

# Velesto Energy Berhad (VEB MK)

## To ride on higher DCRs and utilisation rates in FY24E

### Revise FY23-25E EPS by -13%/+19%, U/G to HOLD

We revise our FY23-25E EPS by -13%/+19%/+12% to account for: (i) higher overall blended drilling rig DCR forecasts of USD93k/110k/120k; and (ii) higher average drilling rig utilisation rates of 82%/88%/85% respectively. We U/G Velesto to HOLD with a higher TP of MYR0.24 (from MYR0.20) pegged to 14x FY24E EPS, 15% above the average PER of its domestic OGSE peers to reflect a higher FY23-FY24E earnings growth of 99% (vs. peers avg. of 15%).

### Robust regional drilling rig outlook for 2024

Based on our findings, we expect a regional (in SEA) deficit in the number of drilling rigs as the average demand throughout 2024 is estimated to range between 40-45 rigs while we understand that the industry total rig supply currently stands at only 38. This shows a tight market - which will continue to drive prices upward in 2024. As at July 2023, the highest DCR recorded for a regional competitor's rig stood at USD152k (vs. an average of USD120k a year ago). We expect Velesto to ride on the expectancy of higher DCRs in 2024 as the group wins new jobs in upcoming quarters.

### We expect a strong 99% YoY boost in FY24E profits

With the assumptions of: (i) higher overall blended drilling rig DCR forecast of USD110k in FY24E (vs. USD93k in FY23E); and (ii) higher average drilling rig utilisation rate of 88% in FY24E (vs. 82% in FY23E), coupled with operating leverage - we project yet a 99% YoY net profit jump in FY24E. Note that this is after expectations of a highly successful turnaround in FY23E (1H23 core net profit: MYR31.6m vs 1H22 core net loss: -MYR89.4m).

### Expect a weak 3Q23, but mostly priced in

We expect a marginal net loss from Velesto in its upcoming 3Q23 results with an estimated blended rig utilisation rate of 53% due to planned downtime as follow: (i) repair/maintenance works for Naga 2; (ii) SPS for Naga 4; and (iii) underwater inspection works for Naga 3. However, we believe that the negatives have been priced in, as a lower utilisation rate in 3Q23 has been well-guided during the group's recent analyst briefing.

FYE Dec (MYR m)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue	378	581	1,110	1,230	1,213
EBITDA	112	114	316	402	401
Core net profit	(186)	(72)	71	141	148
Core EPS (sen)	(2.3)	(0.9)	0.9	1.7	1.8
Core EPS growth (%)	nm	nm	nm	99.4	4.9
Net DPS (sen)	0.0	0.0	0.0	0.0	0.0
Core P/E (x)	nm	nm	29.6	14.9	14.2
P/BV (x)	0.4	0.5	0.9	0.8	0.8
Net dividend yield (%)	0.0	0.0	0.0	0.0	0.0
ROAE (%)	(4.0)	(4.4)	3.1	5.8	5.8
ROAA (%)	(5.7)	(2.4)	2.3	4.6	4.8
EV/EBITDA (x)	11.2	14.2	7.8	5.8	5.5
Net gearing (%) (incl perps)	11.8	17.1	15.1	9.7	4.4
Consensus net profit	-	-	71	114	147
MIBG vs. Consensus (%)	-	-	(0.5)	23.5	0.9

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# HOLD

[Prior:SELL]

Share Price MYR 0.26  
12m Price Target MYR 0.24 (-6%)  
Previous Price Target MYR 0.20

### Company Description

Velesto Energy provides drilling and oilfield services for the oil and gas industry.

