

COMPANY UPDATE

Velesto Energy (VEB MK)

Rates And Utilisation Fully Priced In For 2024

As expected, VEB is likely to have secured another extension of the Petronas umbrella contract; hence, 2024 contracted utilisation should be similar to that of 2023. Having said that, the locked-in rates also imply that VEB is unlikely to benefit from a continued upward trajectory of global rig rates. 2024 may come with a new set of challenges ie rising costs and supply chain delays causing slippage risk on new rig fixtures. As risk-reward is priced in, downgrade to HOLD, with adjusted target of RM0.29.

WHAT'S NEW

- **VEB's high 4Q23 profit of RM67m contained a RM10m gain**, by way of a provision reversal for the Naga 7 rig, which sank in May 21 after a punch-through occurred. Although the rig was fully claimed under insurance as total construction loss, the RM10m provisions against any potential vendor/client claims were no longer deemed necessary. Excluding this non-recurring gain, Velesto Energy's (VEB) 4Q23 EBITDA of RM131m is still one of its best quarterly EBITDA to date (and surpassed 2022 levels), partly due to a very high operating efficiency of 99% (average: 97-98%) with no unplanned downtime incidents, which translated into an opex improvement of nearly RM8m.
- **JU rig industry outlook for 2024 continues to be bullish on rates...** 2022-23 were the "fast and the furious" rig upcycle periods that saw a sharp tightening of the global rig supply, owing to the Middle East oil majors absorbing a large jackup (JU) fleet for their own domestic usage. Learning the lessons of past oil cycles, drillers continued to focus on financial prudence and curbed the appetite of ordering speculative newbuilds. Also, Westwood's data (overleaf) shows that 2023 recorded the lowest attrition of rigs in history (only two globally), and this may well extend into 2024. Among the 450 global JU fleet, there were 16 JU rigs still in shipyards without contracts in 2023.
- **...with new contracts on offer showing multi-year tenures.** As upstream activities and rig demand remain strong, global JU utilisation may rise further yoy, from 93% in 2023 to Westwood's forecast of 96%, relying only on reactivated or delivered newbuilds. However, JU rig daily rates have already recovered back to pre-2014 levels, ie at US\$145,000 for Malaysia, or up to US\$180,000 in Australia and Vietnam. Rising costs and a scarcity of available rigs for hire have increased the pressure for oil majors and drillers to lock in rig programmes earlier to secure the right assets at as low a price as possible. New rig tenders are being heard to offer at least 1.5 years to as long as 10 years.

KEY FINANCIALS

Year to 31 Dec (RMm)	2022	2023	2024F	2025F	2026F
Net turnover	581	1,215	1,412	1,410	1,215
EBITDA	114	360	433	393	305
Operating profit	(54)	157	222	167	72
Net profit (rep./act.)	(100)	100	164	114	42
Net profit (adj.)	(63)	82	164	114	42
EPS (sen)	(0.6)	0.8	1.6	1.1	0.4
PE (x)	n.m.	36.2	18.1	26.1	71.2
P/B (x)	1.3	1.2	1.1	1.1	1.1
EV/EBITDA (x)	20.4	6.4	5.3	5.9	7.6
Dividend yield (%)	0.0	0.9	0.0	0.0	0.0
Net margin (%)	(17.2)	8.2	11.6	8.1	3.4
Net debt/(cash) to equity (%)	19.3	9.4	(0.3)	(6.1)	(5.4)
Interest cover (x)	4.2	10.1	44.0	22.5	18.8
ROE (%)	n.a.	4.2	6.4	4.2	1.5
Consensus net profit	-	-	153	199	213
UOBKH/Consensus (x)	-	-	1.07	0.58	0.20

Source: Velesto Energy, Bloomberg, UOB Kay Hian
n.m. : not meaningful; negative P/E reflected as "n.m."

HOLD

(Downgraded)

Share Price	RM0.29
Target Price	RM0.29
Upside	+2.5%
(Previous TP)	RM0.28)

COMPANY DESCRIPTION

Velesto Energy, formerly UMW O&G, is the premier local jackup (JU) rig service provider in Malaysia.

