

Friday, 23 June 2023

#### MALAYSIA GEMS CONFERENCE HIGHLIGHTS

# **Velesto Energy (VEB MK)**

Solid Trajectory For QOQ Earnings Increase

The latest rig schedule updates confirm that VEB will enjoy high utilisation of 90% throughout 2023 (save for a slight utilisation weakness in 3Q23). With this, we expect qoq earnings to improve in tandem with higher average rig rates, as long as VEB maintains solid execution and cost control. The multi-year rig upcycle will give VEB another chance to renegotiate for better rates. However, risk-reward has been priced in relative to global peers' valuations. Maintain HOLD. Target price: RM0.21.

#### WHAT'S NEW

- Updates on N2, N3, N4 and N6. After drilling for Roc Oil, Naga 2 (N2) will undergo some maintenance, and will be deployed in Aug 23 to drill four infield wells (about 120 days) for Jadestone in PM323, offshore Malaysia. From end-23, N2 will execute a US\$10.9m contract for Vestigo, for five wells in offshore Sarawak. Naga 3 (N3) is still drilling for PTTEP for a three-well contract that began in March. We understand that the optional works from mid-July to end-3Q23 for PTTEP is still subject to finalisation of the current contract, but at the same time N3 has a follow-on contract with Petronas Carigali for eight wells starting in end-3Q23. The Carigali contract was won together with Naga 4 (N4) and Naga 6 (N6), which were also for Carigali for works commencing in 3Q23.
- Earnings will improve qoq, as average JU daily rates trend higher to our US\$94,000 assumption. With 1Q23 utilisation already at optimal levels of 90%, growth will primarily be driven by a higher mix of the new contract rates at US\$100-110,000 levels. Also, note that 1Q23's average US\$86,000 rates would have been higher if not for a key equipment (blowout preventor) failure in N4. This caused VEB's efficiency (for all rigs) to fall to 94% in 1Q23, vs the required 98%. Our back-of-envelope calculations estimate a downtime of almost three weeks for N4, and this was more than enough to trigger a clause for equipment breakdown (ie zero-rated pay if breakdown lasts >24 hours). Hence, maintaining rig efficiency and execution continues to matter.
- JU rig market will remain tight, partly due to asset acquisitions by the Middle East. According to Clarksons, Saudi Aramco continues to dominate the region's JU fixtures, or about 67% of the 58 fixtures. Aramco's plans to boost its production capacity from 12m bpd to 13m bpd by 2027, which requires its JU rig fleet to almost double from 40 in 2022. Middle East JU demand increased by 23% yoy to 179 units in May 23, and due to this phenomenon that we highlighted one year ago, it soaked up excess capacity (32 JU were contracted since 2022). Both Clarksons and IHS Markit estimated that global available JU supply had declined by >10% since 2022. Hence, even if rig demand normalises due to lower oil prices, the continued supply tightening will likely support a case of >90% utilisation and a multi-year upcycle for the rig industry.

## **KEY FINANCIALS**

Year to 31 Dec (RMm)	2021	2022	2023F	2024F	2025F
Net turnover	378	581	858	810	691
EBITDA	83	107	338	333	252
Operating profit	(74)	(54)	159	149	66
Net profit (rep./act.)	(91)	(100)	116	106	32
Net profit (adj.)	(145)	(63)	116	106	32
EPS (sen)	(1.4)	(0.6)	1.1	1.0	0.3
PE (x)	n.m.	n.m.	19.4	21.3	70.8
P/B (x)	1.0	1.0	0.9	0.9	0.9
EV/EBITDA (x)	25.2	19.5	6.2	6.3	8.3
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Net margin (%)	(24.1)	(17.2)	13.5	13.0	4.6
Net debt/(cash) to equity (%)	12.8	19.3	13.5	2.5	(6.4)
Interest cover (x)	2.2	3.9	14.5	14.1	18.0
ROE (%)	n.a.	n.a.	5.0	4.3	1.3
Consensus net profit	-	-	88	121	139
UOBKH/Consensus (x)	-	-	1.31	0.87	0.23

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

## HOLD

## (Maintained)

Share Price RM0.22
Target Price RM0.21
Upside -2.0%

#### 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):	1,766.4
Market cap (US\$m):	380.3
3-mth avg daily t'over (US\$m):	1.6

