

| Malaysia

ADD (no change)

Consensus ratings*: Buy 8 Hold 1 Sell 0

Current price:	RM0.40
Target price:	RM0.47 ▲
Previous target:	RM0.36
Up/downside:	18.0%
CGS-CIMB / Consensus:	11.8%
Reuters:	VELE.KL
Bloomberg:	VEB MK
Market cap:	US\$784.7m
	RM3,245m
Average daily turnover:	US\$2.39m
	RM9.95m
Current shares o/s:	8,216m
Free float:	28.0%

*Source: Bloomberg

Key changes in this note

- FY19-20F core EPS forecast reduced by 3-6% as we factor in the expensing of ESOS costs.
- FY21F core EPS forecast raised by 22% on account of the new Hess charter for Naga 8, and higher overall daily charter rate assumptions.



Source: Bloomberg

Price performance	1M	3M	12M
Absolute (%)	25.4	31.7	54.9
Relative (%)	22.1	32.1	61.4

Major shareholders	% held
Permodalan Nasional Bhd	60.0
EPF	6.8
Lembaga Tabung Haji	5.1

Analyst(s)

Raymond YAP, CFA

T (60) 3 2261 9072

E raymond.yap@cgs-cimb.com

Velesto Energy Berhad

Market heats up, rates on upward trajectory

- We have reviewed our assumptions for Velesto following rising spot daily charter rates and Velesto's success in securing a new high-rate contract.
- Maintain Add with higher FY21F forecasts, and raise DCF-based target price to 47 sen on the back of higher utilisation and charter-rate assumptions.

A new benchmark rate of US\$98,000/day?

Last week, Velesto secured a 3-year firm period drilling contract with Carigali Hess for US\$98k/day, higher than contracts secured earlier in 2019 that ranged between US\$67k-76k/day. The fact that Carigali Hess had agreed to significantly higher rates suggests that the Malaysian and Southeast Asian (SEA) jack-up (JU) rig market is heating up, as can be seen by the rise in JU utilisation rates across SEA markets. But to what extent is US\$98k/day the new benchmark against which future contracts will also be priced? In our model, we assumed that Velesto will price contracts in 2020F at US\$75k/day, and US\$80k/day in 2021F. If US\$98k/day is the new benchmark, our assumptions are conservative, suggesting upside to our earnings and target price assessment.

Further JU rate upside seems assured...

The JU rig utilisation rate in SEA has risen from only 46% at end-Dec 2018, to 73% as at 6 Nov 2019, with Malaysian utilisation up from 67% to 88%, and from 56% to 91% in Indonesia. We are confident of further JU rate upside in FY20-21F, because Petronas and its production sharing contract partners have only fulfilled 75% of its drilling days forecast for 2019F, due to various operational delays. There is the potential for the 2019F shortfall of four rig-years to spill over into next year's original demand for an average of 18 rig years, for a total revised demand of 22 rig-years in 2020F, the highest in half-a-decade. Also, in recent months, JU rates for numerous contracts in the Middle East and Vietnam have exceeded US\$80k/day with increasing frequency. We are already seeing JU rigs tempted back to those markets from SEA, draining supply from this region and helping SEA rates catch up to their Middle East levels. Velesto itself is ready to bid for work in UAE, Qatar and Kuwait, if the opportunity arises and if it has available rigs.

...though up to 10 cold- and ready-stacked rigs may be available

While the current utilisation looks tight, we note that there are three young Seadrill units (below 15 years old) that are cold-stacked in Malaysia, and another seven young JUs (six years or younger) that are ready-stacked in Singapore waters. If Malaysian JU demand, activity levels and DCR rates rise sufficiently, these 10 units may be reactivated, which could moderate the rate upside. We will keep our rate assumptions of US\$75k/day in 2020F and US\$80k/day in 2021F until we see more evidence to support further upside.

Target price revised up to 47 sen

Our target price is raised to 47 sen as we factor in higher utilisation and charter rate assumptions, lower the cost of equity from 10% to 9.5% due to the decline in the Malaysian risk-free rate, and roll forward our target price to end-CY20F. Downside risks may emerge if Petronas decides to slow down drilling work to cool down the market.

Financial Summary

	Dec-17A	Dec-18A	Dec-19F	Dec-20F	Dec-21F
Revenue (RMm)	586.5	573.2	661.6	770.1	840.0
Operating EBITDA (RMm)	214.9	244.8	313.4	375.5	433.8
Net Profit (RMm)	(1,132)	(20)	34	85	145
Core EPS (RM)	(0.046)	0.001	0.004	0.010	0.018
Core EPS Growth	(77%)		288%	152%	70%
FD Core P/E (x)	NA	344.8	95.9	38.1	22.4
DPS (RM)	-	-	-	-	-
Dividend Yield	0%	0%	0%	0%	0%
EV/EBITDA (x)	11.11	17.49	13.56	10.95	8.74
P/FCFE (x)	NA	NA	NA	94.56	19.48
Net Gearing	43.6%	37.0%	35.5%	29.7%	17.8%
P/BV (x)	1.02	1.16	1.15	1.11	1.06
ROE	(5.66%)	0.32%	1.20%	2.96%	4.85%
% Change In Core EPS Estimates			(5.6%)	(3.4%)	22.1%
CGS-CIMB/Consensus EPS (x)			1.37	1.30	1.60

SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

Carigali Hess sets a new benchmark rate of US\$98,000/day – is this the new normal? ➤

Velesto announced on 5 November last week that Carigali Hess Operating Company Sdn Bhd had awarded it a 3-year firm contract for **Naga 8** which will begin in 2H20F, with three 6-month options thereafter. The value of the firm contract was disclosed as US\$131m, representing a gross rate of US\$120,000/day. After deducting the reimbursement for mobilisation and demobilisation costs, the underlying daily charter rate (DCR) is approximately **US\$98,000/day**, according to Riglogix, to commence from 1 October 2020F.

The DCR for this contract was a major surprise, as Velesto's previous contracts were at much lower rates:

- On 22 April, Velesto announced that Petronas Carigali awarded four 1+1+1 year drilling contracts to Naga 2, Naga 3, Naga 5 and Naga 6 at DCRs of **US\$69,700/day**, **US\$69,700/day**, **US\$71,700/day**, and **US\$75,700/day**, respectively.
- On 4 September, Velesto announced that the Naga 7 will drill two wells for Petronas Carigali. Riglogix reported the applicable rate as **US\$67,000/day**.

The latest Carigali Hess contract for the Naga 8 suggests that the jack-up (JU) rig market is heating up in favour of rig owners, and this is very positive for Velesto. Velesto pushed for a high rate of US\$98,000/day with Carigali Hess, because Velesto believed that the availability of JU rigs was becoming limited, and over the next three years, JU rates would be much higher than today. Carigali Hess apparently agreed with this assessment.

We have reflected the new Naga 8 contract into our bottom-up rig employment and earnings model, as reflected in Figure 1.

The key debate is whether we should reflect US\$98,000/day as the 'new normal' for Velesto future contracts, or is this likely to be a one-off aberration?

In our discussions with Velesto following the contract award, Velesto itself seemed to downplay the likelihood that US\$98,000/day will be the new normal, and believed that DCRs for contracts to be secured in 2020F will still likely range in the mid-70s to low-80s.

Our rig model in Figure 1 reflects the following assumptions:

- When the 1-year firm drilling contracts for Naga 2, Naga 3 and Naga 5 end in 2020F (priced at **US\$69,700-71,700/day**), we have assumed that they will be renewed for a further 1-year option period to 2021F at **US\$75,000/day**. The second 1-year option from 2021-22F is assumed to be renewed at **US\$80,000/day**.
- When the 1-year firm drilling contract for Naga 6 ends in 2020F (priced at **US\$75,700/day**), we have assumed that it will be renewed for a further 1-year option period to 2021F at **US\$80,000/day**. The second 1-year option from 2021F to 2022F is assumed to be renewed at **US\$85,000/day**.
- In addition, we believe that Velesto will likely soon secure a new contract for the Naga 7 (reflected under the 'potential contracts' section), which we assume will last 1½ years from 2020-22F at **US\$78,000/day**.

Our rate assumptions above for 2020-21F are within the range of rates that have been contracted in the Middle East during 2Q19-4Q19 at US\$75,000-US\$85,000/day (Figure 7).

If the JU market in Southeast Asia heats up further, there is the potential for spot JU DCRs in Malaysia to exceed our assumptions for 2020-21F, with upside risk for Velesto's earnings and DCF valuation. On the other hand, we note that there are three young Seadrill units (below 15 years of age) that are cold-stacked in Malaysian waters, and another seven young JUs (six years or less) that are ready-stacked in Singapore waters. In our opinion, if Malaysian JU demand, activity levels and DCR rates rise sufficiently, these 10 units may be reactivated and find their way into Malaysian waters, which could moderate the rate upside.