STOCK DATA

GICS sector	Energy
Bloomberg ticker:	VEB MK
Shares issued (m):	8,215.6
Market cap (RMm):	2,341.4
Market cap (US\$m):	493.4
3-mth avg daily t'over (US\$m):	2.9

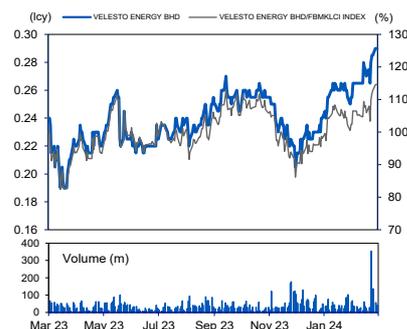
Price Performance (%)

52-week high/low	RM0.285/RM0.190			
1mth	3mth	6mth	1yr	YTD
9.6	26.7	21.3	46.2	23.9

Major Shareholders

	%
Skim Amanah Saham Bumiputera	37.9
Yayasan Pelaburan Bumiputera	11.1
FY24 NAV/Share (RM)	0.25
FY24 Net Cash/Share (RM)	0.00

PRICE CHART



Source: Bloomberg

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STOCK IMPACT

- 2024 rig outlook comes with its own set of dilemmas.** Westwood expects rig rates to continue their upward trajectory for 2024, but more as a response to surging reactivation/mobilisation costs and running opex (rig manpower, inventory costs etc) amid persistently high inflation and supply chain delays (Red Sea crisis). These factors are already causing slippage risks on the availability of new rigs for work, subsequently forcing oil majors to defer drilling plans to 2025, and there is no guarantee that oil price will remain high for the deferred plans to materialise (please refer to RHS table). For the same reason, Westwood does not expect changes to long-term contract rates.
- We expect a similar 83% utilisation for 2024.** Naga 2, Naga 3, Naga 4 and Naga 6 were allotted jobs, implying that the extension of Petronas' two-year umbrella contract (likely to mid-26) was successful. However, four of the rigs will undergo special periodic survey (SPS) in 2H24, limiting 2H24's utilisation at <75%. While 1H24 will see strong utilisation, note that Naga 2 completed its job for Jadestone Energy in early-Dec 23, and had to wait on weather until Feb 24 whereby it started work in Berantai field for Vestigo's five-well programme. We assumed that under "wait on weather" conditions, only some costs are reimbursed back.
- VEB is unlikely to benefit from >US\$140,000 regional rates,** save for Naga 3 and 5. Although the new rates were not revealed, we understand that they are almost similar to the extension of the Naga 8 rig contract by 1.5 years to Oct 25 (daily rate: US\$135,000), and this covers almost all of VEB's contracted utilisation for 2024. Rigs available for potential overseas works include Naga 5 (from 4Q24 only), and Naga 3 (from 2Q25 only).

EARNINGS REVISION/ RISK

- Adjust 2024-26 earnings by -17%/33%/7%, and EBITDA by -2%/24%/11% respectively.** We retain utilisation assumptions, but adjusted 2024/2025 daily rate assumptions from US\$119,000 and US\$114,000 previously. We now assume rig upcycle will be longer. Even if future day rates start to decline, long-term contracts will remain in force until the end of the tenure. However, we are contrarian vs consensus for 2025/26 forecasts as we assume the rig cycle will turn, and when it does, the rate decline can be very harsh, as rigs were working on opex breakeven levels of US\$30,000 in 2016-18.
- A potential risk we foresee is changes in the competitive landscape.** In the past, Petrovietnam Drilling did not mind securing Malaysian contracts at low rates, and it now has at least three rigs working in Malaysia. A Sarawakian listed player, Ocean Vantage, is the exclusive agent for Noble rigs. We understand that Noble's JU rig Noble Tom Pressor is begin its Shell contract in Mar 24, consistent with Ocean's Jul 23 announcement.
- There is an emerging new marine player in the region - an asset manager named Keystone Offshore** that has already been managing China JU rigs KS Java Star 2 and GSF Magellan. Keystone now has secured marketing rights to the marine assets of a financially distressed Chinese state-backed property developer SinoOcean. That portfolio has about 80 offshore assets including 34 drilling platforms and 31 oilfield vessels.