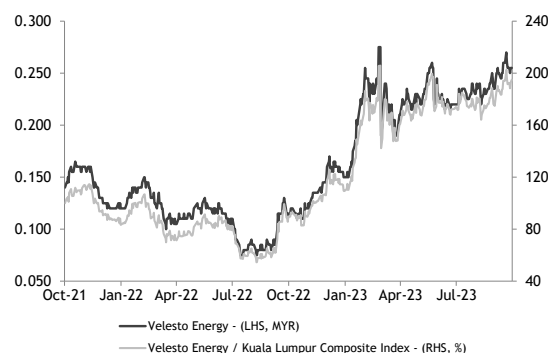
### Statistics

52w high/low (MYR)	0.28/0.11
3m avg turnover (USDm)	1.6
Free float (%)	91.7
Issued shares (m)	8,216
Market capitalisation	MYR2.1B USD446M

### Major shareholders:

Permodalan Nasional Bhd.	46.6%
Bumiputra Investment Foundation	7.1%
The Vanguard Group, Inc.	1.7%

### Price Performance



	-1M	-3M	-12M
Absolute (%)	4	16	132
Relative to index (%)	6	13	127

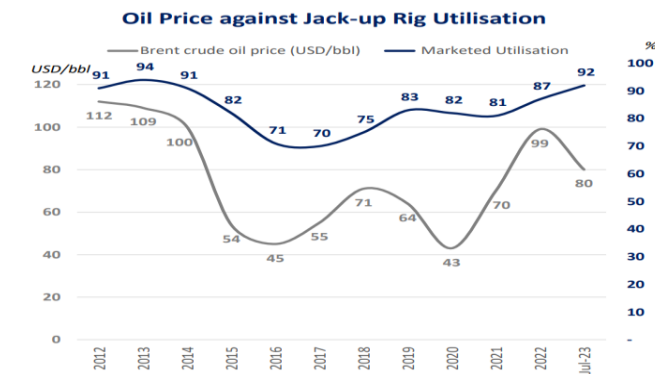
Source: FactSet

**ESG@MAYBANK IBG**  
Tear Sheet Insert

## Value Proposition

- Malaysia's JU rigs operator with a relatively young fleet (6 units, averaging 10 years).
- JUs are Malaysia-flagged and owned and will be able to capitalise on Malaysian cabotage rules.
- Velesto is going through a challenging but gradually improving macro environment, as it faces a bottoming of DCRs but gradual recovery of JU utilisation.
- Returns outlook is improving but the pace of recovery will be gradual, backed by its continuous efforts to optimise costs and utilisation.

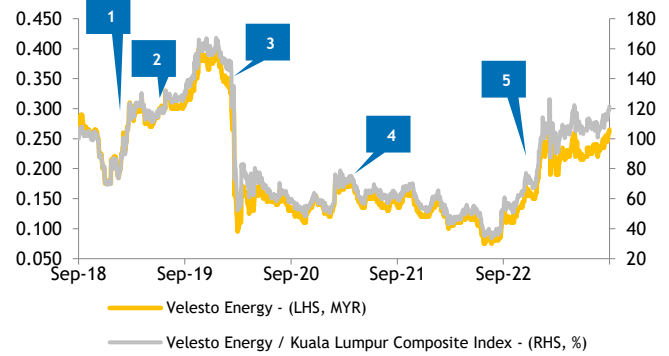
### SEA JUs utilisation (%) 2019 onwards



Source: Company

## Price Drivers

### Historical share price trend



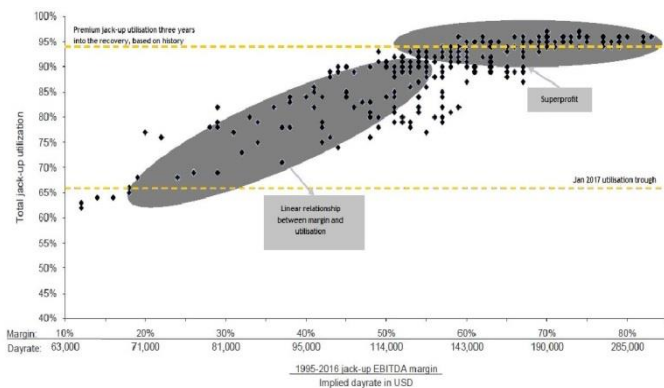
Source: Company, Maybank IBG Research

- Secured 4 charters from PCSB (1+1+1 year contract) with a total value of USD105m in April 2019.
- Won Carigali Hess 3-year job with a USD99k DCR (total contract value: USD131m) in November 2019.
- OPEC+ pact falls apart in Mar 2020.
- Lost Naga 7 rig during ops in May 2021.
- Slow recovery in DCRs in the drilling rig subsegment to (from an average of USD77k in 2022).

