# Valaris (VAL)

By: Eduardo Ribeiro
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## About the company:

Valaris (NYSE: VAL) is a leading global provider of offshore contract drilling services to the oil and gas industry. The company owns and operates the largest offshore drilling fleet in the world, serving both international oil companies and US based oil companies. The company was established after the merger of Ensco and Rowan in 2019 and operates a large, robust and diverse fleet of 49 vessels, broken down by drillships, semisubmersibles, (harsh, benign and legacy) jackups as well as ARO jackups, which is an arrangement with Saudi Aramco to form a 50/50 joint venture that owns vessels.

Valaris drills and explores oil and gas on behalf of energy producers. They do not own the oil or have to deal with any logistics or risks related to the price of oil, once the day rates are arranged and the period is established, Valaris is set to generate cash. Valaris's revenue outlook for 2025 is exceptionally predictable. According to the company's Q1 2025 earnings report, nearly 99 percent of its expected 2025 contract drilling revenue is already under long-term agreements, giving the business unparalleled visibility into next year's cash flows and insulating it from short-term commodity price swings.

**49 Rigs**
Largest offshore driller by fleet size with 15 high-spec floaters and 34 jackups

**92%**
7th generation assets within Valaris' drillship fleet (12 of 13)

**96%+**
Revenue efficiency for four consecutive years

**>50%**
Better safety performance than offshore peer group average in 2024[1]

**$4.2 Billion**
Contract backlog as of April 30, 2025

**$500-560 Million**
FY 2025 EBITDA guidance[2]

**ARO business**

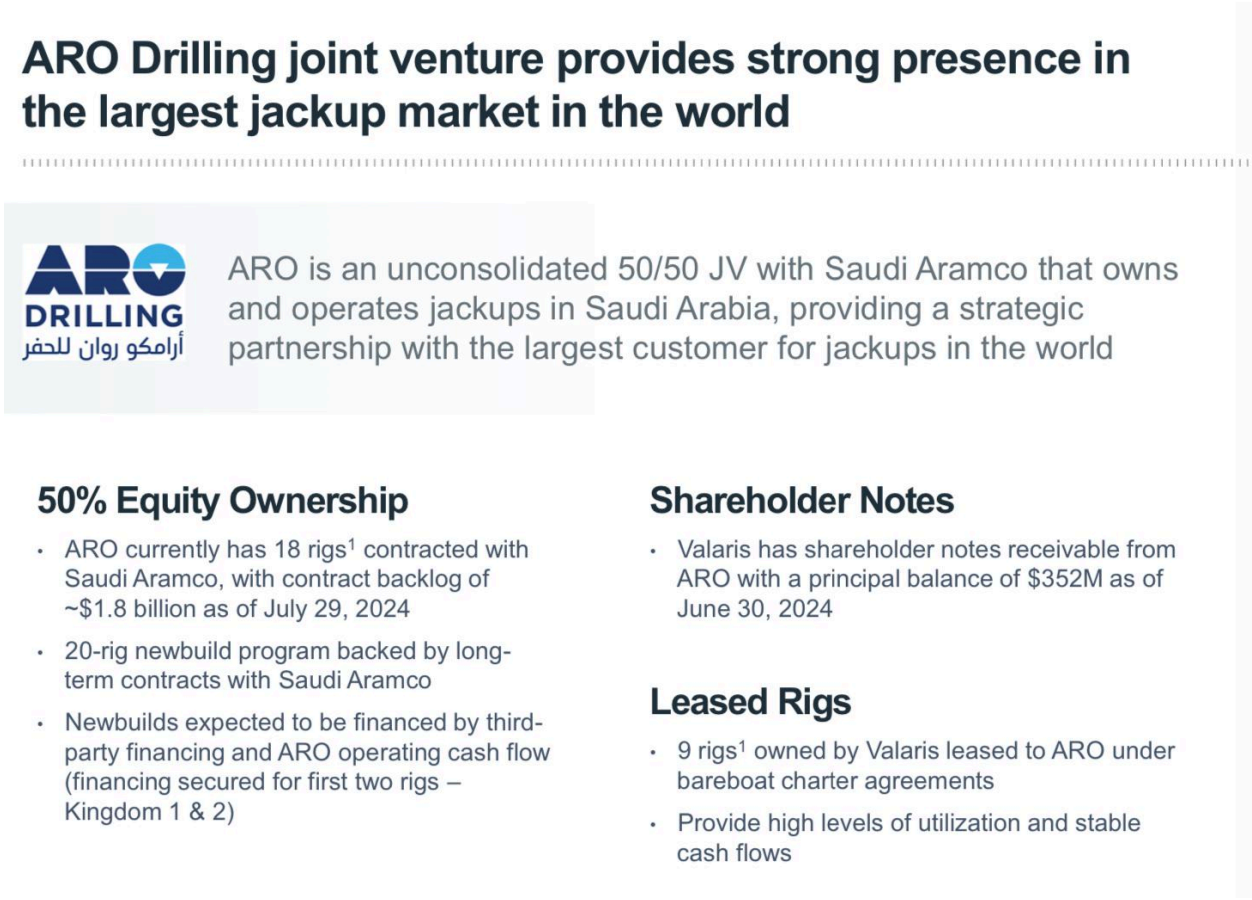
ARO Drilling is a 50/50 joint venture formed in late 2017 between Valaris Limited and Saudi Aramco to own, operate and finance jack-up drilling rigs in the Kingdom of Saudi Arabia. Each partner has equal representation on the ARO Board of Directors, and ARO operates with its

