

Velesto Energy Berhad (VEB MK)

Look beyond the temporary blip in 3Q23 results

Turning positive; U/G to BUY

We revise our FY23-25E EPS forecasts by -20%/+26%/+52% to account for the following changes: (i) blended JU rig DCR forecast of USD93k/114k/126k; (ii) average JU rig utilisation rates of 81%/83%/82%; and (iii) higher EBITDA margin assumptions. With that, we U/G Velesto to BUY with a TP of MYR0.30 (from MYR0.24) pegged to 14x FY24E EPS, 20% above the average PER of its domestic OGSE peers of about 11.5x, to reflect the anticipated strong earnings recovery (>200%) in FY24E (+15% for peers).

Look beyond the blip in 3Q23 results

Velesto's 3Q23 result will be release by end-Nov 2023. We expect its 3Q23 utilisation rate to be low at 53% due to: (i) repair/maintenance works for Naga 2; (ii) SPS for Naga 4; and (iii) underwater inspection works for Naga 3. We think Velesto will temporarily slip into the red in 3Q23 with core net losses to come in within the range of -MYR10m-20m, barring any unforeseen cost swings. However, as we expect a bright outlook in FY24E (with our revised earnings growth of >200% YoY), investors should look beyond what we believe will be temporary earnings weakness in 3Q23.

Tight supply to continue driving DCRs in 2024E

As we understand, average SEA demand for JU rigs in 2024 is estimated to range between 40-45 rigs while the industry total JU rig supply currently stands at only 38. This shows a tight market - which will continue to drive prices upward in 2024. As at Sep 2023, the highest DCR recorded for a regional competitor's rig stood at USD160k (vs. an average of USD120k a year ago). We expect Velesto to ride on higher DCRs in 2024E as the group wins new jobs/renews its existing contracts in the upcoming quarters.

We expect a >200% YoY boost in FY24E profits

With the assumptions of: (i) higher overall blended JU rig DCR forecast of USD114k in FY24E (vs. USD93k in FY23E); and (ii) a marginally higher average JU rig utilisation rate of 83% in FY24E (vs. 81% in FY23E), coupled with operating leverage - we project a >200% YoY net profit jump in FY24E. Note that this is following our expectation of a successful turnaround in FY23E (1H23 core net profit: MYR31.6m vs 1H22 core net loss: -MYR89.4m).

FYE Dec (MYR m)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue	378	581	1,096	1,344	1,424
EBITDA	112	114	308	455	503
Core net profit	(186)	(72)	57	178	225
Core EPS (sen)	(2.3)	(0.9)	0.7	2.2	2.7
Core EPS growth (%)	nm	nm	nm	214.3	26.5
Net DPS (sen)	0.0	0.0	0.0	0.0	0.0
Core P/E (x)	nm	nm	37.0	11.8	9.3
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)	2.4	7.3	8.6
ROAA (%)	(5.7)	(2.4)	1.8	5.7	7.1
EV/EBITDA (x)	11.2	14.2	8.0	5.1	4.3
Net gearing (%) (incl perps)	11.8	17.1	15.4	9.7	2.6
Consensus net profit	-	-	71	127	154
MIBG vs. Consensus (%)	-	-	(20.0)	39.9	46.5

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BUY

[Prior:HOLD]

Share Price	MYR 0.26
12m Price Target	MYR 0.30 (+18%)
Previous Price Target	MYR 0.24

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)	1.7
Free float (%)	91.7
Issued shares (m)	8,216
Market capitalisation	MYR2.1B
	USD439M

Major shareholders:

Permodalan Nasional Bhd.	46.6%
Bumiputra Investment Foundation	7.1%
Hong Leong Asset Management Bhd.	3.1%