## Financial Metrics

- JU DCR, utilisation and opex are Velesto's key earnings drivers. Variations to any of these parameters will impact profitability.
- Softness in rigs utilisation and earnings expected due to seasonality effect but cash flow remains positive, on better cost control.
- With low oil prices, cost management, capital discipline and cashflow preservation are priorities over growth.

### Historical JU margin & utilisation



Source: Company

## Swing Factors

### Upside

- Recovery in crude oil prices a near-term share price driver.
- Rising utilisation/DCRs and margin expansion are key catalysts.
- Though unlikely in our view, a potential privatisation exercise would likely generate excitement.

### Downside

- Further weakness in oil price will hurt share price performance.
- Execution mishap, cost overruns and / or absence / non-extension of charters will cause adverse reaction.
- Failure to meet debt repayment/covenant is a sign of financial distress.



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Risk Rating & Score <sup>1</sup>	Medium & 21.7
Score Momentum <sup>2</sup>	+0.5
Last Updated	20 Apr 2023
Controversy Score <sup>3</sup>	N/A

## Business Model & Industry Issues

- Continues to improve on its sustainability journey & milestones: (i) started its Sustainability reporting in 2017, (ii) improved disclosures in 2018 (with a more systematic data-gathering approach), (iii) adoption of 6 UNSDGs in 2019, (iv) developed its Sustainability Blueprint in 2020 and (iv) set emissions intensity reduction goal in 2022: 10% by operating days & 30% by revenue.
- As a service provider in the O&G industry (drilling ops), Velesto’s operations have limited direct exposure to the risk of environmental damage but improved ‘E’ targets (i.e. carbon emissions, carbon neutral, net zero) would be well-received.
- We are comfortable with Velesto given its strong track record across the ESG parameters and compliance with international standards.

### Material E issues

- It consumed: (i) 16,426 MT of diesel, (ii) 2,359 GJ of electricity, (iii) 741.3 TJ (+4% YoY) of energy and (iv) 75.6k litres of water (3<sup>rd</sup> consecutive decline YoY) - used for drilling rig ops, mainly seawater and 60%-70% of water withdrawn is used for non-potable applications such as flushing & drilling in FY22.
- Its: (i) GHG emissions (Scope 1 & 2), (ii) total waste generated in FY22 totalled 53,085 TCO<sup>2</sup>e (FY21: 53,189 TCO<sup>2</sup>e), 137 MT (-29% YoY) respectively.
- Reported zero major spills from its JUs in 2022.
- As a common practice, all its JUs continue to operate in marine locations deemed NOT high in biodiversity/ considered sensitive to ecological challenges.
- Participates in Plug and Abandonment decommissioning activities and complies with the local/ international conventions.

