waters off Latin American and Middle Eastern coasts.

BORR has one of the cleanest fundamental/value setups I've seen this year. The company trades at half its replacement cost and has ~\$2B in backlog revenue.

Dayrates are inflecting as aging fleets and a historically low order book amplifies an already supply-constrained industry. Newbuild economic dayrates are 40% higher than today's prices.

The company has the youngest fleet (~6 years) and the lowest breakeven in the industry (around \$59K), allowing it to generate significant profits in a higher-rate environment.

Finally, BORR refinanced its long-term debt and pushed maturities to 2028-2029. This leaves five years to return capital via quarterly dividends (currently \$0.05/share) and share buybacks (\$100M on the current plan).

The company has a path to \$750M+ in annual EBITDA over the next two years as it benefits from higher dayrates, lower breakevens, a supportive oil price, and a growing supply/demand imbalance.

We're at 94% utilization rates today. Historically, day rates skyrocket beyond \$200K when utilization rates cross 95%. If that happens, BORR will earn **\$900M+** in annual EBITDA.

We bought our position around \$7.16/share or at a \$1.8B market cap and \$3.3B EV (~\$1.5B in net debt).

These stocks trade around 5-7x EBITDA and can reach 7-9x during an upcycle.

BORR is a \$12 stock at 6x EBITDA and even higher in a sustained newbuild economic pricing environment. I don't see how we lose money buying at today's prices.

Let's dive in.

What Are Jackups?

Let's start with the basics. Here's a picture of one of BORR's jackups.



Jackups are giant floating steel contraptions that drill for oil in water ranging from 30 to 400 feet (i.e., shallow water). The maximum depth a jackup can drill is ~34,000 feet. The critical thing to remember is the *water* depth. Jackups drill in shallow water.

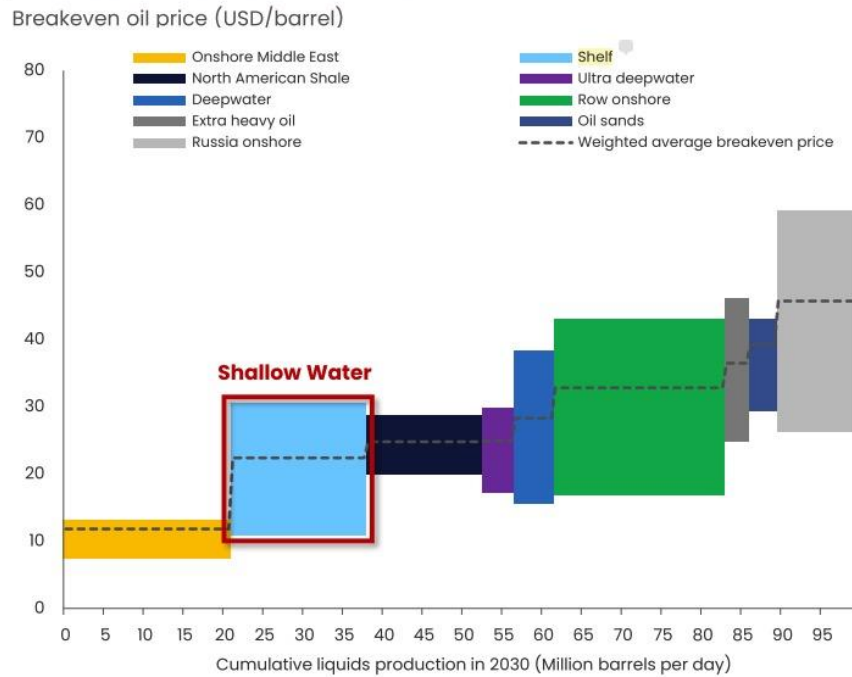
This is an important distinction because I know some of you reading this are thinking, “*Wait a minute. I’ve seen Deep Water Horizon with Mark Wahlberg. I know about jackups.*” Wrong. Those are deep-water drillers with their own unique supply/demand dynamics.

BORR owns 24 jackups, 22 operating and two under construction, with deliveries in 2024-2025. You can nerd out on BORR’s fleet specs [here](#).

Let’s talk shallow water. Oil and gas production flows on a spectrum from low-cost to high-cost barrels. The Canadian Oil Sands – which we discussed in our NOA deep dive – is a low-cost barrel (around \$40). In contrast, Russian onshore shale costs nearly \$60 per barrel.