VALUATION/ RECOMMENDATION

- Downgrade to HOLD with adjusted target price of RM0.29** (7x diluted EV/EBITDA), which implies 19x 2024F PE (previous target: RM0.28). We retain our view that risk-reward is balanced, as VEB is unlikely to leverage fully on current industry JU rates of US\$180,000, vs other listed rig peers that may deserve a higher EV/EBITDA valuation. Our target price implies 9x PE on a 2024 earnings scenario of peak utilisation of 85%, average daily rate of US\$140,000, and opex breakeven of US\$55,000 respectively.

ENVIRONMENTAL, SOCIAL, GOVERNANCE (ESG)

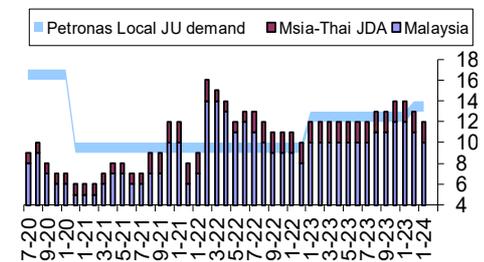
<ul style="list-style-type: none"> Environmental <ul style="list-style-type: none"> Greenhouse gas (GHG) emission compliance. Achieved 15% reduction of carbon intensity of operational emissions, and is developing emission reduction guidelines. Safety. Loss time injury frequency (LTIF) was 0.50 in 2022 (2021: 0.54). Social <ul style="list-style-type: none"> Diversity. 16% of total staff are female; 29% of total staff are non-Malaysians. COVID-19 policies. Set up compliance measures and hired a health advisor. Governance <ul style="list-style-type: none"> 5 out of 9 board members are independent.
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RECENT DEFERRED UPSTREAM PLANS/AWARDS

Oil major (region)	Remarks
Aramco (Saudi Arabia)	Reverse its long-term sustainable capacity from 13m bpd to 12m bpd
Petrobras (Brazil)	Contract award activity for rigs in Brazil fell by 50% from 2022 level
Unknown operator (Norway)	At least one drilling plan may be deferred. The harsher tax regime and North Sea uncertainties are forcing rigs to look out elsewhere
PTTEP, Petrovietnam (SouthEast Asia)	PTTEP's deepwater program, and several Vietnam plans were pushed to 2025 due to lack of JU rigs
Petronas (Malaysia)	In Petronas Activity Outlook, Petronas cut its JU rig requirement for 2024 from 14 to 13

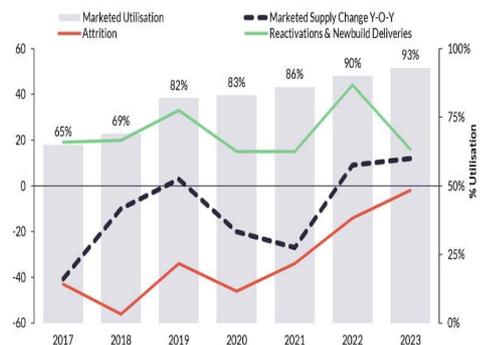
Source: Various

MALAYSIA JU RIG COUNT VS PAO*



Source: Westwood Global, *Petronas Activity Outlook (PAO) documents

OFFSHORE RIG SUPPLY CHANGES



Source: Westwood Global

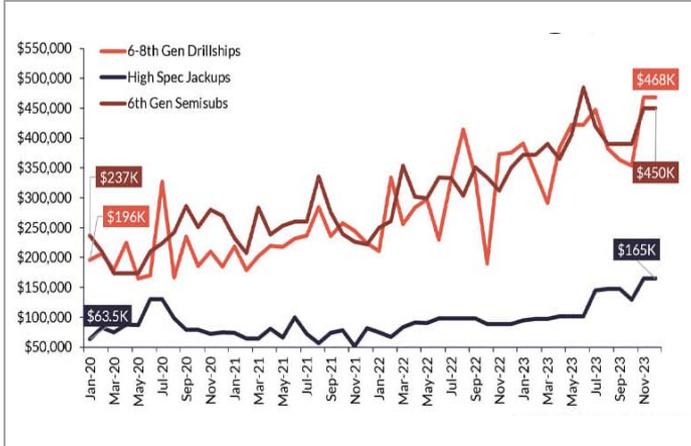
KEY ASSUMPTION (ON DAILY RATE BASIS)