### Material S issues

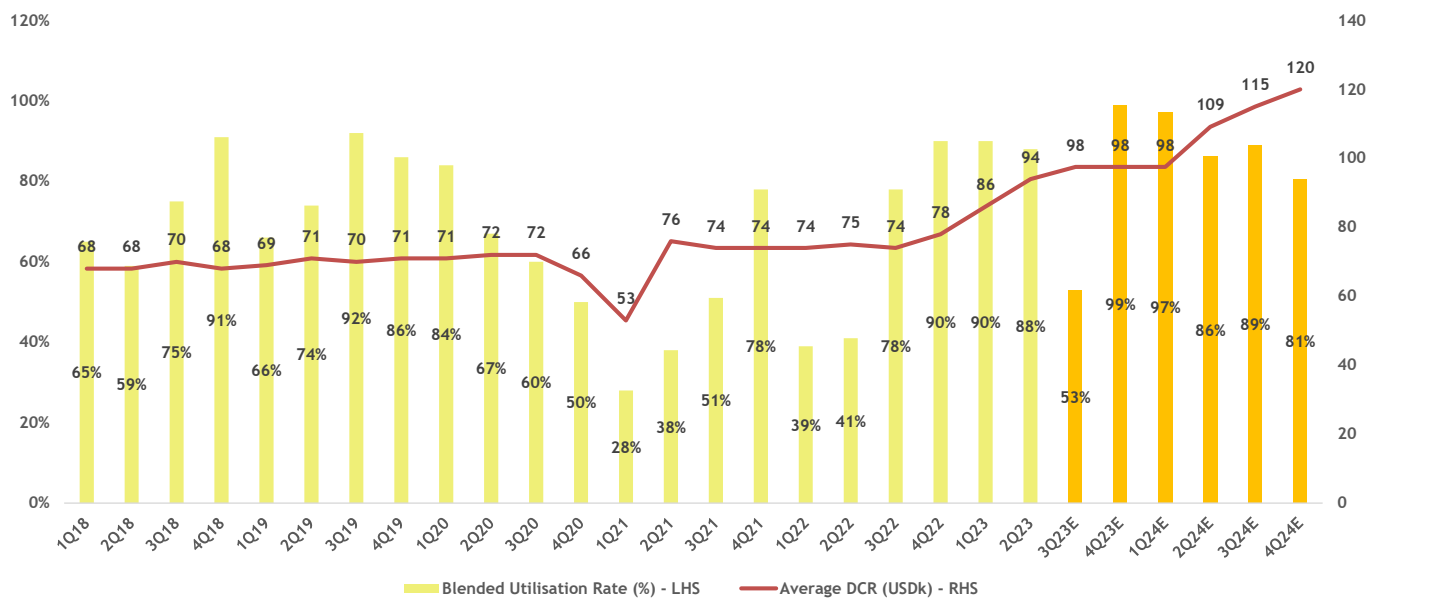
- Has a diversified workforce, with 27% non-Malaysian employees in FY22 (FY21: 25%).
- Female representation in FY22 for: (i) executive positions (51%); (ii) managerial roles (29%); and (iii) non-executive roles (2%).
- Females accounted for 36% of senior management positions.
- Does not intend to set any target for gender diversity. Ensures equal opportunity and non-discrimination of Race, Religion, Gender, Age, and Marital Status.
- Registered: (i) zero Loss Time Incident (LTI), (ii) 0.5 recordable case (TRCF) incidents; (iii) zero fatalities; (iv) zero incidence of corruption in FY22.

### Key G metrics and issues

- A constituent of the FTSE4Good Index Series and a winner of the MSWG-ASEAN Corporate Governance Scorecard Award 2021 and MSOSH Gold Class 1 Award 2022.
- Velesto’s board comprises 9 directors - 4 Independent Non-Executive Directors (INEDs), 1 Senior INED (SINED), 3 NINEDs (incl. Chairman), and 1 ED (President).
- A very experienced and gender-diversified board - 56% are above 65 years old and 44% are female.
- PNB, a major shareholder of Velesto has 1 board seat representation (direct appointment).
- The Executive Directors’ total remuneration package of MYR2.0m for FY22 accounted for 1.8% of the Group’s EBITDA.
- Velesto is audited by Ernst & Young PLT (EY), one of the Big Four accounting firms in the world.
- Its Audit Committee is made up of 3 INEDs and 1 SINED.
- Its Board Risk Management Committee is made up of 3 INEDs and 1 NINED.
- Its Board Nomination & Remuneration Committee comprise of 1 SIEND, 2 INED and 2 NINED.
- The de-merger of UMW Holdings and Velesto (formerly known as UMW O&G) in 2016 was completed in 2017.
- Subsequently, the planned merger with Icon Offshore and Orkim S/B in Jan 2017 was aborted in May 2017 following a due diligence exercise.
- Proposed a 14-for-5 rights issue @ MYR0.30/ unit in Oct 2017, raising MYR1.8b to recapitalise its balance sheet.

