Overview

Valeura Energy (Toronto: VLE) is headquartered in Singapore, trades on the Toronto Stock Exchange, and operates in the Gulf of Thailand as an oil producer, with four producing oil fields. Their two acquisitions in 2022 transformed Valeura into the largest independent producer in Thailand (the second largest overall after PTT, majority owned and controlled by the Thai government), leading to the present situation where they are gushing cash with excellent prospects for the future and sharply undervalued. (Note that despite being traded in Toronto, all figures in this report are in US Dollars, except where noted.)

Acquisition #1 — A Great Acquisition

Although in general the history of how a company got to its present state is not necessarily crucial to understanding the company as it is now, in Valeura's case, we do believe it to be an important element of the story. Valeura was formerly an operator of Turkish oil and gas assets, both onshore and offshore, with a potentially large gas exploration asset that had yet to advance to development stage. In 2020, Valeura sold their remaining production assets, leaving themselves as basically a shell with $40 million in cash on the hunt for acquisitions in the oil and gas space. (Valeura still owns the Turkish exploration asset — a deep, tight gas appraisal play — which they are not presently investing in, but are seeking a partner for.)

The vast majority of corporate acquisitions are ill-advised. Doubly so when the acquirer has money burning a hole in their pocket urging them to sign off on an acquisition, any acquisition. To Valeura's credit — or more precisely said, to management's credit — Valeura patiently bided their time and waited for an optimal acquisition. And they succeeded beyond the wildest imagination, pulling off not one, but two, incredible acquisitions over the course of 2022. Valeura successfully transformed their $40 million stake of cash into an oil powerhouse in the Gulf of Thailand worth north of half a billion dollars today and still undervalued.

Their first acquisition, announced in April 2022 and closed in June, was purchasing the Wassana oil field out of bankruptcy from Kris Energy. Wassana had been a profitable, producing oil field which had been overleveraged with debt, pushing Kris Energy under when oil prices plummeted in 2020 and 2021. Valeura bought Wassana, together with an aging mobile production platform and associated equipment, and together with Rossukon, another oil field ready for development but having yet to produce, for a total of $12.3 million cash and $7 million in contingent payments. ($2 million of contingent payments were due when oil from certain areas of Wassana were produced and $5 million were due when and if Rossukon was developed and produced first oil.) Valeura later sold Rossukon for $5 million contingent on first oil (offsetting their own contingent payment for Rossukon) and an ongoing royalty. Essentially, Valeura paid a total of $14.3 million for Wassana (counting the Wassana contingent payment, but not counting the $5 million payment which was contingent on Rossukon and was anyways offset with the later sale of Rossukon).

What did Valeura receive in exchange for their $14.3 million? They received an oil field with a history of producing 3,000 bbls/d (barrels per day) which could be brought back to production with relatively little work, and with potential to rise to as much as 5,000 bbls/d with further investment. Considering Wassana's relatively low opex of ~$36/bbl and the then-prevailing price of Brent crude oil (~$100), this was set to produce annual cashflow of $36 million, after all royalties, opex, and tax. Even at a lower oil price of $70, it produces ~$12 million in annual net cashflow. Plus $2 million annually they are now receiving from their Rossukon ongoing royalty. All for just $14.3 million total payment! An absolutely great acquisition.

Mostly unnoted at the time, Wassana also came with significant historical tax losses. These tax losses not only served to make Wassana's own production tax-free, but carried the potential to shield other assets later combined with Wassana from Thailand's hefty 50% tax rate on oil profits. This significant benefit was ultimately realized by the company and just by itself was worth almost $200 million. So, an absolutely great acquisition in its own right together with significant tax losses making it worth substantially more when combined with another acquisition.

There were some hiccups along the way in getting Wassana restarted and some temporary accidents and closures, but all in all, Wassana has indeed produced as expected and has generated the anticipated cashflow. Originally, the Wassana acquisition was only for the 89% operating interest owned by Kris Energy, but shortly before the restart, the 11% partner forfeited their share to Valeura in exchange for no longer sharing the cost burden (and ultimate decommissioning costs), bringing Valeura's present stake in Wassana to 100%, with no further investment on their part.