Figure 1: Velesto's drilling contracts from FY17 onwards

Firm contracts	Days						Revenue (US\$ m)					
	FY17	FY18	FY19F	FY20F	FY21F	FY22F	FY17	FY18	FY19F	FY20F	FY21F	FY22F
Naga 2	247	127	220	146	0	0	17.4	8.7	15.3	10.2	0.0	0.0
Naga 3	161	273	247	148	0	0	11.6	20.1	17.4	10.3	0.0	0.0
Naga 4	171	258	365	366	90	0	12.3	18.8	25.7	27.3	6.8	0.0
Naga 5	169	335	289	143	0	0	12.3	24.8	20.9	10.3	0.0	0.0
Naga 6	357	172	255	258	0	0	26.8	12.9	19.2	19.5	0.0	0.0
Naga 7	275	303	297	259	0	0	17.9	20.2	20.3	17.9	0.0	0.0
Naga 8	365	365	365	305	365	365	25.6	25.6	25.6	23.9	35.8	35.8
Total firm contract days	1,745	1,833	2,038	1,625	455	365	123.8	130.9	144.4	119.3	42.5	35.8
Option periods												
Naga 2	0	0	0	219	365	146	0.0	0.0	0.0	16.4	28.5	11.7
Naga 3	0	0	0	172	365	193	0.0	0.0	0.0	12.9	28.2	15.4
Naga 4	0	0	0	0	0	0	0.0	0.0	0.0	0.0	0.0	0.0
Naga 5	0	0	0	222	365	143	0.0	0.0	0.0	16.7	28.5	11.4
Naga 6	0	0	0	108	365	257	0.0	0.0	0.0	8.6	29.7	21.8
Naga 7	0	0	0	0	0	0	0.0	0.0	0.0	0.0	0.0	0.0
Naga 8	0	0	0	0	0	0	0.0	0.0	0.0	0.0	0.0	0.0
Total option contract days	0	0	0	721	1,460	739	0.0	0.0	0.0	54.6	114.9	60.4
Potential contracts												
Naga 2	0	0	0	0	0	0	0.0	0.0	0.0	0.0	0.0	0.0
Naga 3	0	0	0	0	0	0	0.0	0.0	0.0	0.0	0.0	0.0
Naga 4	0	0	0	0	0	0	0.0	0.0	0.0	0.0	0.0	0.0
Naga 5	0	0	0	0	0	0	0.0	0.0	0.0	0.0	0.0	0.0
Naga 6	0	0	0	0	0	0	0.0	0.0	0.0	0.0	0.0	0.0
Naga 7	0	0	0	92	365	92	0.0	0.0	0.0	7.2	28.5	7.2
Naga 8	0	0	0	0	0	0	0.0	0.0	0.0	0.0	0.0	0.0
Total potential contract days	0	0	0	92	365	92	0.0	0.0	0.0	7.2	28.5	7.2
(A) EXCLUDING POTENTIAL BUT UNCONFIRMED CONTRACTS												
Total contract days	1,745	1,833	2,038	2,346	1,915	1,104	123.8	130.9	144.4	174.0	157.5	96.2
- Firm contract days	1,745	1,833	2,038	1,625	455	365	123.8	130.9	144.4	119.3	42.5	35.8
- Option contract days	0	0	0	721	1,460	739	0.0	0.0	0.0	54.6	114.9	60.4
Total calendar days	2,555	2,555	2,555	2,555	2,555	2,555	Avg charter rates (US\$/day)					
Total utilisation rate (%)	68.3%	71.7%	79.8%	91.8%	75.0%	43.2%	70,960	71,432	70,840	74,150	82,219	87,115
- Firm contract days	68.3%	71.7%	79.8%	63.6%	17.8%	14.3%	70,960	71,432	70,840	73,440	93,451	98,000
- Option contract days	0.0%	0.0%	0.0%	28.2%	57.1%	28.9%				75,749	78,719	81,739
(B) INCLUDING POTENTIAL BUT UNCONFIRMED CONTRACTS												
Total contract days	1,745	1,833	2,038	2,438	2,280	1,196	123.8	130.9	144.4	181.1	185.9	103.4
- Firm contract days	1,745	1,833	2,038	1,625	455	365	123.8	130.9	144.4	119.3	42.5	35.8
- Option contract days	0	0	0	721	1,460	739	0.0	0.0	0.0	54.6	114.9	60.4
- Potential contract days	0	0	0	92	365	92	0.0	0.0	0.0	7.2	28.5	7.2
Total calendar days	2,555	2,555	2,555	2,555	2,555	2,555	Avg charter rates (US\$/day)					
Total utilisation rate (%)	68.3%	71.7%	79.8%	95.4%	89.2%	46.8%	70,960	71,432	70,840	74,295	81,544	86,414
- Firm contract days	68.3%	71.7%	79.8%	63.6%	17.8%	14.3%	70,960	71,432	70,840	73,440	93,451	98,000
- Option contract days	0.0%	0.0%	0.0%	28.2%	57.1%	28.9%				75,749	78,719	81,739
- Potential contract days	0.0%	0.0%	0.0%	3.6%	14.3%	3.6%				78,000	78,000	78,000
(C) ASSUMING 60 DAYS OF ZERO RATES												
Total contract days	1,745	1,833	1,798	2,198	2,040	1,196	123.8	130.9	127.2	162.8	167.6	103.4
- Firm contract days	1,745	1,833	1,798	1,625	455	365	123.8	130.9	127.2	119.3	42.5	35.8
- Option contract days	0	0	0	481	1,220	739	0.0	0.0	0.0	36.3	96.6	60.4
Total calendar days	2,555	2,555	2,555	2,555	2,555	2,555	Avg charter rates (US\$/day)					
Total utilisation rate (%)	68.3%	71.7%	70.4%	86.0%	79.8%	46.8%	70,960	71,432	70,725	74,082	82,167	86,414
- Firm contract days	68.3%	71.7%	70.4%	63.6%	17.8%	14.3%	70,960	71,432	70,725	73,440	93,451	98,000
- Option contract days	0.0%	0.0%	0.0%	18.8%	47.7%	28.9%				75,499	79,205	81,739

SOURCES: CGS-CIMB RESEARCH, RIGLOGIX, COMPANY REPORTS

In terms of utilisation rates for Velesto, we have analysed three potential scenarios in Figure 1.

- **Scenario A** reflects only Velesto's existing contracts without any unconfirmed contracts. In this scenario, we expect that Velesto may be able to report 79.8% utilisation in FY19F, rising to 91.8% in FY20F, but then declining to 75% in FY21F and 43.2% in FY22F. With FY20F already very full, Velesto will most likely focus on securing additional contracts for FY21-22F.
- **Scenario B** reflects Velesto's existing contracts, and also includes one potential 1½ year contract for the Naga 7. In this scenario, Velesto's FY20F utilisation rises to 95.4%, FY21F rises to 89.2%, and FY22F rises to 46.8%.
- **Scenario C** reflects Scenario B, but after deducting 60 days of zero rates for the Petronas Carigali contracts for Naga 2, Naga 3, Naga 5 and Naga 6. Petronas Carigali has the option of not utilising the above rigs for up to 60 days p.a. and does not have the obligation to pay charter hire to Velesto during this idle period. Assuming that the entire 60-day period per rig-year is exercised by Petronas Carigali, Velesto's FY19F utilisation rate may fall to 70.4%, FY20F may decline to 86%, FY21F may drop to 79.8%, but FY22F may remain unchanged at 46.8%.

Our **top-down utilisation rate assumptions** for Velesto stand at 80% for FY19F and sustain at 90% for FY20F and all future years thereafter. As time progresses and we secure more information, we will tweak our utilisation assumptions to reflect the on-the-ground reality.

Jack-up employment and utilisation rate trends ►

Current strong JU utilisation rates in Southeast Asia appear to be supportive of Velesto's elevated utilisation rate assumptions and our base case is for continued DCR rate recovery in the region.

The risk to this view lies in the fact that there are relatively young units in the region that may be reactivated from lay-up should demand and DCRs continue to rise – Seadrill has three units cold-stacked in Malaysian waters that are less than 15 years old, while Borr Drilling and one other owner have seven young JUs (six years or less) that are ready-stacked in Singapore waters.

Southeast Asian JU utilisation rates are higher vs. other regions

In Figure 2, we have calculated utilisation rates for Southeast Asia using the overall JU fleet on the left, and utilisation rates excluding cold-stacked units on the right. The latter calculation reflects the reality that many cold-stacked units are not being marketed actively and may never be reactivated due to their age and costs associated with reactivation.

For Southeast Asia as a whole, JU utilisation excluding cold-stacked units peaked on 31 December 2013 at 91%, and bottomed at 36% in 2016. It hovered at the 46-52% level at the end of 2017-18, before rising dramatically to 73% as at 6 November 2019, according to Riglogix data.

Malaysia saw a dramatic recovery in JU utilisation rates (excluding cold-stacked units) from just 20% as at 31 December 2016, to 41% at end-2017, 67% at end-2018, and finally to 88% as at 6 November 2019.

Between 31 December 2018 and 6 November 2019, utilisation rates have risen the greatest in the Southeast Asian region, up by 27.1% pts from 46.2% (ex-cold-stacked units), to 73.3% which is also the highest of any region in the world. This is an impressive achievement, because Southeast Asian utilisation was the second-lowest globally at end-2018.