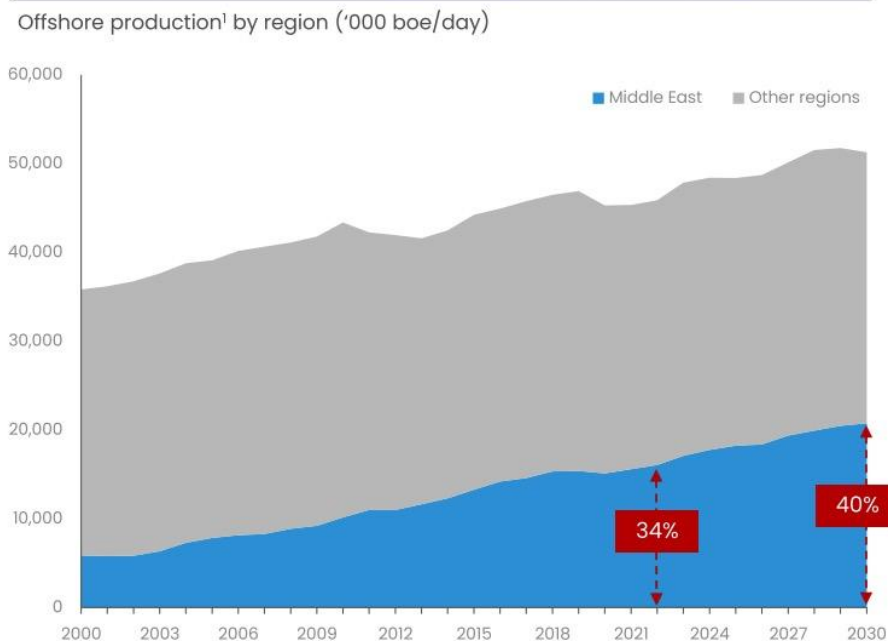
Shallow water drilling costs ~\$25 per barrel, making it one of the lowest-cost and largest-producing oil sources (see below).

Large resources at low breakeven cost



Large Middle Eastern producers are noticing. In 2000, the Middle East produced ~10% of its oil from offshore sources. By 2022, that figure jumped to 34%. And by 2030, it's estimated that 40% of the Middle East's oil will come from offshore drilling.

Middle East with increased focus on offshore shallow water



How does this relate to BORR?

Shallow water drilling “works” as long as oil stays above \$50/bbl. And since our base case is that oil trades between \$70-\$100 over the next 12-18 months, BORR will have no problem contracting its jackups.

Another reason why I’m so confident in the BORR thesis is because of the crippling supply outlook for jackup rigs.