Acquisition #2 — The Greatest-Acqusition-of-All-Time-You-Have-to-See-It-to-Believe-It-Absolutely-Incredible-Acquisition

Valeura's next acquisition, announced in December 2022 and closed in March 2023, was absolutely breathtaking. I have never, ever, seen such an amazing acquisition at such an incredible price. Valeura purchased all the Gulf of Thailand oil assets from Mubadala Energy, a subsidiary of one of Abu Dhabi's sovereign wealth funds, an acquisition which instantly catapulted Valeura into position as the largest independent oil producer in Thailand. This acquisition included three producing oil fields — Jasmine (100% interest), Nong Yao (90% interest), and Manora (70% interest). It is important to note that they did not just purchase the oil fields themselves, but purchased the entire business, together with all the employees and management systems intact, a full business operating at full speed straight out of the gate.

These three oil fields were then producing a combined 21,000 bbls/d at an even lower opex of ~$22/bbl. All this for a headline price of $10.4 million. (There was also a contingent payment of up to $50 million if Brent averaged above $100 in 2022, 2023, or 2024, a situation in which the fields would have become even more profitable. In any event, the contingency never activated, and the total payment for the Mubadala assets was ultimately the headline $10.4 million.) The Mubadala assets were very profitable, netting ~$15 million *a month* in net cashflow, after royalties, opex, and taxes. For this they paid only $10.4 million! An absolute steal!

However incredible that acquisition sounds, in reality the deal was absurdly better. As is common for oil and gas deals, the effective date of the acquisition was backdated to months before the actual closing, in this case all the way back to September 2022, three months before the deal was even signed. This means that the economics of the business, producing $15 million a month in net cashflow, all accrued to Valeura during the three months from the effective date to the deal signing and again during the four months between the deal signing and the actual deal closing. When Valeura closed the acquisition on March 22, 2023, Valeura handed Mubadala $10.4 million as agreed, and in exchange received a company with $105 million in net cash! In addition to the ongoing highly profitable operations! Valeura paid negative money to acquire a highly profitable oil business! There are simply no words in the English language to describe how incredible this deal was.

Obviously, one wonders how such a deal could come to be and what the sellers were thinking. The answer is complex, but a major contributing factor was Mubadala Energy's decision from the top to exit oil and focus on clean energy (natural gas and renewables). One wonders what the world is coming to if even Arab oil states are acting on such ESG considerations in their sovereign wealth funds.

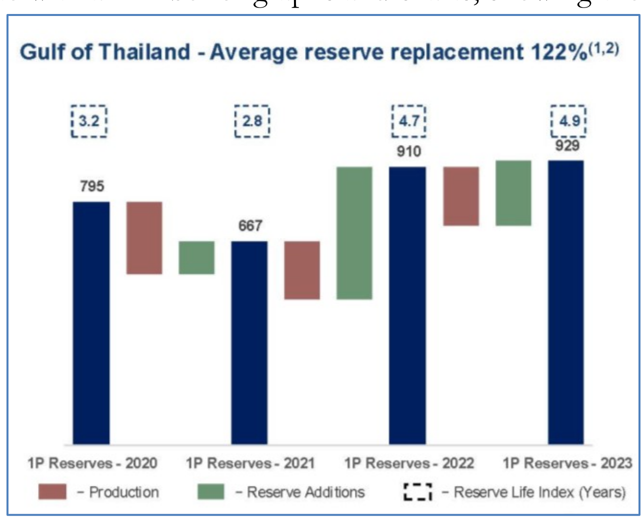
As a final note, the tax losses from the Kris Energy acquisition now came in handy. By combining Wassana together with Nong Yao and Manora in the same corporate structure, all of their cashflow was now able to take advantage of the $400 million+ of tax losses acquired with Wassana. Given the 50% Thai tax rate on net oil profits, these tax assets are worth an additional $200 million, only a small portion of which Wassana was able to take advantage of. After restructuring (as of November 1, 2024), Valeura is now able to use the entirety of the tax loss assets over the next few years. (Jasmine operates under Thai I, a separate tax regime, so it is ineligible to be combined with the other three oil fields which operate under the Thai III regime.)