<sup>1</sup>**Risk Rating & Score** - derived by Sustainalytics and assesses the company’s exposure to unmanaged ESG risks. Scores range between 0 - 50 in order of increasing severity with low/high scores & ratings representing negligible/significant risk to the company’s enterprise value, respectively, from ESG-driven financial impacts. <sup>2</sup>**Score Momentum** - indicates changes to the company’s score since the last update - a **negative** integer indicates a company’s improving risk score; a **positive** integer indicates a deterioration. <sup>3</sup>**Controversy Score** - reported periodically by Sustainalytics in the event of material ESG-related incident(s), with the impact severity scores of these events ranging from Category 0-5 (0 - no reports; 1 - negligible risks; ...; 5 - poses serious risks & indicative of potential structural deficiencies at the company).

**Fig 1: DCR and Utilisation Rate Projections**



Source: Maybank IBG Research, Company

**Fig 2: OGSE Peer Valuation Matrix**

Company	Country	Price 30-Sep-23 (MYR)	Mkt Cap (MYRm)	PER (x)			Div. Yld (%)	ROE (%)		PBV (x)		EV/EBITDA	PEG	NP Growth (%)	
				Actual	1 Yr Fwd	2 Yr Fwd		1 Yr Fwd	1 Yr Fwd	1 Yr Fwd	1 Yr Fwd			2 Yr Fwd	
RESERVOIR LINK ENERGY BHD	Malaysia	0.32	101	18.2	100.9	10.4	NA	1.9	1.1	11.1	0.0	-81.9	870.0		
DAYANG ENTERPRISE HLDGS BHD	Malaysia	1.93	2,234	18.4	13.6	11.6	1.7	10.3	1.4	6.6	0.7	35.3	17.5		
MALAYSIA MARINE AND HEAVY EN	Malaysia	0.53	840	12.4	24.2	19.5	1.5	-0.8	0.5	29.5	0.8	-48.8	23.9		
WASCO BHD	Malaysia	1.05	813	-129.1	12.5	10.7	0.0	9.4	1.1	8.3	0.6	-1132.3	16.6		
UZMA BHD	Malaysia	0.85	327	8.4	7.6	7.5	NA	7.5	0.5	5.5	12.2	11.0	0.6		
<b>Simple Average</b>				<b>-14.3</b>	<b>31.8</b>	<b>12.0</b>	<b>1.1</b>	<b>5.7</b>	<b>0.9</b>	<b>12.2</b>					

Source: Maybank IBG Research, Company

FYE 31 Dec	FY21A	FY22A	FY23E	FY24E	FY25E
<b>Key Metrics</b>					
P/E (reported) (x)	nm	nm	29.6	14.9	14.2
Core P/E (x)	nm	nm	29.6	14.9	14.2
P/BV (x)	0.4	0.5	0.9	0.8	0.8
P/NTA (x)	0.4	0.5	0.9	0.8	0.8
Net dividend yield (%)	0.0	0.0	0.0	0.0	0.0
FCF yield (%)	nm	nm	5.4	8.8	11.7
EV/EBITDA (x)	11.2	14.2	7.8	5.8	5.5
EV/EBIT (x)	nm	nm	17.3	10.5	10.5

**INCOME STATEMENT (MYR m)**

Revenue	377.5	580.9	1,109.8	1,230.3	1,212.9
EBITDA	112.0	114.4	315.6	401.5	401.3
Depreciation	(157.0)	(167.9)	(174.0)	(180.0)	(191.0)
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	(45.0)	(53.5)	141.6	221.5	210.3
Net interest income / (exp)	(40.3)	(31.8)	(48.5)	(36.0)	(15.7)
Associates & JV	0.2	0.2	0.0	0.0	0.0
Other pretax income	2.4	3.4	0.0	0.0	0.0
Pretax profit	(82.7)	(81.8)	93.0	185.6	194.6
Income tax	(8.1)	(18.6)	(22.3)	(44.5)	(46.7)
Minorities	0.0	0.0	0.0	0.0	0.0
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	(90.8)	(100.4)	70.7	141.0	147.9
Core net profit	(185.6)	(71.8)	70.7	141.0	147.9