Price Performance



	-1M	-3M	-12M
Absolute (%)	0	13	132
Relative to index (%)	1	11	133

Source: FactSet

Abbreviation

JU = Jack-Up

DCR = Daily Charter Rates

OGSE = Oil & Gas Service/Equipment Providers

SPS = Special Periodic Survey

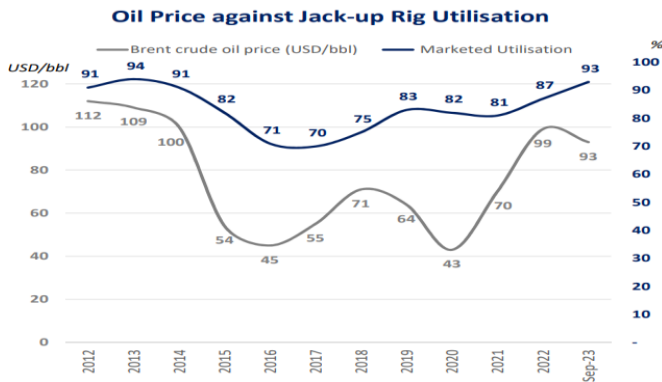
ESG@MAYBANK IBG

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 and gradual recovery of JU utilisation.
- Its returns outlook is improving, backed by its continuous efforts to optimise costs and utilisation.

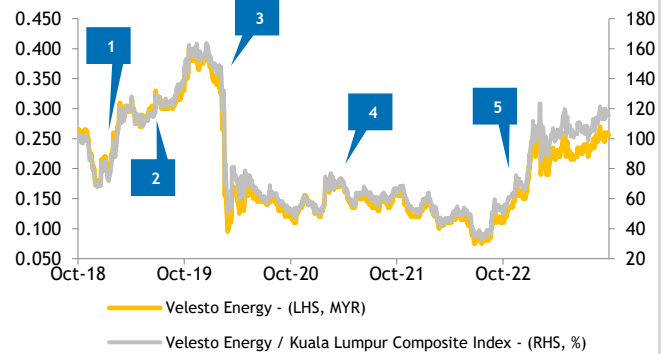
SEA JUs utilisation (%) 2012 onwards



Source: Company

Price Drivers

Historical share price trend



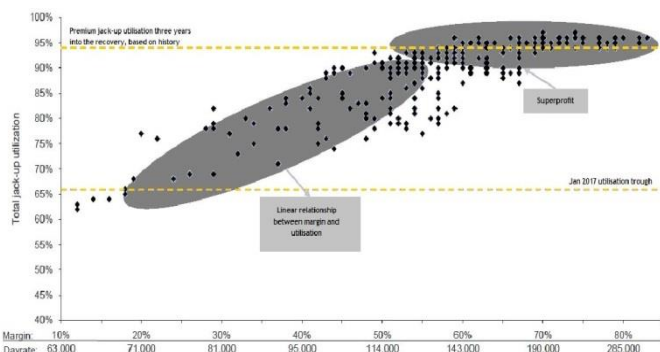
Source: Company, Maybank IBG Research

- 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

- Weakness in oil price will hurt share price performance, as this will induce a pull-back of upstream capex from oil majors in the region.
- The inability to negotiate higher rates for its contract renewals, or to win new jobs.
- Longer-than-expected downtime for some of its JU rigs.
- The inability to win new jobs.
- Failure to meet debt repayment/covenant is a sign of financial distress.

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Risk Rating & Score ¹	21.7 (Medium)
Score Momentum ²	+0.5
Last Updated	20 Apr 2023
Controversy Score ³ (Updated: N/A)	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 (+4% YoY), (ii) 2,359 GJ of electricity (+107% YoY), (iii) 741.3 TJ (+4% YoY) of energy and (iv) 75.6k litres of water (3rd 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 TCO²e (FY21: 53,189 TCO²e), 137 MT (-29% YoY) respectively.
- Reported zero major spills from its JUs in 2022 (FY21: one major spill).
- 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