Reserves Replacement and the Unique Geology of the Gulf of Thailand

When glancing at Valeura, probably the most common error is to look at their oil reserves and immediately write them off as dying assets. A common rule of thumb in the oil industry is to look for a RLI (Reserve Life Index; a measure of how many years of life the oil assets have left until the reserves run out) of at least 10 years; Valeura's acquired assets had an RLI of just 3.5 years! No wonder they got it cheap! The assets are close to end of life, at which point there will be hefty decommissioning expenses to retire the assets. Indeed, ARO (Asset Retirement Obligations) on the balance sheet post-acquisition was close to $200 million.

This analysis is a mistake.

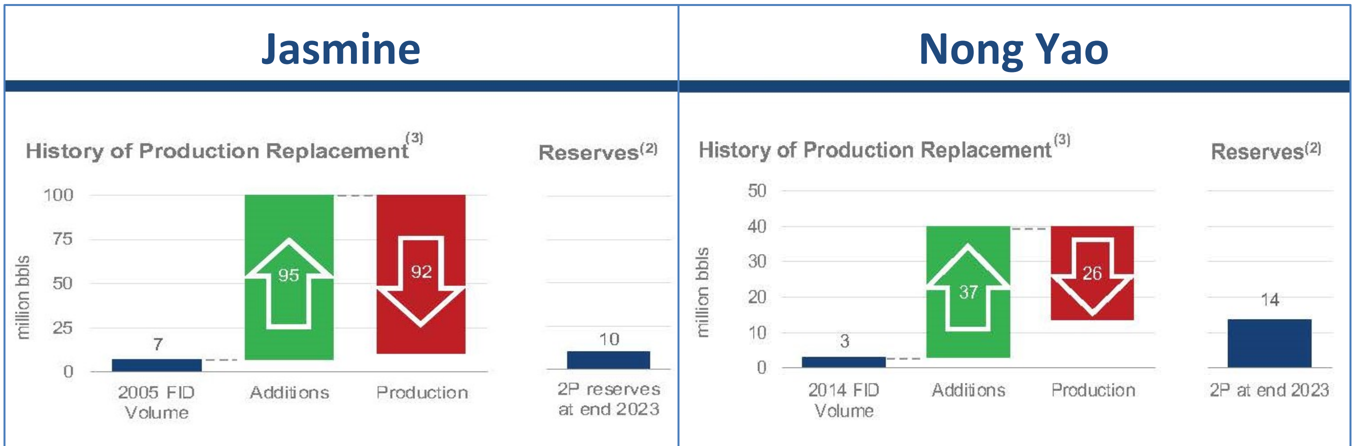
The Gulf of Thailand has a somewhat unique geology, with multiple stacked reservoirs featuring numerous fault blocks. What this means is that although the technical reported reserves on the books may be relatively limited, when you finish one well and dig another well right next to it, you reveal more reserves. Even when the reserves appear limited and set to run out in a few years, this is not actually indicative of how long the oil field will last. For every barrel of oil that is produced, another equivalent barrel of oil gets added to reserves, so that at the end of the year, the reserves stand at the same place they started at. In other words, the reserves replacement ratio is above 100%. ***This is a crucial point to understand; indeed, I would say that the whole crux of understanding Valeura's value opportunity rests on understanding this point.*** Because of how central this is to the thesis, I will illustrate with a number of graphs and charts, showing the general situation in the Gulf of Thailand as a whole, the past history of these particular oil fields, and the performance of these fields under Valeura's stewardship for the past two years.