	2024F	2025F	2026F
US\$/ RM forex rate	4.40	4.40	4.40
Rig number	6	6	6
Utilisation	83%	79%	74%
Daily Charter Rate, US\$,000	115.0	120.0	100.0
Rigs Revenue, RMm	919.8	913.5	713.1
Workover Revenue, RMm	57.9	62.9	67.9
Workover Revenue (%)	5.9	6.4	8.7
Daily OPEX, US\$,000	50.8	52.8	47.2
- Utilised, US\$,000	71.6	78.7	66.9
- Stacking, US\$,000	23.1	24.3	25.5
Daily depreciation,	21.9	23.5	24.2
Daily finance cost,	2.0	2.7	3.6
Daily tax cost, US\$,000	4.9	3.7	1.5
Profit Breakeven at 100% util, US\$,000	79.6	82.7	76.4

Source: UOB Kay Hian

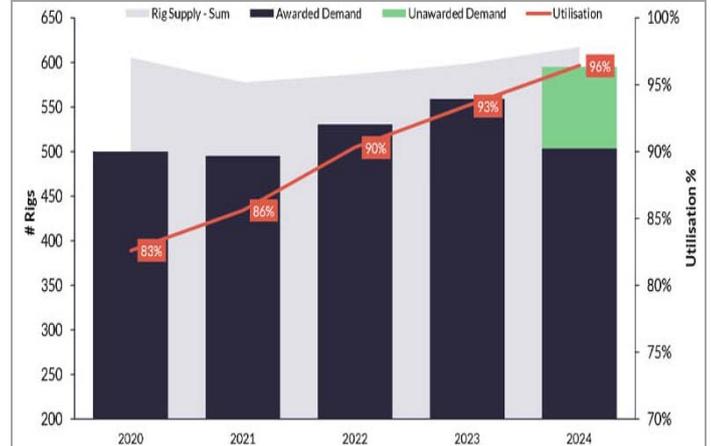
JU RIG DATA AND OUTLOOK AT A GLANCE

RIG RATE MOVEMENTS SINCE JAN 20 TO JAN 24



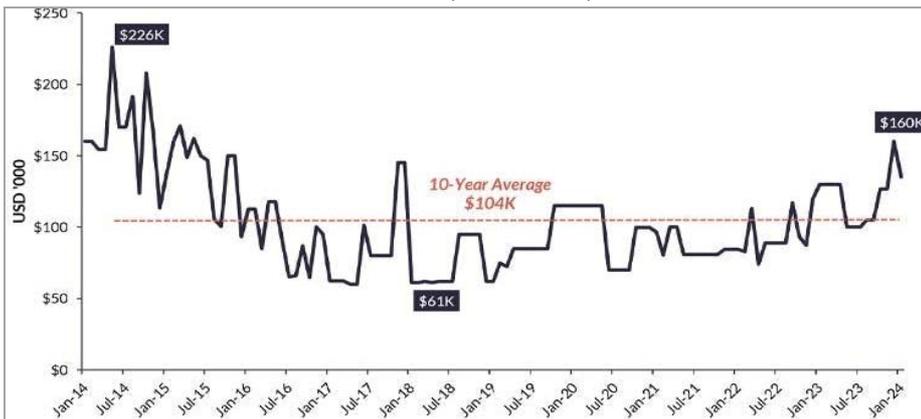
Source: Westwood Global

OFFSHORE RIG SUPPLY-DEMAND & UTILISATION



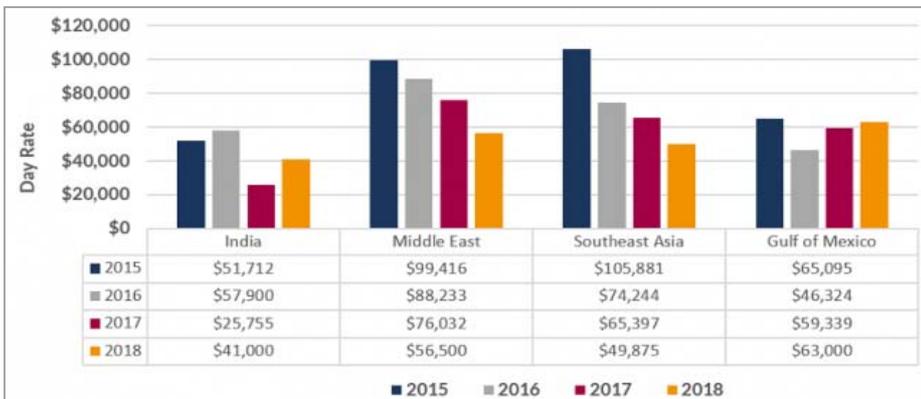
Source: Westwood Global

EUROPE REGION AVERAGE JU RIG DAY RATES (JAN 14-JAN 24)



Source: Westwood Global

ANNUAL AVERAGE JU RATES BY REGION (2015-18)



Source: Westwood Global

PROFIT & LOSS

Year to 31 Dec (RMm)	2023	2024F	2025F	2026F
Net turnover	1,215	1,412	1,410	1,215
EBITDA	360	433	393	305
Deprec. & amort.	203	211	226	233
EBIT	157	222	167	72
Associate contributions	0	0	0	0
Net interest income/(expense)	(36)	(10)	(17)	(16)
Pre-tax profit	121	212	150	56
Tax	(22)	(47)	(35)	(14)
Minorities	0	0	0	0
Net profit	100	164	114	42
Net profit (adj.)	82	164	114	42

CASH FLOW

Year to 31 Dec (RMm)	2023	2024F	2025F	2026F
Operating	383	321	332	302
Pre-tax profit	121	212	150	56
Tax	(22)	(47)	(35)	(14)
Deprec. & amort.	203	211	226	233
Associates	0	0	0	0
Working capital changes	32	(46)	0	45
Other operating cashflows	48	(9)	(9)	(18)