**BALANCE SHEET (MYR m)**

Cash & Short Term Investments	293.5	120.0	114.1	168.4	232.6
Accounts receivable	198.7	359.1	395.1	438.0	431.8
Inventory	173.5	185.2	203.7	225.8	222.7
Reinsurance assets	0.0	0.0	0.0	0.0	0.0
Property, Plant & Equip (net)	2,294.3	2,408.1	2,334.1	2,254.1	2,163.1
Intangible assets	8.9	8.0	8.0	8.0	8.0
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	37.1	8.9	8.9	8.9	8.9
<b>Total assets</b>	<b>3,006.0</b>	<b>3,089.4</b>	<b>3,063.8</b>	<b>3,103.2</b>	<b>3,067.0</b>
ST interest bearing debt	279.9	255.0	235.0	205.0	175.0
Accounts payable	154.3	237.4	261.2	289.5	285.4
Insurance contract liabilities	0.0	0.0	0.0	0.0	0.0
LT interest bearing debt	279.9	255.0	235.0	205.0	175.0
Other liabilities	34.0	60.0	(20.0)	(90.0)	(210.0)
<b>Total Liabilities</b>	<b>747.9</b>	<b>807.7</b>	<b>711.4</b>	<b>609.8</b>	<b>425.7</b>
Shareholders Equity	2,258.1	2,281.7	2,352.4	2,493.4	2,641.3
Minority Interest	0.0	0.0	0.0	0.0	0.0
<b>Total shareholder equity</b>	<b>2,258.1</b>	<b>2,281.7</b>	<b>2,352.4</b>	<b>2,493.4</b>	<b>2,641.3</b>
<b>Total liabilities and equity</b>	<b>3,006.0</b>	<b>3,089.4</b>	<b>3,063.8</b>	<b>3,103.2</b>	<b>3,067.0</b>

**CASH FLOW (MYR m)**

Pretax profit	(82.7)	(81.8)	93.0	185.6	194.6
Depreciation & amortisation	157.0	167.9	174.0	180.0	191.0
Adj net interest (income)/exp	4.7	8.5	0.0	0.0	0.0
Change in working capital	3.7	(98.0)	(30.7)	(36.7)	5.3
Cash taxes paid	(20.1)	(14.6)	(22.3)	(44.5)	(46.7)
Other operating cash flow	(91.7)	(8.6)	0.0	0.0	0.0
Cash flow from operations	(29.1)	(26.4)	214.0	284.4	344.2
Capex	(71.9)	(147.4)	(100.0)	(100.0)	(100.0)
Free cash flow	(101.1)	(173.8)	114.0	184.4	244.2
Dividends paid	0.0	0.0	0.0	0.0	0.0
Equity raised / (purchased)	0.0	0.0	0.0	0.0	0.0
Change in Debt	(511.7)	(51.0)	(120.0)	(130.0)	(180.0)
Other invest/financing cash flow	645.0	64.2	0.0	0.0	0.0
Effect of exch rate changes	8.9	29.5	0.0	0.0	0.0
Net cash flow	41.2	(131.2)	(6.0)	54.4	64.2

