

Velesto Energy

Superb Rates Negated by Depreciation

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VELESTO's 1QFY23 results met our expectation but disappointed the market consensus. Multi-year high daily charter rates (DCR) was partly counter-balanced by a spike in depreciation costs. We believe that current valuations are stretched and have baked-in expectations of a recovery in earnings. We maintain our forecasts, TP of RM0.19 and UNDERPERFORM call.

Tracked our expectations but below consensus. Core net profit of RM13.6m came in within our expectation at 23% of our full-year forecast but disappointed the market at only 12% of the full-year consensus estimate.

Multi-year high DCRs. 1QFY23 average fleet DCR of USD86K translates to VELESTO's highest quarterly rate since 2016 (4QFY22: USD86K, 1QFY22: USD74K). Meanwhile, its fleet utilization remained escalated at 90% (4QFY22: 90%, 1QFY22: 39%). Its utilization would have been higher if not for NAGA 4's downtime caused by breakdown of a key component. Moreover, due to supply chain interruptions, the rig's idle period was dragged by a long lead time to secure its replacement part.

Drag from surge in depreciation. The improved operational metrics mentioned above enabled VELESTO to turn around from YoY and QoQ losses. Therefore, earnings returned to the black in spite of a spike in depreciation costs (+75% QoQ, +130% YoY). This was following implementation of a new Enterprise Resource Planning (ERP) software system.

Sequential turnaround due to low base. Nevertheless, QoQ improvement was also due to an exceptionally bad quarter in 4QFY22. Recall that it was dragged by various one-off costs emanating from reactivation of a Hydraulic Workover Unit (HWU), unanticipated changes to a work programme, and prolonged wait caused by bad weather during rig demobilisation etc.

Briefing highlights. Key takeaways from VELESTO's analyst briefing include the following:

1. The company provided guidance that fleet utilisation in FY23 is expected to fall in the range of 75%-80%. This is after taking into account scheduled exercises in 3QCY23 for the following rigs: (i) NAGA 2: repair and maintenance, (ii) NAGA 4: mandatory special periodic survey, and (iii) NAGA 8: underwater Inspection.
2. For the fleet of 40 jack-ups available in the South East Asia (SEA) market for hire, utilization is currently at 100%. This includes 10 rigs in Malaysia (cold stacked: 1 rig). Meanwhile, DCRs in SEA currently range between USD68K-USD131K. However, the floor rate in Malaysia starts high from USD90K. Whereas for HWU units, current DCRs in Malaysia have inched up to USD15K-19K (CY22: USD18K-22K).
3. For overseas projects, VELESTO will only consider bidding for long-term contracts with tenure of at least two years. This is after taking into account expensive logistics costs to deploy its rigs outside Malaysia.
4. VELESTO's customers indicated that oil price at USD60/bbl is the floor price that will trigger them to review the economics of approved offshore projects. Therefore, if oil price trends at or below USD60/bbl for a prolonged period of time, they will consider shelving exploration and production projects.

UNDERPERFORM ↔

Price : **RM0.225**
Target Price : **RM0.19** ↔

Share Price Performance



KLCI 1,402.48
YTD KLCI chg -6.2%
YTD stock price chg 50.0%

Stock Information

Shariah Compliant Yes
Bloomberg Ticker VEB MK Equity
Market Cap (RM m) 1,848.5
Shares Outstanding 8,215.6
52-week range (H) 0.29
52-week range (L) 0.08
3-mth avg daily vol: 52,792,140
Free Float 40%
Beta 1.0

Major Shareholders

Amanah Saham Nasional 44.3%
Yayasan Pelaburan Bumiputera 7.1%
Urusharta Jamaah Sdn Bhd 4.8%

Summary Earnings Table

FY Dec (RM m)	2022A	2023F	2024F
Revenue	580.9	685.1	800.8
EBIT	(54.8)	111.3	171.0
PBT	(81.8)	81.3	141.0
Net Profit (NP)	(100.4)	61.0	105.7
Core NP	(95.5)	61.0	105.7
Consensus CNP	-	100	141
Earnings revision (%)	-	0.0	0.0
Core EPS (sen)	(1.2)	0.7	1.3
C. EPS growth (%)	-44.6	-163.8	73.5
DPS (sen)	0.0	0.0	0.0
BVPS (RM)	0.3	0.3	0.3
Core PER (x)	-23.7	37.1	21.4
Price/BV (x)	1.0	1.0	0.9
Net Gearing (x)	0.2	0.1	0.0
Div. Yield (%)	0.0	0.0	0.0

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Margin pressure from inflationary cost environment. We believe that VELESTO's earnings momentum may potentially be derailed by inflationary cost pressures. This will largely emanate from increased expenses for manpower resources and supply chain interruptions. The latter had led to scarcity of equipment which translates to higher opex for replacement rig parts. On top of that, the company provided guidance that there may be increased "personnel costs adjustment" in FY23 to retain talent. This is on top of higher depreciation costs emanating from the ERP system as mentioned above.

Forecasts. Maintained.

We also maintain our TP of RM0.19 based on 15x FY24F PER. There is no adjustment to our TP based on ESG given a 3-star rating as appraised by us (see page 4).

We prefer to avoid VELESTO at this juncture due to: (i) margin compression from inflationary cost environment, (ii) catalysts have already played out (i.e. rebound in jack-up fleet utilization and charter rates), and (iii) stretched valuations as VELESTO is currently trading at 17.5x FY24F PER versus international peers at 9.8x. Maintain **UNDERPERFORM**.

Risks to our call include: (i) fleet expansion via acquisition of new jack-up rigs, and (ii) higher DCRs as jack-up market tightens further.