#### Price Performance (%)

52-week high/low			RM0.275/RM0.075		
1mth	3mth	6mth	1yr	YTD	
(15.7)	7.5	38.7	95.5	43.3	
Major SI	nareholder	s		%	
Skim Ama	nah Saham	Bumiputera		37.9	
Yayasan I	Pelaburan Bu	umiputera		11.1	
FY23 NA\	//Share (RM)	)		0.23	
FY23 Net	Debt/Share		0.03		

#### PRICE CHART



Source: Bloomberg

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#### STOCK IMPACT

- Negotiations are favourable towards long-term tenures (>three years). Although only five long-term contracts were in VEB's bidbook profile, their values surged from RM1.1b to RM2.7b from Feb 23 to May 23. Therefore, there is a high chance for the umbrella contracts to be extended beyond Feb 24, and the rig market fundamentals are in favour to request for better terms/ timing on renegotiating rig rates. Current market rates are at >US\$130,000. This is crucial in our view, as cost inflation remains sticky. Management guided a total profit breakeven/day of US\$70,000, consistent with our forecast.
- Finding the right balancing act. Oil majors like Petronas have a track record of being sensitive to industry cost increases. We understand that Petronas is gathering industry feedback, to consider a "Master Service Agreement" (MSA) for deepwater drillship requirements, for Petronas' global upstream projects (including Brazil, Mexico and Suriname). The MSA idea was to commence in early-24 for three years, but on a noncommittal, call-out basis. The MSA is meant to reduce Petronas' resources and time to secure a floater for its global projects. Although it is too premature to assume the local JU umbrella contract will have similar adoption, we understand the MSA may be similar to the umbrella contract structure but without locking in the rig rates in advance.
- Retrieval of the sunken rig N7 is not expected to result in any more insurance/dispute changes. According to the Malaysia Coast Guard, Boskalis' Taklift 7 floating sheerleg crane will restart Naga 7 (N7) removal work from May 23 to Nov 23, and will continue from Mar 24 to Nov 24. To recap, N7 sank in May 21 after a punch through while getting in location for ConocoPhillips. VEB already secured the maximum insurance claims (RM561m) for total constructive loss. We understand the new removal process will not change the status of the insurance claims.

#### **EARNINGS REVISION**

• Maintain 2023-25 earnings and EBITDA forecasts.

#### VALUATION/ RECOMMENDATION

 Maintain HOLD with a target price of RM0.21 (7x EV/EBITDA), which implies 21x forward PE. We continue to assume markets have fully priced in a peak utilisation scenario (for 2023 horizon) and partially priced in upside in 2024 rig rates to be above vs our conservative forecasts. Still, we note that VEB is trading at a premium 2024F EV/EBITDA, vs foreign peers like Borr Drilling (6x), Transocean (6x), and Seadrill (4x). Our target price essentially implies 15x PE on a 2024 earnings scenario of peak utilisation of 85%, average DCR of US\$125,000, and opex breakeven of US\$85,000 respectively.

#### **ENVIRONMENTAL, SOCIAL, GOVERNANCE (ESG) UPDATES**

#### Environmental

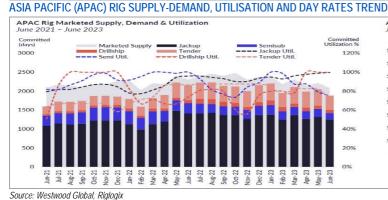
- Greenhouse gas (GHG) emission compliance. Achieved 15% reduction of carbon intensity of operational emissions, and is developing emission reduction guidelines
- Safety. Loss time injury frequency (LTIF) was 0.50 in 2022 (2021: 0.54).

#### Social

- 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

- 5 out of 9 board members are independent.



\$450,000 \$400,000 \$350,000 \$300,000 \$200,000 \$150,000 \$100,000 Jun-21
Jul-21
Jul-21
Jul-21
Jul-22
Sep-2-23
Jul-22

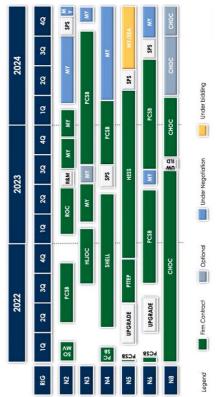
#### **KEY ASSUMPTION (ON DAILY RATE BASIS)**