The Middle East stands in second place in terms of the improvement in utilisation over the past 10 months, with utilisation up 6.7% pts from end-2018 to 69.6% at 6 November 2019. The Indian subcontinent saw utilisation rise 6.4% pts to 67.7%, while China's JU utilisation rose 6.2% pts over the same period to 64.5%. Globally, JU utilisation (ex-cold-stacked units) rose from 56% at end-2018 to 64.4% as at 6 November 2019, up 8.4% pts.

Figure 2: Development of jack-up rigs utilisation in Southeast Asia since 2008

Year end	Utilisation Rate (%) - Overall						Utilisation Rate (%) - Excluding cold-stacked units					
	Malaysia	Indonesia	Brunei	Thailand	Vietnam	Southeast Asia	Malaysia	Indonesia	Brunei	Thailand	Vietnam	Southeast Asia
2008	79%	100%	100%	100%	100%	74%	79%	100%	100%	100%	100%	74%
2009	52%	57%	67%	100%	70%	58%	79%	57%	67%	100%	70%	67%
2010	30%	89%	100%	83%	92%	62%	50%	89%	100%	83%	92%	72%
2011	58%	100%	100%	100%	100%	73%	88%	100%	100%	100%	100%	85%
2012	74%	100%	100%	100%	88%	77%	93%	100%	100%	100%	88%	83%
2013	79%	100%	100%	100%	100%	87%	94%	100%	100%	100%	100%	91%
2014	78%	94%	100%	100%	100%	81%	82%	94%	100%	100%	100%	82%
2015	33%	50%	100%	100%	33%	43%	42%	50%	100%	100%	33%	47%
2016	18%	33%	100%	100%	40%	33%	20%	33%	100%	100%	40%	36%
2017	36%	55%	100%	100%	100%	46%	41%	55%	100%	100%	100%	52%
2018	63%	56%	100%	75%	67%	42%	67%	56%	100%	75%	67%	46%
6-Nov-19	67%	91%	100%	80%	75%	61%	88%	91%	100%	80%	75%	73%

SOURCES: CGS-CIMB RESEARCH, RIGLOGIX

Malaysia now has the largest number of JUs working in Southeast Asia...

Within Southeast Asia, the Malaysian market is now the largest, with 14 JUs contracted to work as at 6 November 2019, followed by 10 in Indonesia. There are four JUs contracted to work in Thailand, three in Vietnam, and two in Brunei (see Figure 3 for the breakdown).

Within Malaysia, there are a further two JUs classified under the “others” category. One of these is the PV Drilling VI which is drilling at Sapura Energy’s SK408 until 9 April 2020, but is currently undergoing workover maintenance, and headed to Vietnam for further drilling work thereafter. The second is Velesto’s Naga 7 which is currently undergoing special periodic survey, but is already contracted to begin its charter to Sabah Shell from mid-December 2019. Including these two rigs, there are actually up to 16 JUs employed in Malaysia as at 6 November.

...up to 10 additional JUs may be available to Malaysian charterers

Should the demand for JUs in Malaysia pick up further, there is the potential for new JU supply to emerge.

Within Malaysian waters, there are five JUs which have been cold-stacked, i.e. the Hercules 208 (39 years old) owned by Lexanda International, the Trident 15 (37 years old) owned by Shelf Drilling, and three units owned by Seadrill, i.e. the West Leda (9 years old), West Prospero (12 years old), and West Vigilant (11 years old). Seadrill may eventually restore its three JU rigs to operational readiness, but the other two rigs are likely too old and are not favoured by oil and gas companies.

Within Singapore waters, which is proximate to Malaysia, there are seven JUs that are currently listed as ready-stacked or warm-stacked, including six units owned by Borr Drilling (i.e. the 2018-built Gunnlod, Gyne, Saga, Skald, and Thor, and the 2019-built Hermod), and one unit owned by Dynamic Drilling (the 2013-built Dynamic Vision).

Hence, we think that if the demand for JUs in Malaysia continues to increase, and DCRs continue to improve, the above 10 JUs may eventually come back into the market. This may play a role in capping the quantum of upside to Malaysian JU DCRs, but may not impact Velesto’s high utilisation rates as long as the overall demand for JUs in Malaysia remains in excess of locally-owned JUs, currently made up of the seven Velesto rigs and one rig owned by Perisai Petroleum.

Figure 3: Number of Jack-up Rigs - Contracted and Non contracted

Rig Location	No of jack-up rigs as at 31 Dec 2018					No of jack-up rigs as at 6 Nov 2019					Utilisation rate on total fleet		Utilisation rate on fleet excluding cold-stacked units	
	Contracted	Non-Contracted Ready	Cold	Others	Total	Contracted	Non-Contracted Ready	Cold	Others	Total	31-Dec-18	6-Nov-19	31-Dec-18	6-Nov-19
Southeast Asia														
Malaysia	10	5	1	0	16	14	0	5	2	21	62.5%	66.7%	66.7%	87.5%
Singapore	0	12	2	4	18	0	7	2	0	9	0.0%	0.0%	0.0%	0.0%
Indonesia	5	3	0	1	9	10	1	0	0	11	55.6%	90.9%	55.6%	90.9%
Brunei Darussalam	2	0	0	0	2	2	0	0	0	2	100.0%	100.0%	100.0%	100.0%
Thailand	3	1	0	0	4	4	0	0	1	5	75.0%	80.0%	75.0%	80.0%
Philippines	0	0	2	0	2	0	0	2	0	2	0.0%	0.0%	-	-
Myanmar	0	0	0	0	0	0	0	0	0	0	-	-	-	-
Vietnam	4	2	0	0	6	3	0	0	1	4	66.7%	75.0%	66.7%	75.0%
East Timor	0	0	0	0	0	0	0	0	0	0	-	-	-	-
Total - Southeast Asia	24	23	5	5	57	33	8	9	4	54	42.1%	61.1%	46.2%	73.3%
China	14	6	0	4	24	20	4	0	7	31	58.3%	64.5%	58.3%	64.5%
Indian Subcontinent														
India	19	6	3	6	34	21	2	2	8	33	55.9%	63.6%	61.3%	67.7%
Pakistan	0	0	0	0	0	0	0	0	0	0	-	-	-	-
Bangladesh	0	0	0	0	0	0	0	0	0	0	-	-	-	-
Total - Indian Subcontinent	19	6	3	6	34	21	2	2	8	33	55.9%	63.6%	61.3%	67.7%
Middle East														
Egypt	9	4	2	3	18	13	2	1	0	16	50.0%	81.3%	56.3%	86.7%
UAE	8	14	6	13	41	12	14	6	11	43	19.5%	27.9%	22.9%	32.4%
Saudi Arabia	50	0	0	2	52	51	1	0	2	54	96.2%	94.4%	96.2%	94.4%
Qatar	13	4	1	1	19	12	2	1	3	18	68.4%	66.7%	72.2%	70.6%
Iran	8	2	1	1	12	6	2	0	0	8	66.7%	75.0%	72.7%	75.0%
Saudi-Kuwait Neutral Zone	1	0	0	0	1	1	1	0	0	2	100.0%	50.0%	100.0%	50.0%
Israel	0	0	0	0	0	0	0	0	0	0	-	-	-	-
Oman	0	0	0	0	0	0	0	0	0	0	-	-	-	-
Turkmenistan	0	0	0	0	0	0	0	0	0	0	-	-	-	-
Bahrain	0	5	5	3	13	0	3	3	1	7	0.0%	0.0%	0.0%	0.0%
Turkey	1	0	0	1	2	1	0	0	0	1	50.0%	100.0%	50.0%	100.0%
Total - Middle East	90	29	15	24	158	96	25	11	17	149	57.0%	64.4%	62.9%	69.6%
Africa														
Tunisia	0	0	0	1	1	1	0	0	1	2	0.0%	50.0%	0.0%	50.0%
Libya	0	0	0	0	0	0	0	0	0	0	-	-	-	-
Equatorial Guinea	0	0	0	1	1	0	0	0	0	0	0.0%	-	0.0%	-
Benin	0	0	0	0	0	0	0	0	0	0	-	-	-	-
Gabon	2	0	0	0	2	2	0	0	0	2	100.0%	100.0%	100.0%	100.0%
Angola	1	0	0	0	1	1	0	0	0	1	100.0%	100.0%	100.0%	100.0%
Nigeria	5	0	3	1	9	7	1	3	1	12	55.6%	58.3%	83.3%	77.8%
Cote d'Ivoire	0	0	0	0	0	0	0	0	0	0	-	-	-	-
Cameroon	1	2	1	0	4	0	1	2	2	5	25.0%	0.0%	33.3%	0.0%
Sudan	0	0	0	0	0	0	0	0	0	0	-	-	-	-
South Africa	0	0	1	0	1	0	0	1	0	1	0.0%	0.0%	-	-
Tanzania, United Republic of	0	0	0	0	0	0	0	0	0	0	-	-	-	-
Congo	2	0	0	1	3	3	0	0	0	3	66.7%	100.0%	66.7%	100.0%
Ghana	0	1	0	0	1	0	1	0	0	1	0.0%	0.0%	0.0%	0.0%
Total - Africa	11	3	5	4	23	14	3	6	4	27	47.8%	51.9%	61.1%	66.7%

SOURCES: CGS-CIMB RESEARCH, RIGLOGIX

Figure 4: Number of Jack-up Rigs - Contracted and Non contracted (continued)