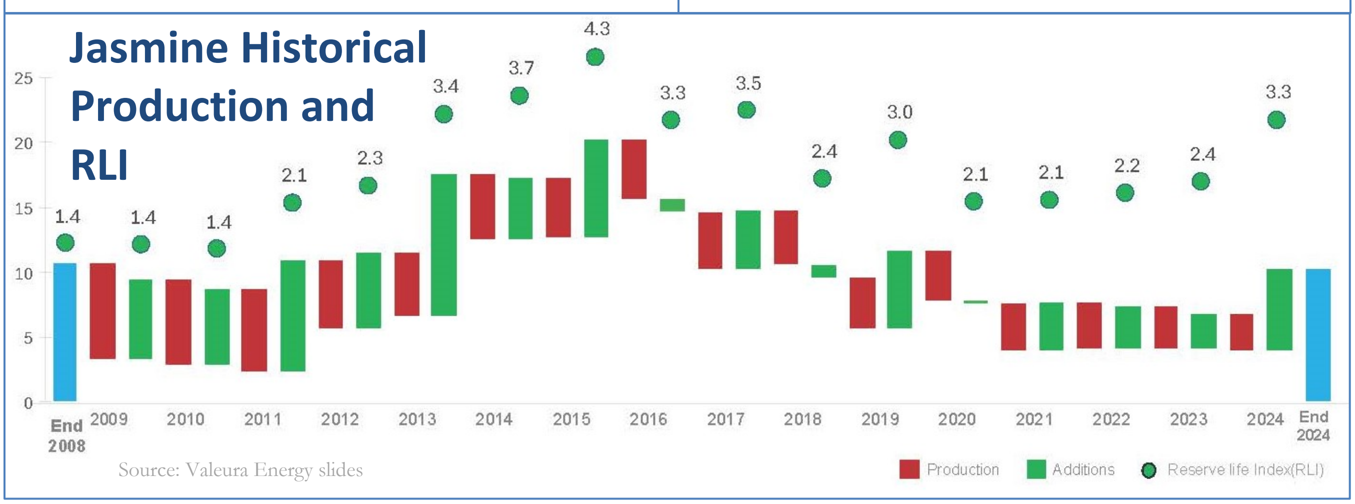


The chart on the right shows the combined reserves of all oil fields in the Gulf of Thailand over the 2020-2023 period, based on public data available from Thai regulators. You can see that even as steady production "depletes" the oil reserves, new reserves more than replaced what was produced. This phenomenon is the expected progression of the Gulf of Thailand's unique geology.

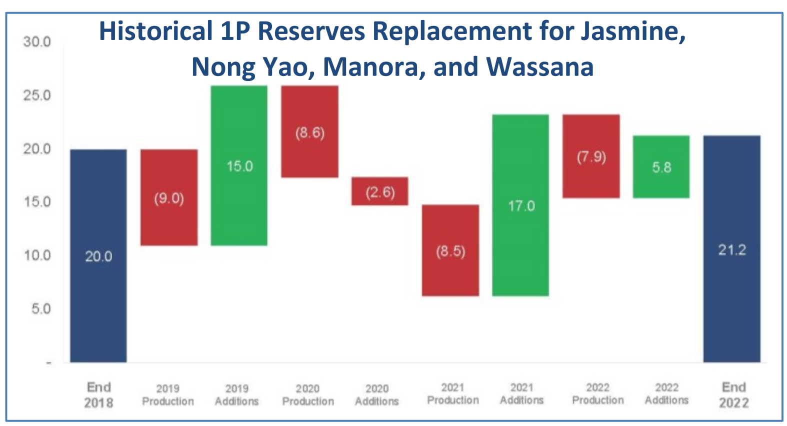
Valeura Energy

Moving on to Valeura's specific fields, we see this exact phenomeno across their portfolio. Jasmine is their oldest field, having entered production in 2005 on the back of just 7 million barrels of oil in reserves. Close to twenty years later, Jasmine has produced 92 million barrels of oil and ended 2023 with 10 million barrels of reserves, more than when it started. And if you look at Jasmine's stated RLI, you will see that it has always shown a short remaining "life", never rising above 4.3 years remaining, despite consistently producing for decades and still going strong. Nong Yao is a similar story, having started production in 2014 with just 3 million barrels of reserves, having since produced 26 million barrels, and ten years later, now showing 14 million barrels in reserves.