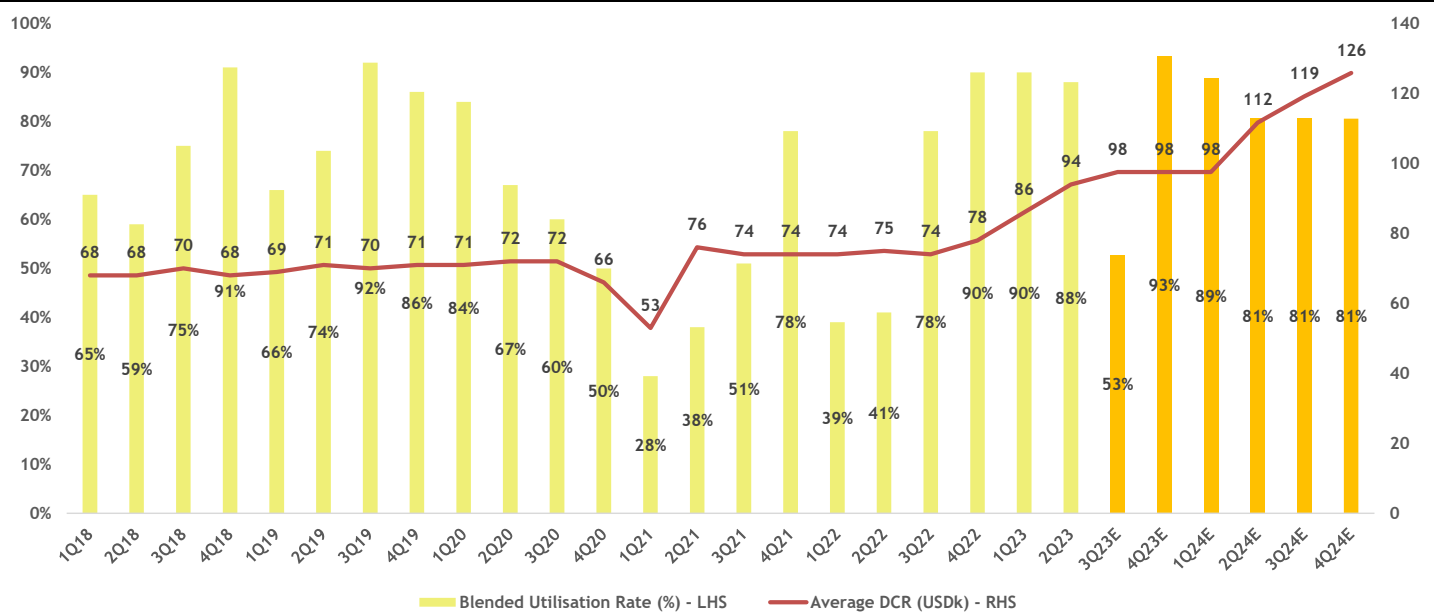
- Has a diversified workforce, with 27% non-Malaysian employees in FY22 (FY21: 25%).
- Female representation in FY22 for: (i) executive positions (51%); (ii) managerial roles (29%); and (iii) non-executive roles (2%).
- Females accounted for 36% of senior management positions.
- Does not intend to set 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.
- Implemented a 14-for-5 rights issue @ MYR0.30/ unit in Oct 2017, raising MYR1.8b to recapitalise its balance sheet.

¹**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. ²**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. ³**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	FYE	Country	Price 22-Oct-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	2 Yr Fwd
Local														
RESERVOIR LINK ENERGY BHD	06/2024	Malaysia	0.32	99	18.0	99.4	10.2	N/A	1.9	1.1	10.9	0.0	-81.9	N/A
DAYANG ENTERPRISE HLDGS BHD	12/2023	Malaysia	1.87	2,165	17.9	13.2	11.1	1.9	10.4	1.3	6.7	0.6	35.5	18.3
MALAYSIA MARINE AND HEAVY EN	12/2023	Malaysia	0.52	832	12.3	24.0	19.3	1.5	-0.8	0.5	29.2	0.8	-48.8	23.9
WASCO BHD	12/2023	Malaysia	1.00	770	-122.3	11.8	10.2	0.0	9.4	1.1	8.0	0.6	-1132.3	16.6
UZMA BHD	06/2024	Malaysia	0.77	296	7.6	6.8	6.8	N/A	7.5	0.5	5.3	14.7	11.0	0.5
Simple Average					-13.3	31.0	11.5	1.1	5.7	0.9	12.0			