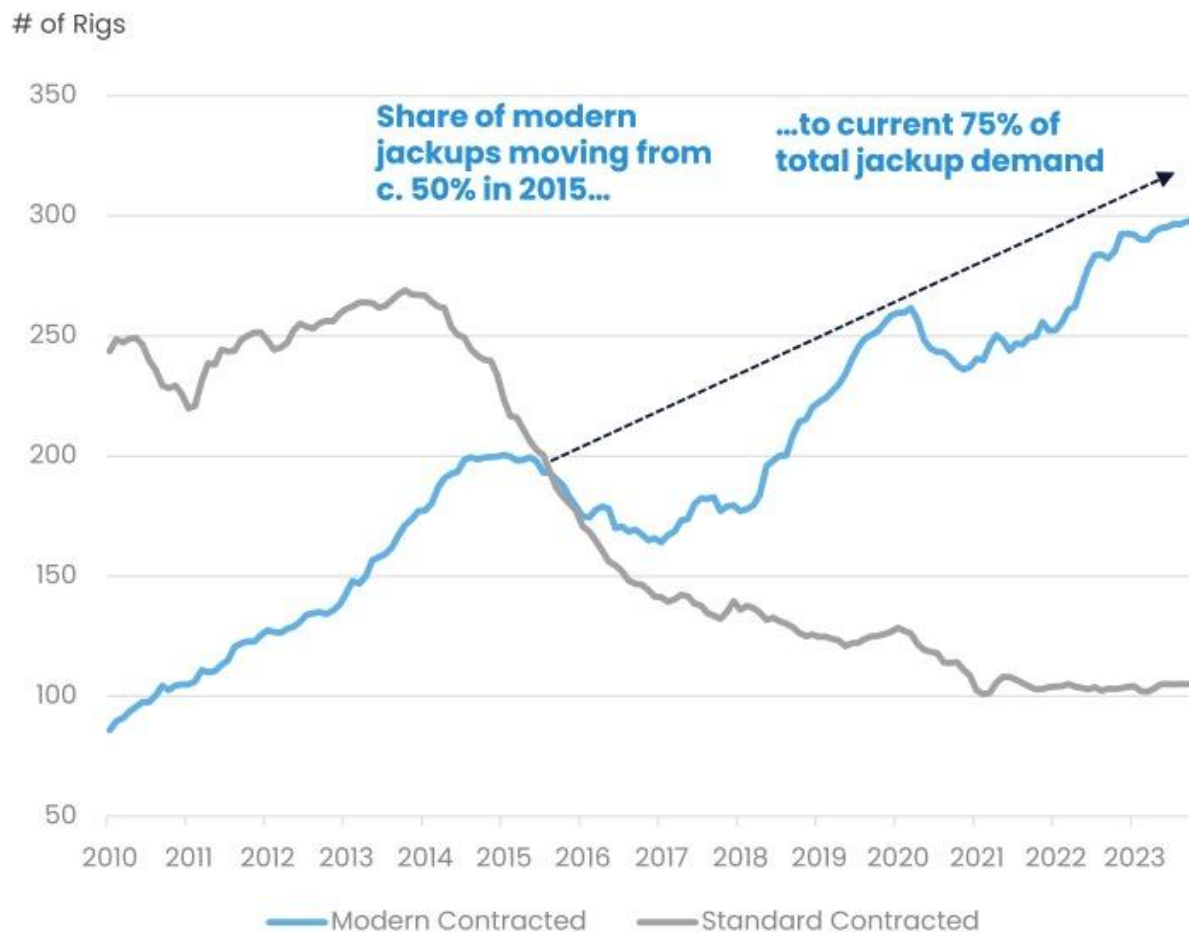
Jackup Rig Supply Outlook

This sounds obvious, but newer, modern jackup rigs are better than older rigs. The key difference is that modern rigs are *faster* at [tripping drill pipe/casing](#) and [BOP operations](#).

More speed equals less costs and quicker payback periods. Shorter payback periods mean better ROIs and returns for wells and E&Ps.

All the major producers know this, and they’re gobbling up every modern jackup rig in the market. In 2015, modern jackups accounted for 50% of rig demand. Today it’s 75%.

Modern rigs taking the lion’s share of demand

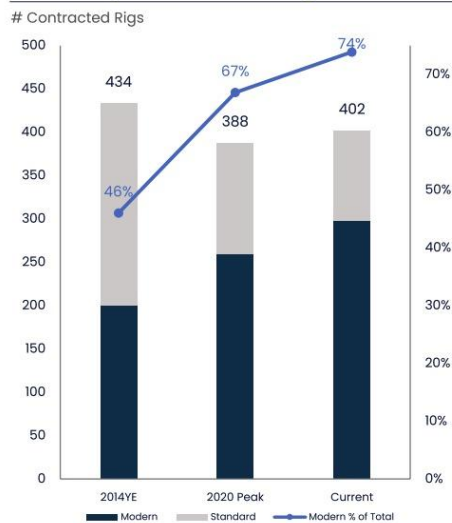


Aramco is a great example of the global thirst for modern rigs. In 2022, modern rigs represented 66% of Aramco’s contracted fleet. A year later, it’s 79% modern rigs.

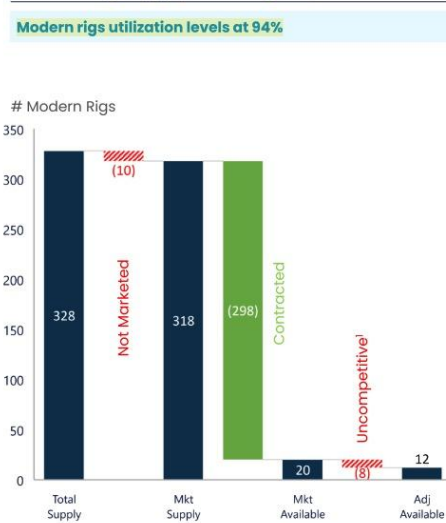
The problem is you can’t find enough modern rigs. Only 12 rigs of 328 are available for contract.