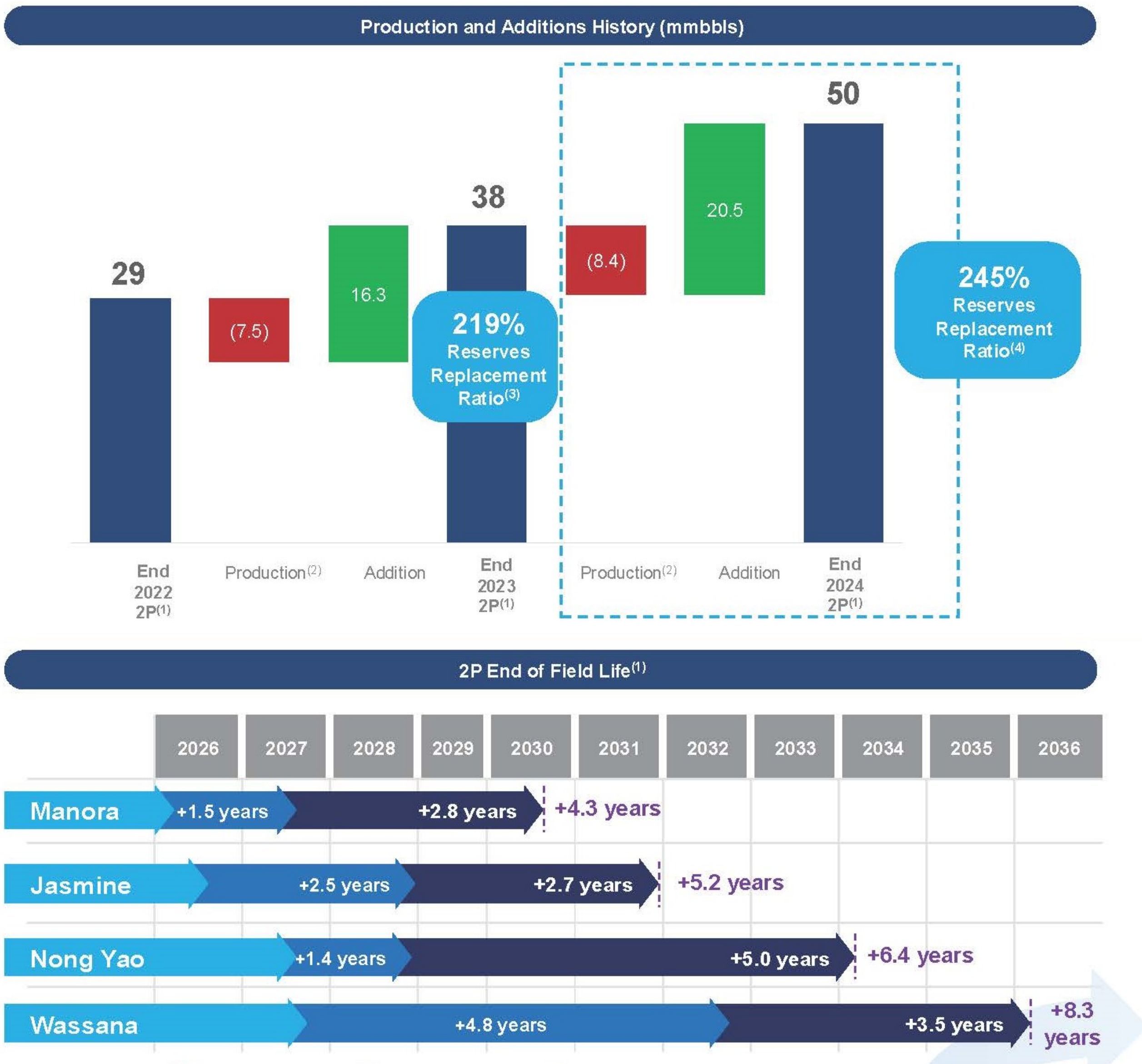




This is true across their portfolio. The chart on the right shows the combined reserves of all four of their fields over the 2018-2022 period, showing that even as steady production "depleted" their reserves, new reserves more than replaced what was produced.



Since Valeura took over stewardship of the oil fields, they have done an excellent job of managing the oil fields and investing in them to further bring out their potential. In both 2023 and 2024, their reserve replacement ratio exceeded 200%, meaning that for every barrel of oil removed from the ground, they added more than two barrels to reserves, increasing the reserves and extending the oil field end-of-life date. In fact, over the past two years, Valeura has extended each field's life a minimum of 4 years and as much as 8+ years. There is no reason to believe that the field lives will not continue to be extended far into the future as they have consistently been doing for years.