Source: Maybank IBG Research, Company

FYE 31 Dec	FY21A	FY22A	FY23E	FY24E	FY25E
Key Metrics					
P/E (reported) (x)	nm	nm	37.0	11.8	9.3
Core P/E (x)	nm	nm	37.0	11.8	9.3
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	5.3	8.9	13.9
EV/EBITDA (x)	11.2	14.2	8.0	5.1	4.3
EV/EBIT (x)	nm	nm	20.0	8.7	6.9

INCOME STATEMENT (MYR m)

Revenue	377.5	580.9	1,095.6	1,344.4	1,424.4
EBITDA	112.0	114.4	307.9	455.2	502.8
Depreciation	(157.0)	(167.9)	(185.0)	(185.0)	(191.0)
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	(45.0)	(53.5)	122.9	270.2	311.8
Net interest income / (exp)	(40.3)	(31.8)	(48.5)	(36.3)	(15.9)
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)	74.4	233.9	295.9
Income tax	(8.1)	(18.6)	(17.9)	(56.1)	(71.0)
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)	56.5	177.7	224.9
Core net profit	(185.6)	(71.7)	56.5	177.7	224.9

BALANCE SHEET (MYR m)

Cash & Short Term Investments	293.5	120.0	110.9	166.9	278.2
Accounts receivable	198.7	359.1	395.1	484.8	513.6
Inventory	173.5	185.2	203.7	250.0	264.9
Reinsurance assets	0.0	0.0	0.0	0.0	0.0
Property, Plant & Equip (net)	2,294.3	2,408.1	2,323.1	2,238.1	2,147.1
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
Total assets	3,006.0	3,089.4	3,049.7	3,156.7	3,220.7
ST interest bearing debt	279.9	255.0	235.0	205.0	175.0
Accounts payable	154.3	237.4	261.2	320.5	339.5
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)
Total Liabilities	747.9	807.7	711.4	640.8	479.8
Shareholders Equity	2,258.1	2,281.7	2,338.2	2,515.9	2,740.9
Minority Interest	0.0	0.0	0.0	0.0	0.0
Total shareholder equity	2,258.1	2,281.7	2,338.2	2,515.9	2,740.9
Total liabilities and equity	3,006.0	3,089.4	3,049.7	3,156.7	3,220.7

CASH FLOW (MYR m)

Pretax profit	(82.7)	(81.8)	74.4	233.9	295.9
Depreciation & amortisation	157.0	167.9	185.0	185.0	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)	(76.7)	(24.6)
Cash taxes paid	(20.1)	(14.6)	(17.9)	(56.1)	(71.0)
Other operating cash flow	(91.7)	(8.6)	0.0	0.0	0.0
Cash flow from operations	(29.1)	(26.4)	210.9	286.0	391.3
Capex	(71.9)	(147.4)	(100.0)	(100.0)	(100.0)
Free cash flow	(101.1)	(173.8)	110.9	186.0	291.3
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)	(9.1)	56.0	111.3