US\$/ RM forex rate	4.30	4.30	4.30
Rig number	6	6	6
Utilisation	85%	75%	65%
Daily Charter Rate, US\$,000	94.0	99.0	94.0
Rigs Revenue, RMm	752.4	699.2	575.4
Workover Revenue, RMm	42.9	47.9	52.9
Workover Revenue (%)	5.4	6.4	8.4
Daily OPEX, US\$'000	55.2	50.7	46.6
- Utilised, US\$,000	61.1	59.8	58.7
- Stacking, US\$,000	22.0	23.1	24.3
Daily depreciation,	19.0	19.5	19.8
Daily finance cost,	2.9	3.1	3.4
Daily tax cost, US\$,000	2.1	2.1	2.1
Profit Breakeven at 100% util, US\$,000	79.2	75.4	71.9

2023F 2024F 2025F

Source: UOB Kay Hian

#### STATUS AS OF APR 23



Source: Velesto Energy



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PROFIT & LOSS					<b>BALANCE SHEET</b>				
Year to 31 Dec (RMm)	2022	2023F	2024F	2025F	Year to 31 Dec (RMm)	2022	2023F	2024F	2025F
Net turnover	581	858	810	691	Fixed assets	2,423	2,146	2,012	1,875
EBITDA	107	338	333	252	Other LT assets	9	9	10	10
Deprec. & amort.	162	179	184	187	Cash/ST investment	120	143	441	699
EBIT	(54)	159	149	66	Other current assets	546	927	883	780
Associate contributions	0	0	0	0	Total assets	3,098	3,225	3,346	3,364
Net interest income/(expense)	(27)	(23)	(24)	(14)	ST debt	255	183	183	183
Pre-tax profit	(81)	136	126	52	Other current liabilities	251	356	336	288
Tax	(19)	(20)	(20)	(20)	LT debt	306	285	320	355
Minorities	0	0	0	0	Other LT liabilities	4	4	4	4
Net profit	(100)	116	106	32	Shareholders' equity	2,282	2,398	2,503	2,535
Net profit (adj.)	(63)	116	106	32	Minority interest	0	0	0	0
					Total liabilities & equity	3,098	3,225	3,346	3,364
CASH FLOW					KEY METRICS				
Year to 31 Dec (RMm)	2022	2023F	2024F	2025F	Year to 31 Dec (%)	2022	2023F	2024F	2025F
Operating	(25)	49	313	273	Profitability				
Pre-tax profit	(81)	136	126	52	EBITDA margin	18.5	39.4	41.1	36.5
Tax	(19)	(20)	(20)	(20)	Pre-tax margin	(14.0)	15.8	15.5	7.5
Deprec. & amort.	162	179	184	187	Net margin	(17.2)	13.5	13.0	4.6
Associates	0	0	0	0	ROA	n.a.	3.7	3.2	0.9
Working capital changes	(81)	(242)	29	72	ROE	n.a.	5.0	4.3	1.3
Other operating cashflows	(6)	(4)	(6)	(18)					
Investing	(103)	(50)	(50)	(50)	Growth				
Capex (growth)	(153)	(50)	(50)	(50)	Turnover	53.9	47.8	(5.6)	(14.7)
Investments	58	58	58	58	EBITDA	29.1	215.4	(1.6)	(24.2)
Proceeds from sale of assets	3	0	0	0	Pre-tax profit	n.a.	n.a.	(7.7)	(58.7)
Others	(12)	(58)	(58)	(58)	Net profit	n.a.	n.a.	(9.0)	(69.9)
Financing	(56)	35	35	35	Net profit (adj.)	n.a.	n.a.	(9.0)	(69.9)
Dividend payments	0	0	0	0	EPS	n.a.	n.a.	(9.0)	(69.9)
Issue of shares	0	0	0	0					
Proceeds from borrowings	0	35	35	35	Leverage				
Loan repayment	(52)	0	0	0	Debt to total capital	19.7	16.3	16.7	17.5
Others/interest paid	(4)	0	0	0	Debt to equity	24.6	19.5	20.1	21.2
Net cash inflow (outflow)	(184)	34	298	258	Net debt/(cash) to equity	19.3	13.5	2.5	(6.4)
Beginning cash & cash equivalent	293	109	143	441	Interest cover (x)	3.9	14.5	14.1	18.0
Changes due to forex impact	11	0	0	0					
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120

143

441

699

Ending cash & cash equivalent



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