own dedicated management team to execute rig campaigns under long-term contracts with Aramco arodrilling.com.

Under its business model, ARO Drilling not only manages existing jack-up units contributed by each shareholder but is also executing an ambitious newbuild program—planning up to 20 purpose-built rigs over the next decade—all supported by attractive, multi-year day-rate contracts with Saudi Aramco.

The joint venture structure gives Valaris and Saudi Aramco shared upside in the Saudi offshore market while de-risking capital deployment: ARO rigs are financed via a combination of equity commitments (each partner provided a $1.25 billion capital commitment) and external debt, and ARO's cash flows fund further rig construction and operations. In turn, Aramco secures reliable drilling capacity through ARO's modern, fit-for-purpose jackups, aligned to the Kingdom's Vision 2030 offshore development goals

The ARO venture represents a way for Valaris to expand without deploying much capital and is a tool for guaranteeing more demand, given that Saudi Aramco will use those ships over contracting other drillers. As long as the Saudis keep their capex up, which they seem to be doing for the foreseeable future, ARO will bring strong cash flow without any additional cost for the company.



As of Q1 2025, Valaris' backlog stood at **$4.2 billion**, up from $3.6 billion in the previous quarter, an increase of nearly 20% driven by about $1.0 billion of new awards since the prior fleet status report. Through early July, Valaris has **added** **$1.9 billion** of new backlog in 2025, including two U.S. Gulf drillship deals worth $760 million (940-day extension for DS-16 and a 914-day campaign for DS-18 with Anadarko/Occidental). This shows how demand is growing rapidly for offshore drilling and Valaris is quickly capitalizing on it. This will be fundamental for the Valuation 2 part of this report.

# How the sector works

The offshore drilling market is the segment of the oil-and-gas industry focused on discovering and developing oil-and-gas reserves located beneath the seabed. Its players provide drilling units that, as we'll see further, are broken down into jack-ups, semi-subs, drillships, and other related services required to drill or disassemble wells in water depths ranging from tens to thousands of meters. Revenue in this market is driven largely by day-rates that can reach hundreds of thousands per day charged by contracts for complete well delivery, meaning that these contractors revenue comes almost exclusively from the Capital Expenditures (capex) of offshore exploration companies that aim to explore new wells. The operators are paid to extract the oil or gas which then is given to the exploration company to sell into the market.

Exploration companies outsource drilling to specialist contractors because offshore wells demand highly technical, capital-intensive assets and seasoned crews, making it an extra burden for a company that has to deal with all the other segments of O&G exploring. Contracts usually last for months, quarters or even years at a time, giving great predictability to the contractors. Contractors bid rates based on rig class, technical capabilities, and track records and, once these contracts awarded, the contractor provides the rig, crew, and core services in exchange for a fixed daily fee set right there and then, transferring equipment, cash flow predictability (regardless of oil prices) and staffing to the contractor, while giving the explorer cost predictability and allowing them to carry less of a burden.

Jack-Ups: Suited for shallow waters (typically up to 400 ft), their simplicity and lower capital cost translate into day-rates often ranging from $50,000 to $150,000. Given their lower day-rates and speed to deploy or retract, Jack-ups are ideal for most exploration wells where lower-risk development drilling and predictable seabed conditions are possible. The price to build a new Jack-up from scratch can reach $250-300 million, which seems high but is reasonable compared to other rigs and justifies lower day-rates.