This wouldn’t be an issue if you could quickly build new rigs. But new rigs take 3+ years to make. And they require 40% higher dayrates to be economical (i.e., generate at least a 15% return). Plus, shipyards are already busy building containerships and dry-bulk vessels. The result is a **historically low order book of ~3% of the current global fleet.**

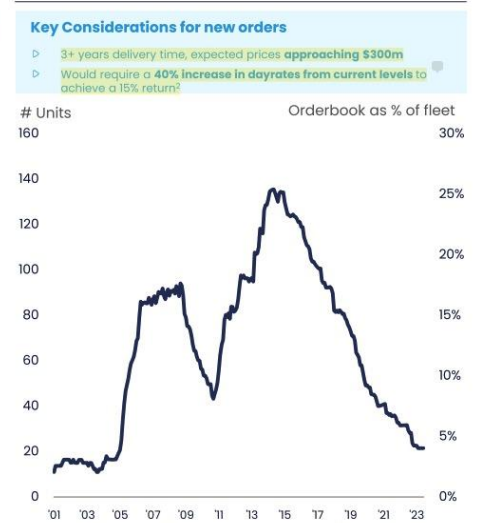
Demand upside for modern rigs



Modern rig supply all but gone



Order book “non-existent”



But it gets worse for the supply side.

There are 402 global rigs (modern + older) in the market. Over 30% of the rigs are 30 years old or older. The average retirement age for a rig is ~38 years. Let’s assume the average age of the 30% cohort is 35.

That means **121 rigs will retire over the next 2-3 years.** The order book is only 3% of the global fleet, so 12 rigs. So call it a net reduction of 109 rigs over the next 2-3 years.

Modern rigs are already at 94% utilization rates. Reducing supply by another 109 rigs would quickly push utilization rates over 95%.

I can’t stress the supply issue enough. We’re already tight. Yet we’re about to retire over 30% of the available fleet with oil at \$74/bbl.

This is when dayrates can get silly.

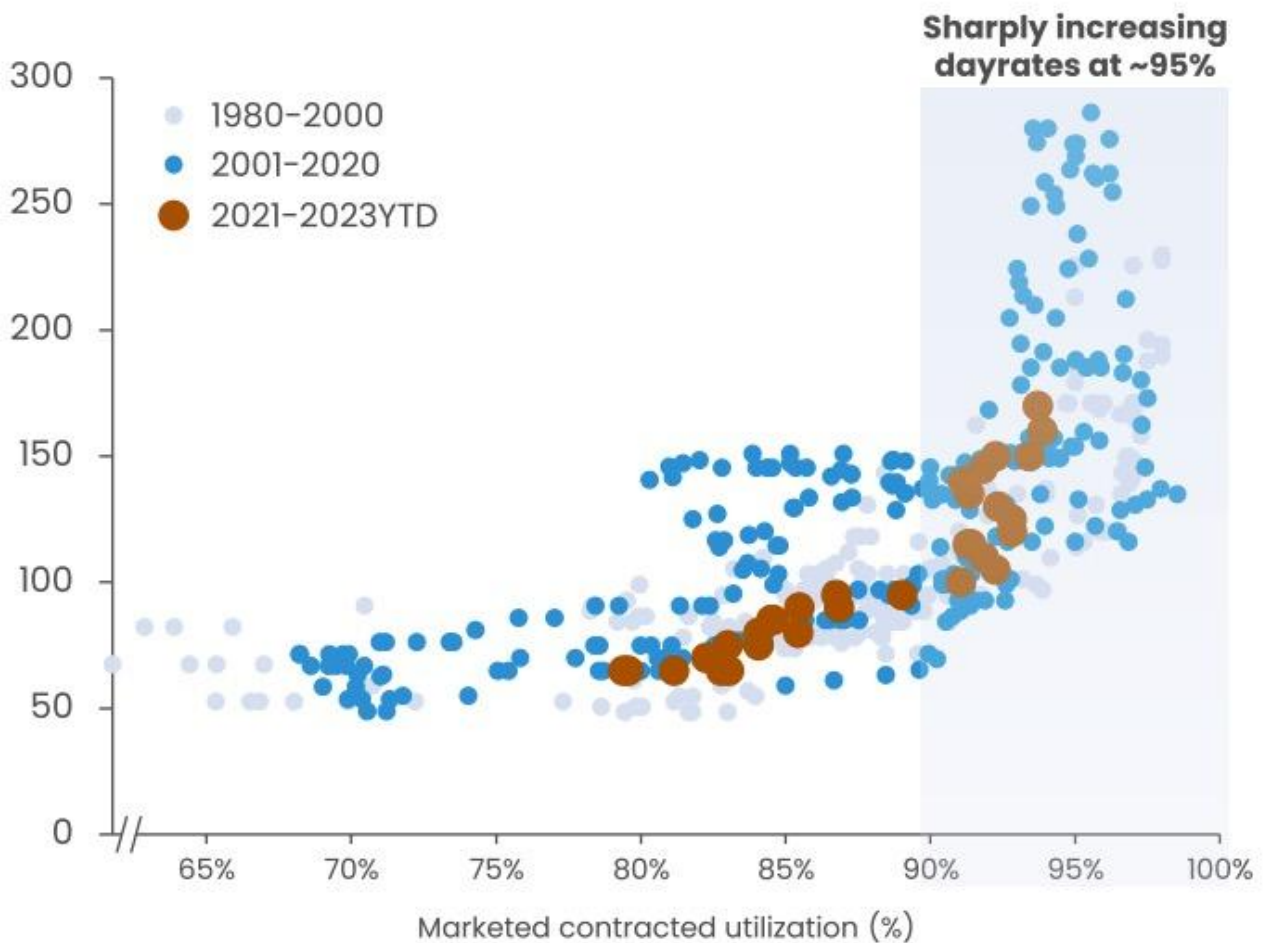
What Happens To Dayrates In Supply Shortages?