Rig Location	No of jack-up rigs as at 31 Dec 2018					No of jack-up rigs as at 6 Nov 2019					Utilisation rate on total fleet		Utilisation rate on fleet excluding cold-stacked units	
	Contracted	Non-Contracted		Others	Total	Contracted	Non-Contracted		Others	Total	31-Dec-18	6-Nov-19	31-Dec-18	6-Nov-19
		Ready	Cold				Ready	Cold						
Europe														
UK	11	0	4	6	21	11	3	2	4	20	52.4%	55.0%	64.7%	61.1%
Norway	6	0	1	6	13	7	0	1	6	14	46.2%	50.0%	50.0%	53.8%
Italy	1	0	0	0	1	1	0	0	0	1	100.0%	100.0%	100.0%	100.0%
Montenegro	0	0	0	0	0	0	0	0	0	0	-	-	-	-
Denmark	1	0	1	1	3	2	0	0	0	2	33.3%	100.0%	50.0%	100.0%
Ireland	0	0	0	0	0	0	0	0	0	0	-	-	-	-
Romania	0	1	0	0	1	1	0	0	0	1	0.0%	100.0%	0.0%	100.0%
Bulgaria	0	0	0	0	0	0	0	0	0	0	-	-	-	-
Greece	1	0	0	0	1	1	0	0	0	1	100.0%	100.0%	100.0%	100.0%
Germany	0	0	0	0	0	0	0	0	0	0	-	-	-	-
Cyprus	0	0	0	0	0	0	0	0	0	0	-	-	-	-
Spain	0	0	0	0	0	0	0	0	0	0	-	-	-	-
Netherlands	2	2	0	2	6	3	3	0	1	7	33.3%	42.9%	33.3%	42.9%
Azerbaijan	0	1	0	0	1	0	1	0	0	1	0.0%	0.0%	0.0%	0.0%
Malta	0	0	2	0	2	0	0	2	0	2	0.0%	0.0%	-	-
Poland	0	0	0	0	0	1	0	0	0	1	-	100.0%	-	100.0%
Croatia	0	1	0	0	1	0	1	0	0	1	0.0%	0.0%	0.0%	0.0%
Total - Europe	22	5	8	15	50	27	8	5	11	51	44.0%	52.9%	52.4%	58.7%
North America														
US	8	5	11	4	28	3	10	10	2	25	28.6%	12.0%	47.1%	20.0%
Mexico	14	18	7	1	40	23	12	7	3	45	35.0%	51.1%	42.4%	60.5%
Canada	0	0	0	1	1	0	0	0	1	1	0.0%	0.0%	0.0%	0.0%
Total - North America	22	23	18	6	69	26	22	17	6	71	31.9%	36.6%	43.1%	48.1%
South America														
Brazil	0	0	1	0	1	0	0	0	0	0	0.0%	-	-	-
Argentina	0	0	0	0	0	0	0	0	0	0	-	-	-	-
Ecuador	0	0	0	0	0	0	0	0	0	0	-	-	-	-
Guyana	0	0	0	0	0	1	0	0	0	1	-	100.0%	-	100.0%
Suriname	0	0	0	0	0	1	0	0	0	1	-	100.0%	-	100.0%
Trin. & Tobago	3	2	0	0	5	2	2	0	0	4	60.0%	50.0%	60.0%	50.0%
Venezuela	0	0	0	0	0	0	0	0	0	0	-	-	-	-
Total - South America	3	2	1	0	6	4	2	0	0	6	50.0%	66.7%	60.0%	66.7%
Australia	1	0	0	1	2	0	0	0	2	2	50.0%	0.0%	50.0%	0.0%
Russian Federation	0	0	0	0	0	0	0	0	0	0	-	-	-	-
New Zealand	0	0	0	0	0	0	0	0	0	0	-	-	-	-
Global Total	206	97	55	65	423	241	74	50	59	424	48.7%	56.8%	56.0%	64.4%

SOURCES: CGS-CIMB RESEARCH, RIGLOGIX

Volume of jack-up drilling work may escalate in 2020F ▶

Based on the guidance from the Petronas Activity Outlook 2019-21 that was released publically in December 2018, Petronas guided for an average demand of 17 JU rigs on a full-year basis in 2019F (with low-case demand at 16 units and high-case demand at 18 units). Sixteen rig-years amount to 5,840 rig-days while 18 rig-years amount to 6,570 rig-days, for an average of 17 rig-years or 6,205 rig-days in 2019F.

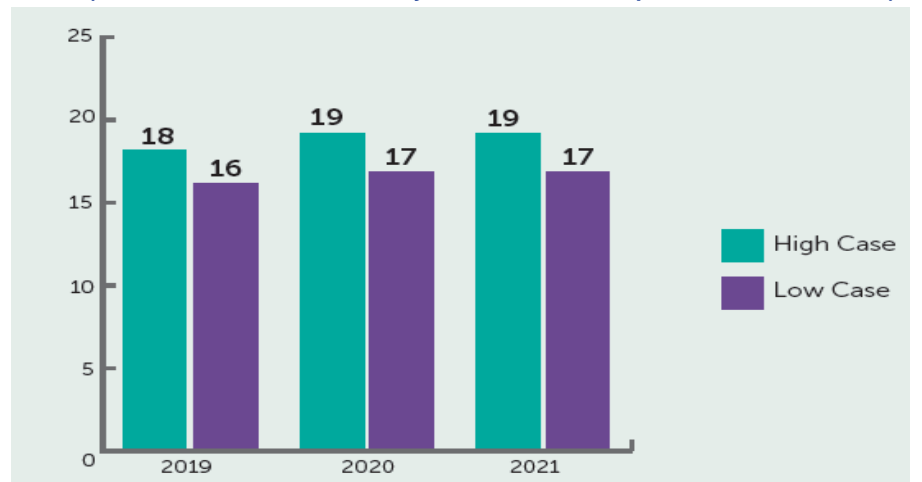
Using Riglogix data as at 6 November 2019, we calculated that between 1 January and 31 December 2019, the market will end up with a total of 4,668 rig working days in Malaysia (equivalent to almost 13 rigs on a full-year basis). Given that there is low likelihood of additional awards for drilling work during the remaining two months of 2019F, it appears that Petronas Carigali and its Production Sharing Contract (PSC) partners have under-delivered by 25% on the average volume of JU drilling work for 2019F that Petronas had guided for in December 2018.

This under-delivery in 2019F is not likely due to a change in Petronas's upstream capex policy, but rather the fact that due to various operational reasons (contract finalisation, rig acceptance inspection, fulfillment of punch-list rectification works on the rig, etc.), Petronas Carigali's planned 2019F drilling programme was delayed, with some work scopes likely to be pushed into 2020F.

Hence, there is the potential for the volume of drilling activity in Malaysian waters in 2020F to be in excess of the 17-19 rig-years that was last guided by Petronas in December 2018. Given that Petronas had originally planned for an average of 17 rig-years in 2019F but only 13 rig-years will ultimately be employed, there is the potential for full-year demand for the remaining four JUs to be pushed into 2020F. Of course, there is also always the risk of operational delays that may push some of the planned drilling work from 2020F to 2021F.

Petronas is scheduled to publish the next edition of its Activity Outlook next month, so we will get clarity on the drilling work-scopes for 2020F soon. For now, we would hazard a guess that next year's planned drilling activity would be at least as large as the 17-19 rig-years guided last year, if not even bigger. If the latter scenario turns out to be correct, there is the potential for DCRs in Malaysia to strengthen further, although this may also incentivise the reactivation of the 10 JU ready- and cold-stacked units in Malaysian and Singaporean waters that we had described earlier.

Figure 5: Petronas guided for an average demand for 17 jack-up rigs (full-year basis) for 2019 (based on the Petronas Activity Outlook 2019-21 report issued in Dec 2018)



SOURCE: PETRONAS

Jack-up drilling rates ►

We have seen a steady upward march in JU rates in the Middle East and in Southeast Asia during 2019.

In Figures 6-9, we have highlighted in red the JU drilling contracts awarded in 2019 that have DCRs of US\$75,000/day or higher. In the Middle East, the frequency of such high-rate contracts have increased from 2Q19 onwards, and continued into 3Q19 and 4Q19. In many instances, rates have reached US\$85,000/day, according to Riglogix, higher than in Malaysia and other countries in Southeast Asia. Velesto used to say in 2018 and even this year, that all of its JU rigs are employed within Malaysian waters because rates outside Malaysia were lower, but this no longer seems to be the case today, especially in the Middle East.

The strong Middle East rates are bullish for global JU DCRs, because the Middle East is the largest employment region for JUs with 96 JUs working there currently, vs. 33 working in Southeast Asia, 27 in Europe, 26 in the US, 21 in the Indian subcontinent, 20 in China, 14 working in Africa, and four in South America.

The strong Middle East DCRs may pull more JUs to be positioned in the region, helping constrict JU supply in other regions. For instance, Seadrill's West Tolesto will be commencing charter to QatarGas from 30 April 2019 at US\$85,000/day after completing a charter in Malaysia at US\$80,000/day.

Velesto itself is ready to bid for work in UAE, Qatar and Kuwait, if the opportunity arises and if it has available rigs.