FYE 31 Dec	FY21A	FY22A	FY23E	FY24E	FY25E
<b>Key Ratios</b>					
<b>Growth ratios (%)</b>					
Revenue growth	(31.0)	53.9	91.1	10.9	(1.4)
EBITDA growth	(62.3)	2.1	175.9	27.2	(0.1)
EBIT growth	nm	nm	nm	56.5	(5.1)
Pretax growth	nm	nm	nm	99.4	4.9
Reported net profit growth	nm	nm	nm	99.4	4.9
Core net profit growth	nm	nm	nm	99.4	4.9
<b>Profitability ratios (%)</b>					
EBITDA margin	29.7	19.7	28.4	32.6	33.1
EBIT margin	nm	nm	12.8	18.0	17.3
Pretax profit margin	nm	nm	8.4	15.1	16.0
Payout ratio	0.0	0.0	0.0	0.0	0.0
<b>DuPont analysis</b>					
Net profit margin (%)	nm	nm	6.4	11.5	12.2
Revenue/Assets (x)	0.1	0.2	0.4	0.4	0.4
Assets/Equity (x)	1.3	1.4	1.3	1.2	1.2
ROAE (%)	(4.0)	(4.4)	3.1	5.8	5.8
ROAA (%)	(5.7)	(2.4)	2.3	4.6	4.8
<b>Liquidity &amp; Efficiency</b>					
Cash conversion cycle	nm	nm	nm	nm	nm
Days receivable outstanding	164.9	172.9	122.3	121.9	129.1
Days inventory outstanding	nm	nm	nm	nm	nm
Days payables outstanding	nm	nm	nm	nm	nm
Dividend cover (x)	nm	nm	nm	nm	nm
Current ratio (x)	1.6	1.4	1.4	1.7	1.9
<b>Leverage &amp; Expense Analysis</b>					
Asset/Liability (x)	4.0	3.8	4.3	5.1	7.2
Net gearing (%) (incl perps)	11.8	17.1	15.1	9.7	4.4
Net gearing (%) (excl. perps)	11.8	17.1	15.1	9.7	4.4
Net interest cover (x)	na	na	2.9	6.2	13.4
Debt/EBITDA (x)	5.0	4.5	1.5	1.0	0.9
Capex/revenue (%)	19.1	25.4	9.0	8.1	8.2
Net debt/ (net cash)	266.3	389.9	355.8	241.5	117.3

Source: Company; Maybank IBG Research

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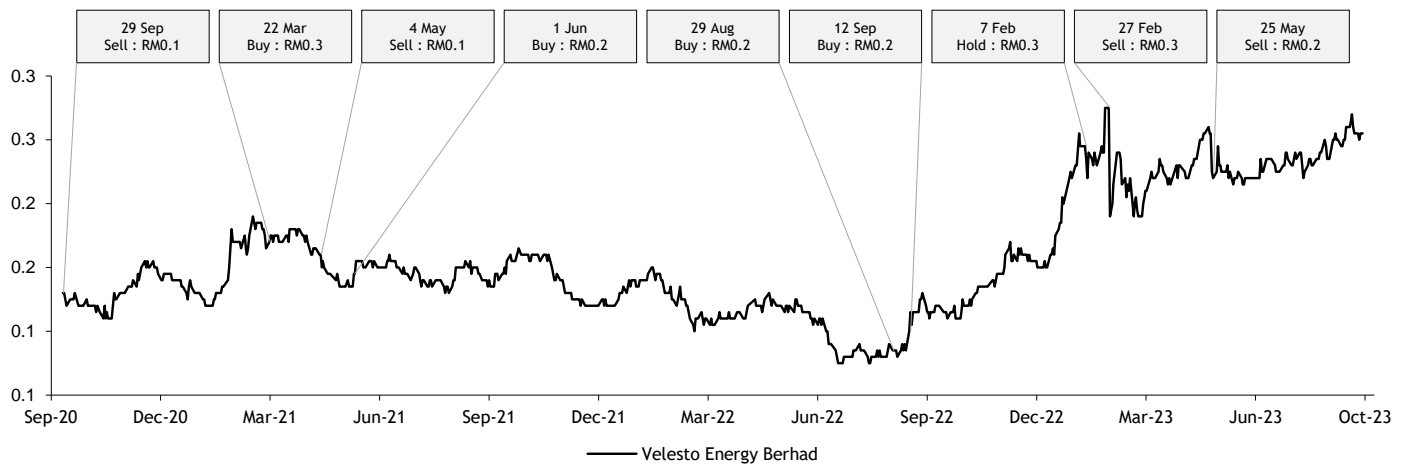
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