Prices must rise to reach equilibrium in a supply-constrained market. So what's the clearing price if 30% of the fleet retires and there are no new ships to replace them?

Historically, dayrates move in a hockey-stick curve as utilization rates pass 95% (see below).

Expected a further acceleration given current utilization levels

Jackup Dayrates USDk/day (inflation adjusted)



If we use newbuild economics as our North Star, we get \$230K/day. But the market hasn't had an order book this low since 2005. And oil will likely trade above \$50/bbl over the next 3-5 years. And we're still recovering from structural underinvestment from the last boom-bust cycle. We may see \$250K-\$300K dayrates.

This brings us to BORR.

Why BORR?

BORR is one of many names we could've bought to play this theme. There's Valaris (VAL), Noble Drilling (NE), Seadrill (SDRL), and Shelf Drilling (SHLF). And to be clear, I think all these names work during the upcycle. Here's why we chose BORR.

First, we wanted to focus on modern drilling rigs, and BORR is one of the largest pure-play modern drillers. Modern rigs are faster, provide better economics from producers, and command higher dayrates.

Second, BORR has the youngest fleet out of its competitors at an average age of 6 years. Valaris's fleet has an average age of 16 years.

The youngest fleet of premium jackups

Avg. Fleet Age



Why does this matter? Younger fleets require less maintenance capex, which means lower breakevens and higher cash flows. This makes younger rigs more valuable in second-hand transactions (i.e., replacement cost).

Third, I like management's capital return and refinancing plans. BORR refinanced its long-term debt at 10% interest (similar to TDW), with maturities due in 2028-2029. They also announced a quarterly dividend of \$0.05/share (with plans on increasing after further deleveraging) and a \$100M share buyback (5% of its stock).

BORR has ~\$2B in backlog, with 79% and 57% of 2024-2025 revenue covered at \$131K and \$133K dayrates, respectively.

This is both good and bad. Good in the sense that we have revenue visibility 1-2 years out. Bad because leading-edge (read: marginal) dayrates are around \$160-\$170K. So BORR is leaving some money on the table.

That said, BORR can still reach \$750M+ in annual EBITDA by 2025 even with 57% of its revenue booked at \$133K rates.

Jackups ... Anything But BORRing

BORR is one of those investments that writes itself. The company trades at half of its replacement cost in a supply-constrained market where 27% of the global fleet will retire in 2-3 years *net of new order supply*.

When that happens, dayrates will moon to \$200-\$250K+, and BORR will generate \$750-\$900M in annual EBITDA. It will use those profits to deleverage (its goal is 1.5x), pay dividends (which increase as leverage declines), and buy back 5% of its outstanding shares.

There are obvious risks to this thesis. Newbuild orders could accelerate. Oil could trade below \$50/bbl. We could enter a global depression where oil demand craters. I just don't see these things happening.

BORR's looming debt maturities were one of the most significant risks to this thesis. But they refinanced those to 2028-2029 and gave themselves five years of runway to delever and return tons of cash to shareholders.

Put simply, BORR is a **Trifecta Lens Trade**.

- **Fundamentals:** 50% discount to replacement cost with a path to generate \$750-\$900M in annual EBITDA. A 6x multiple gets us a \$12-15 stock in 2-3 years versus our entry of \$7.16.
- **Sentiment:** The market hates floating steel. It's a cyclical industry that destroys capital 95% of the time. Most investors simply don't care to look. They're still burned from the last boom-bust cycle.
- **Technicals:** Pull back to the midline in a bull trend on the monthly time frame.

Great trades don't have to be complicated. The best trades are simple. And BORR is simple.