Figure 6: Middle East: Jack-up drilling rig contracts awarded in 2019

Rig Manager	Rig Name	Max water depth	Operator	Fixture Date	Contract Start Date	Contract End Date	Contract days	Day Rate (US\$/day)	Country
ENSCO	Valaris JU-76	350	Saudi Aramco (NOC)	03-Jan-2019	01-Jan-2019	31-Dec-2022	100	96,000	Saudi Arabia
Gulf Drilling International	Al Khor	300	Shell	24-Jan-2019	01-Feb-2019	09-Jul-2019	159	75,000	Qatar
Gulf Drilling International	Dukhan	300	North Oil Co	25-Jan-2019	01-Apr-2019	31-Mar-2022	1,096	65,000	Qatar
Shelf Drilling	Trident 16	300	Petrobrel (NOC)	28-Jan-2019	20-Feb-2019	20-Feb-2020	366	63,000	Egypt
Advanced Energy Systems	Admarine VIII	300	PetroGulf	01-Mar-2019	30-Mar-2019	31-Oct-2019	216	75,400	Egypt
Seadrill Ltd	AOD I	400	Saudi Aramco (NOC)	11-Mar-2019	01-Jul-2019	30-Jun-2022	1,096	73,059	Saudi Arabia
Shelf Drilling	High Island V	270	Saudi Aramco (NOC)	27-Mar-2019	01-Apr-2019	31-Mar-2022	1,025	70,000	Saudi Arabia
Noble Drilling	Noble Joe Beall	300	Saudi Aramco (NOC)	15-Apr-2019	01-May-2019	31-Dec-2019	245	65,000	Saudi Arabia
Gulf Drilling International	West Tucana	400	QatarGas	30-Apr-2019	01-Jan-2020	01-May-2021	487	85,000	Qatar
GulfDrill	Zhenhai 3	400	QatarGas	30-Apr-2019	16-Nov-2019	15-Nov-2022	1,096	85,000	Qatar
GulfDrill	Zhenhai 5	400	QatarGas	30-Apr-2019	16-Feb-2020	15-Feb-2023	1,096	85,000	Qatar
GulfDrill	Zhenhai 6	400	QatarGas	30-Apr-2019	17-May-2020	17-May-2023	1,036	85,000	Qatar
Northern Offshore Ltd	Energy Edge	400	QatarGas	30-Apr-2019	01-Jul-2020	30-Jun-2024	1,461	78,750	Qatar
Northern Offshore Ltd	Energy Enticer	400	QatarGas	30-Apr-2019	01-Apr-2020	31-Mar-2025	1,826	78,750	Qatar
Seadrill Ltd	West Telesto	400	QatarGas	30-Apr-2019	10-May-2020	09-May-2023	1,059	85,000	Qatar
Advanced Energy Systems	Admarine IV	307	GUPCO (NOC)	24-Jun-2019	15-Sep-2019	14-Sep-2020	342	34,000	Egypt
Gulf Drilling International	Al Khor	300	Shell	02-Jul-2019	10-Jul-2019	04-Apr-2022	1,000	75,000	Qatar
Arabian Drilling	Arabdrill 50	400	Saudi Aramco (NOC)	07-Oct-2019	08-Oct-2019	07-Oct-2020	366	80,000	Saudi Arabia
Shelf Drilling	Main Pass IV	300	Saudi Aramco (NOC)	07-Oct-2019	05-Nov-2019	05-Mar-2020	122	80,000	Saudi Arabia
Shelf Drilling	High Island VII	250	ADNOC Offshore (NOC)	09-Oct-2019	01-Jan-2020	31-Dec-2023	1,461	70,000	UAE
Saipem	Perro Negro 9	375	Saudi Aramco (NOC)	24-Oct-2019	01-May-2020	29-Sep-2024	1,613	70,000	Saudi Arabia

SOURCES: CGS-CIMB RESEARCH, RIGLOGIX

In the main Southeast Asian markets of Malaysia, Indonesia and Vietnam, JU contracts awarded in 2019 have also shown increasing rate trends.

- In Malaysia, JU contracts awarded in 1Q19 had an average DCR of US\$60,800/day, rising to US\$68,000-69,000/day in 2Q-3Q19. In 4Q19, Velesto secured the US\$98,000/day contract with Carigali Hess, which is a global outlier.
- In Indonesia, there were only three contract awards in 2019, of which one was at US\$75,000/day. Notably, the contract awarded in July was at a higher rate than the one awarded in April.
- In Vietnam, one contract was awarded in March at US\$83,000/day, while another awarded in September was at US\$82,000/day. In between, some

contracts were awarded at very low rates of below US\$50,000/day, but the latest award was above US\$80,000/day.

Figure 7: Malaysia: Jack-up drilling rig contracts awarded in 2019

Rig Manager	Rig Name	Max water depth	Operator	Fixture Date	Contract Start Date	Contract End Date	Contract days	Day Rate (US\$/day)	Country
PV Drilling	PV Drilling II	400	Sapura Energy	24-Jan-2019	01-Mar-2019	03-Aug-2019	156	62,000	Malaysia
PV Drilling	PV Drilling VI	400	Sapura Energy	24-Jan-2019	25-Aug-2019	09-Apr-2020	229	59,000	Malaysia
PV Drilling	PV Drilling III	400	Repsol	25-Jan-2019	08-Apr-2019	07-Apr-2020	366	57,600	Malaysia
Velesto Energy	Naga 6	375	PTTEP (NOC)	01-Feb-2019	07-Mar-2019	30-Jun-2019	116	75,000	Malaysia
PV Drilling	PV Drilling I	300	Hibiscus Petroleum	11-Mar-2019	24-May-2019	30-Nov-2019	191	59,000	Malaysia
Borr Drilling	Mist	350	Vestigo Petroleum	28-Mar-2019	12-Jun-2019	20-Dec-2019	192	75,000	Malaysia
Aban Offshore	Deep Driller 4	375	CPOC		23-Apr-2020	22-Oct-2021	548	38,000	Malaysia
Aban Offshore	Aban VIII	375	Petronas Carigali (NOC)	01-Apr-2019	01-Sep-2019	28-Feb-2020	181	48,000	Malaysia
Seadrill Ltd	West Telesto	400	IPC	08-Apr-2019	25-Jun-2019	24-Jan-2020	214	80,000	Malaysia
Velesto Energy	Naga 2	350	Petronas Carigali (NOC)	22-Apr-2019	27-May-2019	27-May-2020	367	69,698	Malaysia
Velesto Energy	Naga 3	350	Petronas Carigali (NOC)	22-Apr-2019	28-May-2019	31-May-2020	370	69,698	Malaysia
Velesto Energy	Naga 5	400	Petronas Carigali (NOC)	22-Apr-2019	18-May-2019	30-Apr-2020	349	71,698	Malaysia
Velesto Energy	Naga 6	375	Petronas Carigali (NOC)	22-Apr-2019	15-Sep-2019	14-Sep-2020	366	75,698	Malaysia
Velesto Energy	Naga 7	375	Petronas Carigali (NOC)	15-Jun-2019	15-Jul-2019	23-Oct-2019	101	67,000	Malaysia
Velesto Energy	Naga 4	400	ROC	20-Jul-2019	15-Aug-2019	31-Mar-2020	230	73,000	Malaysia
Perisai Petroleum	Perisai Pacific 101	400	Petronas Carigali (NOC)	14-Jun-2019	05-Sep-2019	23-Mar-2020	201	74,000	Malaysia
PV Drilling	PV Drilling II	400	Petronas Carigali (NOC)	20-Jun-2019	01-Dec-2019	05-Sep-2020	280	67,500	Malaysia
PV Drilling	PV Drilling I	300	Hibiscus Petroleum	23-Sep-2019	01-Dec-2019	30-Sep-2020	305	59,000	Malaysia
Velesto Energy	Naga 8	400	Carigali-Hess Operating Co.	05-Nov-2019	01-Sep-2020	31-Aug-2023	1,095	98,000	Malaysia

SOURCES: CGS-CIMB RESEARCH, RIGLOGIX

Figure 8: Indonesia: Jack-up drilling rig contracts awarded in 2019

Rig Manager	Rig Name	Max water depth	Operator	Fixture Date	Contract Start Date	Contract End Date	Contract days	Day Rate (US\$/day)	Country
KS Energy Services Ltd.	KS Java Star	300	Camar Resources	05-Apr-2019	15-Oct-2019	14-Dec-2019	61	54,444	Indonesia
China Oilfield Services Ltd.	Asian Endeavor 1	375	West Natuna Exploration Ltd	24-Jun-2019	01-Oct-2019	06-Dec-2019	67	75,000	Indonesia
China Oilfield Services Ltd.	COSLPower	375	PC Ketapang	06-Jul-2019	20-Oct-2019	31-Dec-2021	804	69,000	Indonesia