Source: Valeura Energy slides

The extension of the field lives far into the future both increases the expected amount and value of oil we can expect to ultimately produce from the fields as well as pushes out the ultimate decommissioning liabilities, sharply lowering their discounted value. Valeura has also undertaken a number of studies to further reduce the absolute expected liability of decommissioning, based on updated cost estimates particular to the Gulf of Thailand and using the latest start-of-the-art methods of decommissioning and recycling parts.

Between updated cost estimates and pushing out the date of asset retirements, Valeura has reduced the decommissioning liability approximately 55% from when they purchased the assets.

Valuation

Forecast

Valeura is highly profitable, even with the sharply lower oil prices currently prevailing. As is common in Asia, the pricing is generally tied to the Dubai oil price benchmark, over which Valeura generally receives a slight premium. Historically, Dubai prices have been close to or slightly below the more well known Brent price benchmark, but more recently, and especially with the recent volatility, Dubai prices have been a number of dollars higher than Brent. Either way, the company is highly profitable at present prices, and would remain profitable at much lower prices as well, albeit less so.

As a rough estimate, Valeura can be expected to produce about 24,000 barrels a day, or about 8.8 million barrels a year. As we write, Brent is trading about $63 a barrel. After deducting royalties, opex, capex (most of which is sustaining capex to keep the overall production levels stable as older wells decline), minimal exploration expenses, SRB payments (a special "windfall" tax system in Thailand, calculated using a complex formula based on the oil revenue received and the cumulative meters drilled per license; the SRB payment cannot be offset by historical tax losses), and approximately zero income taxes for the next few years (due to the almost $400 million of historical tax losses acquired with Wassana), we conservatively estimate Valeura's net cashflow to be about $100-$125 million annually, at present oil prices. If oil prices rebound after the tariff brouhaha passes, they will make substantially more.

Valuation

How much did we pay for that income stream? In our November letter from last year, we alluded to beginning to build a position in "a company trading at a $350 million valuation, with no debt and about $150 million of cash on the balance sheet, and making about $150 million a year in net profit," which we called "crazy undervalued". That company, of course, is Valeura Energy. And the price that we were paying in November was absolutely crazily undervalued.

Since writing that letter, the tax restructuring has taken place and the company has initiated a stock buyback, both of which are quite advantageous to us shareholders. On the downside, oil prices have declined sharply this past month, and no one is quite sure what the future will bring. How much is the market charging for that income stream now? At the present stock price of $7.46 CAD (as of May 7, 2025), the market cap is about $790 million CAD, which is equivalent to about $570 million USD. Cash on the balance sheet, net of all financial liabilities, was $200 million as of the end of 2024, and by now is quite a bit higher. Ex-cash, the stock is trading between 2.5x–3.5x its yearly cashflow. Depending on the vagaries of oil prices, it is quite possible that in two years' time, the cash on the balance sheet will equal the present market cap. Not as crazy undervalued as it was back in November, but still deeply undervalued indeed.

Another way to look at valuation is to use the NPV_{10} from their latest reserves report released in February. This is a standard methodology in the oil industry and calculates the net present value of their oil assets (using a 10% discount rate), based on 2P reserves (proved and probable), after deducting all costs needed to get the oil out of the ground and sold and taking into account necessary capex, opex, as well as ultimate decommissioning costs. It is important to underline that this only takes into account their present reserves, and does not assume any reserve replacement at all, despite the reserve replacement occurring like clockwork, as discussed above. The net present value, as calculated by a third-party independent assessor hired by Valeura, equates to $13.60 CAD a share, 82% higher than the present stock price. Again, this is assuming zero reserve replacement, so it is definitely underestimating the amount of oil Valeura will produce and sell in coming years.

Further Potential Growth

None of this accounts for further growth. Valeura has stated numerous times that they would like to grow their asset base with further acquisitions in the region. Valeura is well-positioned to do so, with relatively little competition from other potential buyers in their size bracket, as oil majors seek to exit the region and refocus on their core geographies. Although we usually frown on companies looking to expand via acquisition, as they generally make poor deals to expand their fiefdom at the expense of shareholder value, in this case, management has shown superior capital allocation skills and their ability to land tremendous deals. They were patient in choosing a deal, waiting a few years until they found two amazing deals to invest in. And they have been patient since, with two years having passed as they await another very good deal. Given the circumstances, I'm willing to cut them some slack and give them the benefit of the doubt. It is in fact possible that the present volatility in oil prices will actually help Valeura by bringing sellers to the table.