FYE 31 Dec	FY21A	FY22A	FY23E	FY24E	FY25E
Key Ratios					
Growth ratios (%)					
Revenue growth	(31.0)	53.9	88.6	22.7	5.9
EBITDA growth	(62.3)	2.1	169.2	47.8	10.5
EBIT growth	nm	nm	nm	119.8	15.4
Pretax growth	nm	nm	nm	214.3	26.5
Reported net profit growth	nm	nm	nm	214.3	26.5
Core net profit growth	nm	nm	nm	214.3	26.5
Profitability ratios (%)					
EBITDA margin	29.7	19.7	28.1	33.9	35.3
EBIT margin	nm	nm	11.2	20.1	21.9
Pretax profit margin	nm	nm	6.8	17.4	20.8
Payout ratio	0.0	0.0	0.0	0.0	0.0
DuPont analysis					
Net profit margin (%)	nm	nm	5.2	13.2	15.8
Revenue/Assets (x)	0.1	0.2	0.4	0.4	0.4
Assets/Equity (x)	1.3	1.4	1.3	1.3	1.2
ROAE (%)	(4.0)	(4.4)	2.4	7.3	8.6
ROAA (%)	(5.7)	(2.4)	1.8	5.7	7.1
Liquidity & Efficiency					
Cash conversion cycle	nm	nm	nm	nm	nm
Days receivable outstanding	164.9	172.9	123.9	117.8	126.2
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	2.0
Leverage & Expense Analysis					
Asset/Liability (x)	4.0	3.8	4.3	4.9	6.7
Net gearing (%) (incl perps)	11.8	17.1	15.4	9.7	2.6
Net gearing (%) (excl. perps)	11.8	17.1	15.4	9.7	2.6
Net interest cover (x)	na	na	2.5	7.4	19.6
Debt/EBITDA (x)	5.0	4.5	1.5	0.9	0.7
Capex/revenue (%)	19.1	25.4	9.1	7.4	7.0
Net debt/ (net cash)	266.3	389.9	359.0	243.0	71.7

Source: Company; Maybank IBG Research

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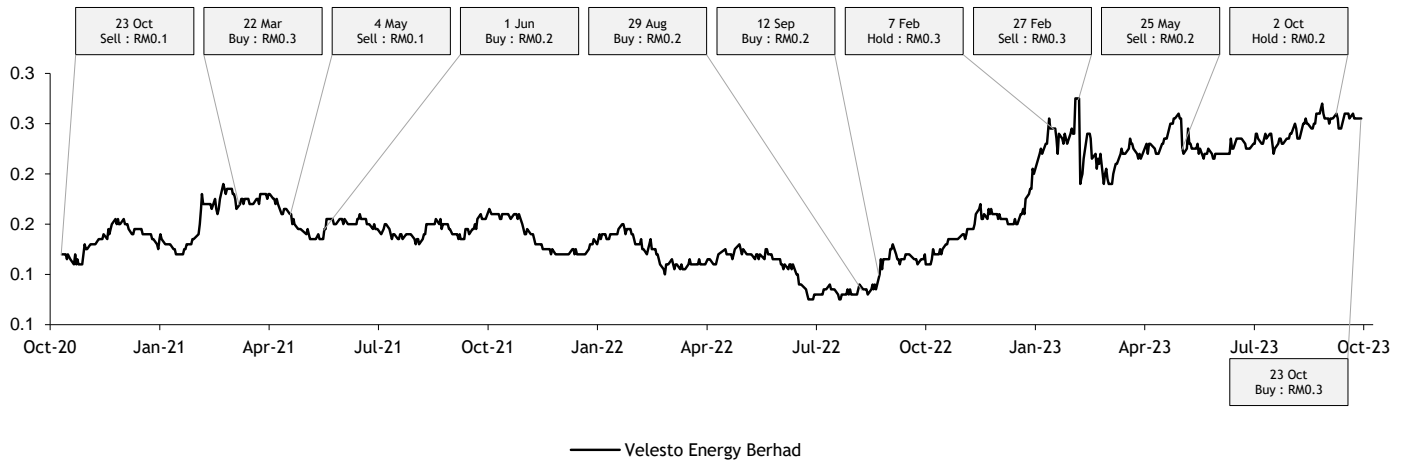
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