SOURCES: CGS-CIMB RESEARCH, RIGLOGIX

Figure 9: Vietnam: Jack-up drilling rig contracts awarded in 2019

Rig Manager	Rig Name	Max water depth	Operator	Fixture Date	Contract Start Date	Contract End Date	Contract days	Day Rate (US\$/day)	Country
Seadrill Ltd	PV Drilling VI	400	Eni	15-Jan-2019	01-May-2019	22-Jul-2019	83	62,000	Vietnam
Seadrill Ltd	PV Drilling II	400	JVPC	30-Jan-2019	19-Aug-2019	30-Nov-2019	104	58,000	Vietnam
Seadrill Ltd	KS Java Star 2	300	VietSovPetro	21-Feb-2019	01-Mar-2019	31-Jul-2019	153	46,500	Vietnam
Seadrill Ltd	Hakuryu-11	425	Idemitsu	27-Mar-2019	22-Nov-2019	15-Feb-2021	452	83,000	Vietnam
Seadrill Ltd	KS Java Star 2	300	VietSovPetro	15-Jul-2019	01-Aug-2019	31-Dec-2019	153	46,500	Vietnam
Seadrill Ltd	Murmanskaya	328	VietSovPetro	15-Aug-2019	26-Aug-2019	25-Nov-2019	92		Vietnam
Seadrill Ltd	Idun	350	Hoang Long JOC	11-Sep-2019	01-Nov-2019	03-Feb-2020	95	82,000	Vietnam

SOURCES: CGS-CIMB RESEARCH, RIGLOGIX

DCF valuation ►

We have raised our DCF valuation and target price for Velesto from 36 sen (based on an end-2019F time frame) to 43 sen (also end-2019F) due to higher utilisation and charter-rate assumptions, and a lower cost of equity discount rate, and then once more to **47 sen** as we roll-forward our valuation to end-2020F.

We previously assumed that utilisation rates for FY22F onwards would fall to 85% from 90% in the previous two years, but we have raised the utilisation rate assumption to 90% for all forecast years. We have also raised the average JU daily earnings from US\$81,923/day in FY23-32F to US\$88,204/day, among other adjustments.

We have reduced our cost of equity assumption from 10% to 9.5%, as we reduce the risk-free rate assumption (based on 10-year Malaysian Government Securities) from 4% to 3.5%. The net result is to raise our DCF valuation and target price to 47 sen.

Figure 10: Assumptions and DCF valuation

Assumptions				
	2017-19F	2020-22F	2023-32F	2033-45F
JU: Utilisation (%)	73%	90%	90%	90%
JU: Daily earnings (US\$/day)	71,081	74,295	89,204	92,500
JU: Daily working cash costs (US\$/day)	37,367	37,173	39,186	41,127
JU: Daily stacked cash costs (US\$/day)	10,000	10,000	10,000	10,000
DCF valuation		Cost of equity		
	FY20F	Rf		3.50%
DCF value to equity (RM m)	3,056.2	ERP		6.00%
Add: Cash (end of FY)	380.3	Beta		1.0
Add: Residual net assets (end of FY)	392.0	Ke (nominal)		9.50%
Total equity valuation (RM m)	3,828.4			
No of shares (m)	8,215.6			
Per share equity valuation (RM)	0.47			

SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

We have cut our FY19-20F core EPS forecasts by 3-6% as we factor in the cost of the ESOS issue (explained in the next section below), while our FY21F core EPS forecast has been raised 22% as we reflect the new 3-year firm Naga 8 charter to Carigali Hess at US\$98,000/day that is scheduled to commence around 1 October 2020F.

Figure 11: Earnings revision

RM m	2018A	2019F			2020F			2021F		
		Old	New	chg	Old	New	chg	Old	New	chg
Revenue	573	663	662	0%	761	770	1%	798	840	5%
EBITDA	245	316	313	-1%	378	376	-1%	405	434	7%
Reported PBT	(18)	44	42	-5%	102	100	-3%	137	166	21%
Core pretax profit	11	44	42	-5%	102	100	-3%	137	166	21%
Reported net profit	(20)	36	34	-6%	88	85	-3%	119	145	22%
Reported EPS	(0.00)	0.00	0.00	-6%	0.01	0.01	-3%	0.01	0.02	22%
Core net profit	9	36	34	-6%	88	85	-3%	119	145	22%
Core EPS	0.00	0.00	0.00	-6%	0.01	0.01	-3%	0.01	0.02	22%

SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

ESOS dilution is immaterial, for now

On 31 October 2019, Velesto secured its shareholders' approval to institute an Employee Share Option Scheme (ESOS) that will enable Velesto to issue up to 7.5% of its outstanding share capital as ESOS shares to its employees. The exercise price of the ESOS is a maximum of a 10% discount to the Volume Weighted Average Price (VWAP) at the time of issue.

Velesto has an outstanding share base of 8,215.6m shares currently, and up to 616.2m new ESOS shares can be issued. However, if all of Velesto's outstanding warrants are converted, its share base will rise to 9,729m shares, which means that up to 729.7m new ESOS shares can be issued.

The ESOS has a validity of five years beginning 1 November 2019, while the warrants can be exercised for a period of seven years to 3Q24F.

Figure 12: Assumptions and DCF valuation

	Minimum scenario		Maximum scenario	
	No. of VEB Shares	Amount	No. of VEB Shares	Amount
	'000	RM'000	'000	RM'000
Issued share capital as at the LPD	8,215,600	4,054,817	8,215,600	4,054,817
Add: No. of new VEB Shares to be issued arising from the full exercise of the Outstanding Warrants	-	-	1,513,400	(1)597,793
	8,215,600	4,054,817	9,729,000	4,652,610
Add: No. of new VEB Shares to be issued arising from the full exercise of the Options	616,170	(2)172,528	729,675	(2)204,309
Enlarged issued share capital after the Proposed ESOS	8,831,770	4,227,345	10,458,675	4,856,919

Notes:

(1) Based on the exercise price of RM0.395 per Outstanding Warrant.

(2) Calculated based on an assumed Option Exercise Price of RM0.28, representing a discount of approximately 10% to the 5-day VWAP of VEB Shares up to and including the LPD of RM0.31.

SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

As at last week, Velesto said it had issued 131m ESOS shares, but it will only be vested to employees in three years' time. Given that this is only 1.6% of the outstanding share base, and can only be converted into new ordinary shares in three years' time, we have not included this ESOS impact into our DCF valuation for Velesto.

Unlikely for warrants to be exercised for now

We have also not included the outstanding 1,513.4m warrants as a dilution to our DCF valuation. This is because the exercise price is 39.5 sen, which is a difference of only 0.5 sen when compared against the mother share's 40 sen closing price on Friday. As far as warrant holders are concerned, it will be more profitable to sell the warrants in the secondary market at the current price of 16 sen.

At our target price of 47 sen for Velesto, warrant holders who exercise and convert to mother shares stand to make a gain of 7.5 sen only, which is also not as profitable as selling the warrants outright in the secondary market.

Expensing of ESOS costs ►

Using the Black-Scholes model, we estimate the intrinsic value of Velesto's 131m ESOS at 14 sen each (Figures 12-13), representing a total cost of RM18.9m that needs to be expensed into the P&L over its 36-month vesting period (Figure 14). We have reflected this expense into our FY19-22F forecasts.

Figure 13: Valuation of Velesto's ESOS (based on CGS-CIMB assumptions and estimates)

Stock price at time of ESOS issue (S ₀)	RM0.36
Exercise (strike) price (K)	RM0.33
Time to maturity (in years) (t)	3
Annual risk free rate (r)	3.45%
Annualized 5-year volatility (σ)	50.39%
Intrinsic value of Velesto's ESOS (RM)	RM0.14

Additional Calculation Parameters

ln(S ₀ /K)	0.087
(r+σ ² /2)t	0.484
σ√t	0.873
d ₁	0.655
d ₂	(0.218)
N(d ₁)	0.744
N(d ₂)	0.414
N(-d ₁)	0.256
N(-d ₂)	0.586
e ^{-rt}	0.902

SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

Figure 14: Black-Scholes model for option valuation

$$C = S_t N(d_1) - K e^{-rt} N(d_2)$$

where:

$$d_1 = \frac{\ln \frac{S_t}{K} + (r + \frac{\sigma_s^2}{2}) t}{\sigma_s \sqrt{t}}$$

and

$$d_2 = d_1 - \sigma_s \sqrt{t}$$

where:

C = Call option price

S = Current stock (or other underlying) price

K = Strike price

r = Risk-free interest rate

t = Time to maturity

N = A normal distribution

SOURCES: INVESTOPEDIA

Figure 15: Calculation of ESOS expense in Velesto's P&L

a	No of ESOS issued (m)	131.0
b	Intrinsic value of ESOS (RM)	0.14
a x b	ESOS cost (RM m) - over 36 months	18.9
	- Expensed to FY19F	1.1
	- Expensed to FY20F	6.3
	- Expensed to FY21F	6.3
	- Expensed to FY22F	5.3

SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

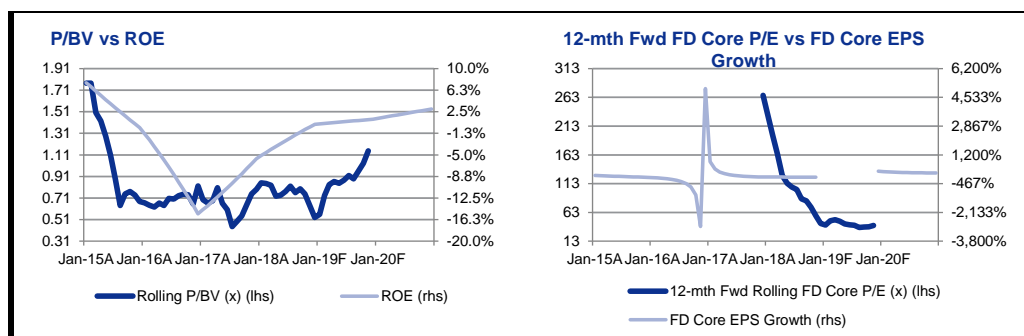
Sector comparison table ►

Figure 16: Sector Comparisons

Company	Bloomberg Ticker	Recom.	Price (local curr)	Target Price (local curr)	Market Cap (US\$ m)	Core P/E (x)		3-year EPS CAGR (%)	P/BV (x)		Recurring ROE (%)		EV/EBITDA (x)		Dividend Yield (%)	
						CY19F	CY20F		CY19F	CY20F	CY19F	CY20F	CY19F	CY20F	CY19F	CY20F
Velesto Energy Berhad	VEB MK	Add	RM0.40	RM0.47	785	95.9	38.1	150.7%	1.1	1.1	1.2%	3.0%	13.6	11.0	0.0%	0.0%
Sapura Energy Bhd	SAPE MK	Hold	RM0.30	RM0.31	1,137	na	na	na	0.4	0.4	-4.1%	-1.7%	17.5	12.4	0.1%	0.0%
PetroVietnam Drilling	PVD VN	Not Rated	VND16,600	-	301	37.7	21.7	88.3%	0.52	0.51	1.4%	2.4%	9.7	5.6	0.0%	0.0%
China Oilfield Services	2883 HK	Not Rated	US\$11.16	-	9,039	19.3	15.0	na	1.3	1.2	6.9%	8.4%	7.7	6.8	1.3%	1.3%
Transocean	RIG US	Not Rated	US\$5.41	-	3,310	na	na	na	0.3	0.3	-7.4%	-3.9%	11.8	10.2	0.0%	0.0%
Valaris PLC	VAL US	Not Rated	US\$4.70	-	930	na	na	na	0.1	0.1	-9.9%	-8.1%	40.0	21.7	2.0%	2.0%
Diamond Offshore	DO US	Not Rated	US\$6.22	-	856	na	na	na	0.3	0.3	-11.0%	-9.1%	35.7	15.6	0.0%	0.0%
Noble Corp	NE US	Not Rated	US\$1.31	-	326	na	na	na	0.1	0.1	-10.2%	-10.0%	14.2	12.2	0.0%	0.0%
Seadrill	SDRL US	Not Rated	US\$1.74	-	174	na	na	na	0.1	0.1	-38.6%	-38.6%	25.8	28.0	0.0%	0.0%
Average						na	na	na	0.4	0.4	-8.2%	-5.6%	14.0	11.6	0.7%	0.7%

SOURCES: CGS-CIMB RESEARCH, BLOOMBERG

BY THE NUMBERS



Profit & Loss

(RMm)	Dec-17A	Dec-18A	Dec-19F	Dec-20F	Dec-21F
Total Net Revenues	586	573	662	770	840
Gross Profit	215	245	313	376	434
Operating EBITDA	215	245	313	376	434
Depreciation And Amortisation	(255)	(191)	(210)	(219)	(220)
Operating EBIT	(40)	53	104	156	214
Financial Income/(Expense)	(120)	(74)	(67)	(62)	(54)
Pretax Income/(Loss) from Assoc.	0	0	1	1	1
Non-Operating Income/(Expense)	19	31	5	5	6
Profit Before Tax (pre-EI)	(141)	11	42	100	166
Exceptional Items	(992)	(28)	0	0	0
Pre-tax Profit	(1,133)	(18)	42	100	166
Taxation	(1)	(3)	(7)	(14)	(20)
Exceptional Income - post-tax					
Profit After Tax	(1,134)	(20)	35	86	146
Minority Interests	2	1	(1)	(1)	(1)
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax					
Net Profit	(1,132)	(20)	34	85	145
Recurring Net Profit	(140)	9	34	85	145
Fully Diluted Recurring Net Profit	(140)	9	34	85	145

Cash Flow

(RMm)	Dec-17A	Dec-18A	Dec-19F	Dec-20F	Dec-21F
EBITDA	215	245	313	376	434
Cash Flow from Inv. & Assoc.					
Change In Working Capital	(150)	(14)	(42)	(57)	(32)
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense	1,247	219	210	225	226
Other Operating Cashflow	(1,228)	(188)	(204)	(213)	(214)
Net Interest (Paid)/Received	(122)	(71)	(67)	(62)	(54)
Tax Paid	(3)	(1)	(7)	(14)	(20)
Cashflow From Operations	(40)	190	204	254	340
Capex	(13)	(28)	(173)	(115)	(20)
Disposals Of FAs/subsidiaries	7	7	0	0	0
Acq. Of Subsidiaries/investments	0	0	0	0	0
Other Investing Cashflow	0	0	0	0	0
Cash Flow From Investing	(5)	(21)	(173)	(115)	(20)
Debt Raised/(repaid)	(1,632)	(421)	(85)	(105)	(154)
Proceeds From Issue Of Shares	1,813	0	0	0	0
Shares Repurchased					
Dividends Paid	0	0	0	0	0
Preferred Dividends					
Other Financing Cashflow					
Cash Flow From Financing	180	(421)	(85)	(105)	(154)
Total Cash Generated	135	(251)	(55)	34	167
Free Cashflow To Equity	(1,678)	(251)	(55)	34	167
Free Cashflow To Firm	94	255	104	208	382

SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

BY THE NUMBERS... cont'd

Balance Sheet

(RMm)	Dec-17A	Dec-18A	Dec-19F	Dec-20F	Dec-21F
Total Cash And Equivalents	679	401	346	380	547
Total Debtors	238	234	270	315	343
Inventories	195	180	190	216	222
Total Other Current Assets	35	14	14	14	14
Total Current Assets	1,147	829	821	925	1,127
Fixed Assets	3,585	3,532	3,495	3,391	3,191
Total Investments	2	2	3	3	4
Intangible Assets	0	0	0	0	0
Total Other Non-Current Assets	2	1	1	1	1
Total Non-current Assets	3,590	3,535	3,499	3,395	3,196
Short-term Debt	459	89	108	158	158
Current Portion of Long-Term Debt					
Total Creditors	170	89	95	107	111
Other Current Liabilities	8	38	38	38	38
Total Current Liabilities	637	217	242	303	307
Total Long-term Debt	1,399	1,348	1,244	1,090	936
Hybrid Debt - Debt Component					
Total Other Non-Current Liabilities	0	0	1	7	14
Total Non-current Liabilities	1,399	1,348	1,245	1,097	950
Total Provisions	0	0	0	0	0
Total Liabilities	2,036	1,565	1,486	1,401	1,257
Shareholders' Equity	2,701	2,797	2,831	2,916	3,061
Minority Interests	1	2	3	4	5
Total Equity	2,702	2,799	2,833	2,919	3,065

Key Ratios

	Dec-17A	Dec-18A	Dec-19F	Dec-20F	Dec-21F
Revenue Growth	82.8%	(2.3%)	15.4%	16.4%	9.1%
Operating EBITDA Growth	N/A	13.9%	28.0%	19.8%	15.5%
Operating EBITDA Margin	36.6%	42.7%	47.4%	48.8%	51.6%
Net Cash Per Share (RM)	(0.17)	(0.13)	(0.12)	(0.11)	(0.07)
BVPS (RM)	0.39	0.34	0.34	0.35	0.37
Gross Interest Cover	(0.29)	0.63	1.40	2.27	3.45
Effective Tax Rate	0.0%	0.0%	16.8%	13.6%	12.1%
Net Dividend Payout Ratio	NA	NA	NA	NA	NA
Accounts Receivables Days	107.3	150.3	139.2	139.0	143.0
Inventory Days	199.3	208.0	193.9	188.3	196.7
Accounts Payables Days	180.8	144.1	96.5	93.7	97.9
ROIC (%)	(0.55%)	1.03%	2.03%	3.06%	4.23%
ROCE (%)	(0.43%)	1.47%	2.62%	3.90%	5.34%
Return On Average Assets	(0.92%)	1.39%	1.97%	3.08%	4.31%

Key Drivers

	Dec-17A	Dec-18A	Dec-19F	Dec-20F	Dec-21F
Outstanding Orderbook (RMm)	N/A	N/A	N/A	N/A	N/A
Order Book Wins (RMm)	N/A	N/A	N/A	N/A	N/A
Order Book Depletion (RMm)	N/A	N/A	N/A	N/A	N/A
Average Day Rate Per Ship (US\$)	70,962.6	70,000.0	70,840.7	74,295.1	81,530.8
No. Of Ships (unit)	7	7	7	7	7
Average Utilisation Rate (%)	68.3%	70.0%	80.0%	90.0%	90.0%
Oil Price (US\$/bbl)	N/A	N/A	N/A	N/A	N/A
Energy Production Volume (mmboc)	N/A	N/A	N/A	N/A	N/A
Average Day Rate - Drilling Rigs (US\$)	N/A	N/A	N/A	N/A	N/A
Average Util. Rate - Drilling Rigs (%)	N/A	N/A	N/A	N/A	N/A
Average Day Rate - FPU's (US\$)	N/A	N/A	N/A	N/A	N/A
Average Util. Rate - FPU's (%)	N/A	N/A	N/A	N/A	N/A
Total Oil Storage Capacity (000 cbm)	N/A	N/A	N/A	N/A	N/A
Equity Share Of Oil Storage Capacity (000 cbm)	N/A	N/A	N/A	N/A	N/A
Assumed Util. Rate Of Oil Storage Capacity (%)	N/A	N/A	N/A	N/A	N/A

SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

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Score Range:	90 - 100	80 – 89	70 - 79	Below 70 or	No Survey Result
Description:	Excellent	Very Good	Good	N/A	

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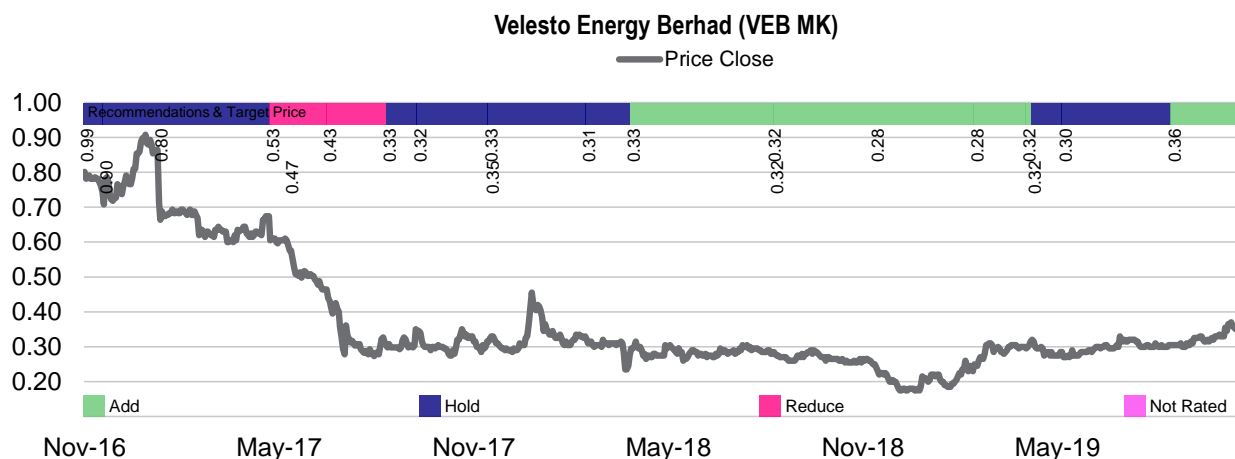
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Distribution of stock ratings and investment banking clients for quarter ended on 30 September 2019		
777 companies under coverage for quarter ended on 30 September 2019		
	Rating Distribution (%)	Investment Banking clients (%)
Add	58.8%	0.9%
Hold	26.3%	0.0%
Reduce	14.9%	0.1%

Spitzer Chart for stock being researched (2 year data)



Corporate Governance Report of Thai Listed Companies (CGR). CG Rating by the Thai Institute of Directors Association (Thai IOD) in 2018, Anti-Corruption 2018

ADVANC – Excellent, Certified, **AEONTS** – Good, n/a, **AH** – Very Good, n/a, **AMATA** – Excellent, Declared, **ANAN** – Excellent, Declared, **AOT** – Excellent, Declared, **AP** – Excellent, Certified, **ASP** – Very Good, Certified, **BANPU** – Excellent, Certified, **BAY** – Excellent, Certified, **BBL** – Very Good, Certified, **BCH** – Good, Certified, **BCP** - Excellent, Certified, **BCPG** – Excellent, Certified, **BEM** – Very Good, n/a, **BDMS** – Very Good, n/a, **BEAUTY** – Good, n/a, **BEC** – Very Good, n/a, **BGRIM** – Very Good, Declared, **BH** - Good, n/a, **BJC** – Very Good, Declared, **BJCHI** – Very Good, Certified, **BLA** – Very Good, Certified, **BPP** – Very Good, Declared, **BR** - Good, Declared, **BTS** - Excellent, Certified, **CBG** – Very Good, n/a, **CCET** – Good, n/a, **CENDEL** – Very Good, Certified, **CHG** – Very Good, Declared, **CK** – Excellent, n/a, **COL** – Excellent, Declared, **CPALL** – Very Good, Certified, **CPF** – Excellent, Certified, **CPN** - Excellent, Certified, **DELTA** - Excellent, n/a, **DEMCO** – Excellent, Certified, **DDD** – Very Good, Declared, **DIF** – not available, n/a, **DREIT** – not available, n/a, **DTAC** – Excellent, Certified, **EA** – Excellent, n/a, **ECL** – Very Good, Certified, **EGCO** – Excellent, Certified, **EPG** – Very Good, n/a, **ERW** – Very Good, n/a, **GFPT** - Excellent, Certified, **GGC** – Excellent, Certified, **GLOBAL** – Very Good, n/a, **GLOW** – Very Good, Certified, **GPSC** – Excellent, Certified, **GULF** – Very Good, n/a, **GUNKUL** – Excellent, Certified, **HANA** - Excellent, Certified, **HMPRO** - Excellent, Certified, **HREIT** - Excellent, Certified, **ICHI** – Excellent, Declared, **HUMAN** – not available, n/a, **III** – Good, n/a, **INTUCH** - Excellent, Certified, **IRPC** – Excellent, Certified, **ITD*** – Very Good, n/a, **IVL** - Excellent, Certified, **JASIF** – not available, n/a, **JWD** – Very Good, n/a, **KBANK** - Excellent, Certified, **KCE** - Excellent, Certified, **KKP** – Excellent, Certified, **KSL** – Excellent, Certified, **KTB** - Excellent, Certified, **KTC** – Excellent, Certified, **LH** - Very Good, n/a, **LPN** – Excellent, Certified, **M** – Very Good, Certified, **MACO** – Very Good, n/a, **MAJOR** – Very Good, n/a, **MAKRO** – Excellent, Declared, **MALEE** – Very Good, Certified, **MC** – Very Good, Certified, **MCOT** – Excellent, Certified, **MEGA** – Very Good, n/a, **MINT** - Excellent, Certified, **MTC** – Excellent, Declared, **NETBAY** – Good, n/a, **OSP** – not available, n/a, **PLANB** – Excellent, Declared, **PLAT** – Very Good, Certified, **PR9** – not available, n/a, **PSH** – Excellent, Certified, **PSTC** – Good, Certified, **PTT** - Excellent, Certified, **PTTEP** - Excellent, Certified, **PTTGC** - Excellent, Certified, **QH** – Excellent, Certified, **RATCH** – Excellent, Certified, **ROBINS** – Excellent, Certified, **RS** – Very Good, n/a, **RSP** – not available, n/a, **S** – Very Good, n/a, **SAMART** - Excellent, n/a, **SAPPE** – Very Good, Declared, **SAT** – Excellent, Certified, **SAWAD** – Very Good, n/a, **SC** – Excellent, Declared, **SCB** - Excellent, Certified, **SCC** – Excellent, Certified, **SCN** – Very Good, Certified, **SF** – Good, n/a, **SIRI** – Very Good, Certified, **SPA** - Good, n/a, **SPALI** - Excellent, n/a, **SPRC** – Excellent, Certified, **STA** – Very Good, Certified, **STEC** – Excellent, n/a, **SVI** – Excellent, Certified, **SYNEX** – Very Good, Declared, **TASCO** – Excellent, Certified, **TCAP** – Excellent, Certified, **THANI** – Excellent, Certified, **TIPCO** – Very Good, Certified, **TISCO** - Excellent, Certified, **TKN** – Very Good, Declared, **TMB** - Excellent, Certified, **TNR** – Very Good, Declared, **TOP** - Excellent, Certified, **TPCH** – Good, n/a, **TPIPP** – Good, n/a, **TRUE** – Excellent, Certified, **TU** – Excellent, Certified, **TVO** – Very Good, Declared, **UNIQ** – Good, n/a, **VGI** – Excellent, Certified, **WHA** – Excellent, Certified, **WHART** – not available, n/a, **WICE** – Very Good, Certified, **WORK** – Good, n/a.

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- Companies that have declared their intention to join CAC, and
- Companies certified by CAC

* The company, its director or management had been reportedly accused for breaching proper corporate governance such as violation of the SEC's regulations or charged with corruption.

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Definition:

- Add** The stock's total return is expected to exceed 10% over the next 12 months.
- Hold** The stock's total return is expected to be between 0% and positive 10% over the next 12 months.
- Reduce** The stock's total return is expected to fall below 0% or more over the next 12 months.

The total expected return of a stock is defined as the sum of the: (i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.

Sector Ratings

Definition:

- Overweight** An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation.
- Neutral** A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
- Underweight** An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

Country Ratings

Definition:

- Overweight** An Overweight rating means investors should be positioned with an above-market weight in this country relative to benchmark.
- Neutral** A Neutral rating means investors should be positioned with a neutral weight in this country relative to benchmark.
- Underweight** An Underweight rating means investors should be positioned with a below-market weight in this country relative to benchmark.

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