Investing	(122)	(210)	(150)	(300)
Capex (growth)	(119)	(210)	(150)	(300)
Investments	402	434	434	434
Proceeds from sale of assets	4	0	0	0
Others	(408)	(434)	(434)	(434)
Financing	(270)	126	54	129
Dividend payments	0	0	0	0
Issue of shares	0	0	0	0
Proceeds from borrowings	0	147	75	150
Loan repayment	(226)	0	0	0
Others/interest paid	(44)	(21)	(21)	(21)
Net cash inflow (outflow)	(9)	237	236	132
Beginning cash & cash equivalent	120	126	363	599
Changes due to forex impact	14	0	0	0
Ending cash & cash equivalent	126	363	599	731

BALANCE SHEET

Year to 31 Dec (RMm)	2023	2024F	2025F	2026F
Fixed assets	2,422	2,178	2,101	2,168
Other LT assets	10	10	10	10
Cash/ST investment	126	363	599	731
Other current assets	555	741	755	691
Total assets	3,112	3,291	3,465	3,600
ST debt	114	183	183	183
Other current liabilities	274	317	317	274
LT debt	244	172	247	397
Other LT liabilities	3	3	3	3
Shareholders' equity	2,476	2,636	2,756	2,804
Minority interest	0	(21)	(41)	(62)
Total liabilities & equity	3,112	3,291	3,465	3,600

KEY METRICS

Year to 31 Dec (%)	2023	2024F	2025F	2026F
Profitability				
EBITDA margin	29.7	30.6	27.9	25.1
Pre-tax margin	10.0	15.0	10.6	4.6
Net margin	8.2	11.6	8.1	3.4
ROA	3.2	5.1	3.4	1.2
ROE	4.2	6.4	4.2	1.5
Growth				
Turnover	109.1	16.2	(0.1)	(13.9)
EBITDA	217.1	20.1	(9.1)	(22.4)
Pre-tax profit	n.a.	74.5	(29.3)	(62.6)
Net profit	n.a.	65.0	(30.5)	(63.4)
Net profit (adj.)	n.a.	99.4	(30.5)	(63.4)
EPS	n.a.	99.4	(30.5)	(63.4)
Leverage				
Debt to total capital	12.7	12.0	13.7	17.5
Debt to equity	14.5	13.5	15.6	20.7
Net debt/(cash) to equity	9.4	(0.3)	(6.1)	(5.4)
Interest cover (x)	10.1	44.0	22.5	18.8

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