I'm not saying that we can expect or even hope for Valeura to make another acquisition as amazingly good as the ones they already made. But I do believe that management has shown itself to have good capital allocation skills and willing to be patient for the right deal to come along. If Valeura announces another sizable deal even half as good as the deals they have already made, we would expect a sizable surge in the stock price.

Besides the potential for growth through acquisitions, their present portfolio holds a few significant areas with potential for organic growth. The furthest developed of these is Wassana North and South, where oil has been found beyond the reaches of their present mobile platform. Their present mobile platform is aging and will soon need to be replaced. It can be replaced by an equivalent mobile platform at relatively small expense, or it can be replaced by a new larger platform with the potential to expand to include the oil discoveries at Wassana North and South as well, for a more substantial investment of ~$150 million over about two years.

The FID (Final Investment Decision) for the Wassana redevelopment is due any day now, although the decision may well be delayed considering the present volatility in oil prices. If the decision is ultimately made to move forward on the Wassana redevelopment, this has the potential to add 10 million barrels of oil to reserves short-term (20% of Valeura's overall reserves at present) and much more over the long-term.

Finally, there is further exploration taking place within their license areas. The two most interesting prospects are Nong Yao D and Ratree. Nong Yao D is likely to further extend the life of Nong Yao, their most profitable oil field. Ratree, an exploration prospect within their Jasmine license area, is more speculative, but has the potential to be quite significant as well.

None of this is being accounted for in our valuation exercise above. Any organic or inorganic growth amounts to a cherry on the top, so to speak, although we would be quite surprised if at least some of these did not end up coming to fruition.

Risk

The main risk facing Valeura is, unsurprisingly, the price of oil. Over April, oil prices have sharply declined, both due to OPEC choosing to increase supply to the market and due to tariff and economic uncertainty heightening fears of an economic slowdown or recession. At present prices, Valeura remains highly profitable, albeit less so than they are at higher prices, naturally. If oil prices decline further, this would lower Valeura's profitability further. Nevertheless, Valeura is a low-cost producer. With their present cost structure, Valeura would remain profitable even if oil prices slid into the mid-40s. If oil prices were to decline to that extent, Valeura would no doubt cut back on discretionary expenses and could lower their breakeven point even further.

Perhaps more importantly than Valeura's low-cost structure is their fortress balance sheet, with more than $200 million in net cash and no debt. Strong balance sheets are the hallmark of resilient companies, and I have no doubt that Valeura could weather any storm of low oil prices, if one were to come. The stock price would surely decline in that scenario, but Valeura would come out the other end in fine shape, and may even be able to take advantage of the turmoil with a well-timed acquisition.

Presentations

We twice publicly presented our thesis on Valeura Energy. The first time was our presentation in January at the MOI Global Best Ideas conference. And the second was in late March when I was hosted by Andrew Walker of Yet Another Value Blog to discuss our Valeura thesis, updated for the release of the latest reserves report and 2024 earnings. Both presentations are available on our website (focuscapitaladvisers.com), under the Research tab. We discuss many of the above themes in more detail, and we believe you will find these presentations informative.

Summary

We are normally loath to invest in a company whose fortunes are tied too closely to commodity prices. We do not have the ability nor the inclination to attempt to divine future movements in a global commodity such as oil; both the demand side and supply side involve vast and varied inputs and do not lend themselves to any confident forecasts.

In Valeura's case, we have made an exception to the rule, due to a confluence of factors that strengthen the investment case. First, the strength of the company and the extreme undervaluation it is experiencing. Second, its resilient balance sheet, combined with experienced management which has shown expertise both in operational excellence and capital allocation skills. And finally, a market that persists in misunderstanding the underlying value of its assets. We expect to do very well with Valeura over the medium-to-long term, no matter which way oil prices trade in the short-term.