Income Statement					
	1Q	4Q	Q-o-Q	1Q	Y-o-Y
	FY23	FY22		FY22	
FYE Dec (RM m)					
Revenue	287.3	243.1	18.2%	77.4	271.1%
Operating Expenses	(260.8)	(244.4)	6.7%	(118.7)	119.7%
Impairment Provisions	0.0	0.0	N.M.	0.0	N.M.
Other Operating Income	0.4	0.2	145.1%	0.1	200.7%
Profit From Operations	26.8	(1.1)	-2518.0%	(41.2)	-165.2%
Finance Costs	(12.2)	(10.4)	17.1%	(5.1)	139.1%
Associates	0.0	0.0	-48.9%	0.0	-38.5%
Investment Income	0.8	0.7	19.9%	0.5	71.4%
Profit Before Tax	15.5	(10.8)	-243.6%	(45.8)	-133.8%
Taxation	(1.3)	(15.2)	-91.7%	(0.4)	201.4%
Non-controlling Interests	0.0	0.0	N.M.	0.0	N.M.
Net Profit	14.2	(26.0)	-154.7%	(46.2)	-130.8%
Core Net Profit	13.6	(17.8)	-176.4%	(43.8)	-131.1%
Operating margin	9.3%	-0.5%		-53.2%	
PBT margin	5.4%	-4.4%		-59.1%	
Net margin	5.0%	-10.7%		-59.7%	
Core net margin	4.7%	-7.3%		-56.5%	
Effective tax rate	8.2%	-141.0%		-0.9%	

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Peer Table Comparison

Name	Rating	Last Price (RM)	Target Price (RM)	Upside (%)	Market Cap (RM'm)	Shariah Compliant	Current FYE	Core EPS (sen)		Core EPS Growth		PER (x) - Core Earnings		PBV (x)	ROE (%)	Net Div. (sen)	Net Div Yld (%)
								1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.
Stocks Under Coverage																	
BUMI ARMADA BHD	OP	0.655	0.750	14.50%	3,876.4	N	12/2023	13.1	13.6	1.0%	3.5%	5.0	4.8	0.6	13.9%	0.0	0.0%
DAYANG ENTERPRISE HLDGS BHD	OP	1.26	1.90	50.79%	1,458.8	Y	12/2023	11.2	12.6	12.0%	11.8%	11.2	10.0	0.9	8.6%	3.0	2.4%
DIALOG GROUP BHD	OP	2.10	3.10	47.62%	11,849.4	Y	06/2023	9.5	9.9	5.1%	4.8%	22.2	21.2	2.2	10.2%	2.8	1.3%
MISC BHD	MP	7.23	7.60	5.12%	32,272.9	Y	12/2023	57.5	55.0	8.1%	-4.3%	12.6	13.1	0.8	6.8%	33.0	4.6%
PETRONAS CHEMICALS GROUP	MP	6.97	7.80	11.91%	55,760.0	Y	12/2023	65.3	52.2	-18.9%	-20.0%	10.7	13.4	1.3	12.9%	33.0	4.7%
PETRONAS DAGANGAN BHD	MP	22.00	24.90	13.18%	21,856.0	Y	12/2023	106.0	92.6	41.3%	-12.6%	20.8	23.8	3.8	18.3%	106.0	4.8%
PETRON MALAYSIA REFINING	MP	4.50	4.65	3.33%	1,215.0	Y	12/2023	103.0	97.8	-7.6%	-5.0%	4.4	4.6	0.5	11.9%	21.0	4.7%
UZMA BHD	OP	0.635	0.900	41.73%	223.5	Y	06/2023	7.7	9.9	85.0%	28.5%	8.3	6.4	0.4	5.1%	0.0	0.0%
VELESTO ENERGY BHD	UP	0.225	0.190	-15.56%	1,848.5	Y	12/2023	0.7	1.3	-36.1%	73.3%	30.3	17.5	0.8	2.6%	0.0	0.0%
WAH SEONG CORP BHD	OP	0.875	0.970	10.86%	677.5	Y	12/2023	10.7	12.8	6.1%	19.1%	8.1	6.8	1.0	13.4%	0.0	0.0%
YINSON HOLDINGS BHD	OP	2.58	3.65	41.47%	7,499.1	N	01/2024	20.8	25.2	-18.4%	21.2%	12.4	10.2	1.6	13.7%	2.0	0.8%
Sector Aggregate					138,537.1					-5.5%	-9.2%	12.2	13.5	1.3	10.7%		2.1%

Source: Kenanga Research

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Stock ESG Ratings:

	Criterion	Rating				
GENERAL	Earnings Sustainability & Quality	★	★			
	Community Investment	★	★			
	Workers Safety & Wellbeing	★	★	★	★	
	Corporate Governance	★	★	★	★	
	Anti-Corruption Policy	★	★	★		
	Emissions Management	★	★	★		
SPECIFIC	Transition to Low-Carbon Future	★	★			
	Conservation & Biodiversity	★	★	★		
	Effluent/Waste Management	★	★			
	Water Management	★	★	★		
	Supply Chain Management	★	★	★		
	Energy efficiency	★	★	★		
OVERALL		★	★	★		

☆ denotes half-star
 ★ -10% discount to TP
 ★★ -5% discount to TP
 ★★★ TP unchanged
 ★★★★ +5% premium to TP
 ★★★★★ +10% premium to TP

Stock Ratings are defined as follows:

Stock Recommendations

OUTPERFORM : A particular stock's Expected Total Return is MORE than 10%
 MARKET PERFORM : A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
 UNDERPERFORM : A particular stock's Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT : A particular sector's Expected Total Return is MORE than 10%
 NEUTRAL : A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
 UNDERWEIGHT : A particular sector's Expected Total Return is LESS than -5%

***Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.

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