Semi-Submersibles: Semi-subs float on partially submerged pontoons (or “logs”) used to ride above wave action for enhanced stability in water depths from about 500 ft to 6,000 ft. With day-rates typically between $150,000 and $350,000, they are more versatile for exploration in areas where the seabed is less stable, maritime movements are harsher, where it would be impossible for jack-ups to stand on its feet. The construction of a new semi-submersible can add up to around $750 million dollars, meaning that it’s only justifiable when the market is optimistic about higher demand and day-rates.

Drillships: Drillships are capable of operating in ultra-deepwater (6,000–12,000 ft+) and can handle extreme maritime and seabed conditions. Because of their high-specificities and extreme cost of production, drillship day-rates can cost north of $400,000. These rigs are extremely costly to produce, at around $1 billion, causing new shipbuilders to produce only when oil prices are extremely attractive and causing a bottleneck that favors contractors with extremely high rates when commodity prices are up.

## Economics Drivers:

Core revenue formula: The name of the game for drilling companies to make money is reliant on a single formula: day-rates x periods x utilization rates. Day-rate is the agreed price that the E&P company will pay the contractor for each day their vessel is used (as discussed before,

different ships have different rates). Periods refers to how long each ship is going to be used for, which is also highlighted in the agreement and closely follows a company's CapEx program (if it is a long term exploration project the periods will be longer, lasting for years at a time). Finally, utilization rates refers to how much of a contractor's total fleet is being utilized at a moment in time. Several times, when the day-rates are low and the wave of CapEx from E&P companies is weak it makes more sense for the drilling company to "shelf" a ship and not operate it at all, saving money on crew and other operational costs. For example, Valaris, a top drilling contractor, projects that their utilization rate will go from 70% to 80% as drillship rates go from $400,000 to $500,000, showing how demand for ships and economic reason guides their deployment decision making.

Most rig contracts lock in day-rates for a fixed term, shielding both parties from short-term price swings. A sustained 10% increase in crude prices only translates into about a 4% boost in drilling activity after roughly four quarters, and the resulting uptick in extraction costs of about 3% (which materializes in contracts to drillers) doesn't materialize until approximately six quarters later.

In terms of costs for contractors, most of it is stable. Once a rig is active, most expenses, like crew, insurance, maintenance are locked in. These companies have virtually no ability to cut costs beyond warm or cold stacking idle rigs. Taking cost mostly as fixed, except for the ability to stack ships, FCF really turns into a formula between the three variables presented above.

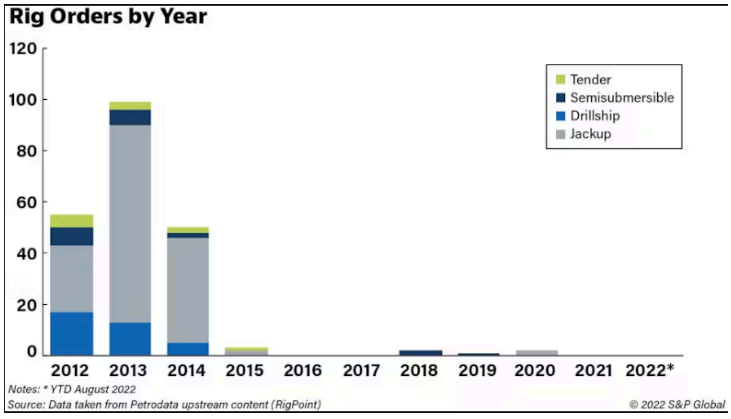
The CapEx landscape for the major oil companies is a little mixed. Petrobras has approved roughly $18.5 billion of capital spending for 2025, a 42% increase from its previous plan, among a $111 billion budget from 2025 to 2029. Equinor, by contrast, expects to allocate $13 billion of organic CapEx in 2025 and a total commitment to spend around $6 billion a year in CapEx until 2035. Shell's cash CapEx outlook of $20–22 billion for 2025 sits broadly in line with its $21.1 billion in 2024. Finally, Saudi Aramco projects to spend between $52 and $58 billion dollars in CapEx in 2025, highlighting this number will be bigger in the next few years, showing their commitment to new projects and a strong influx of money towards contractors.

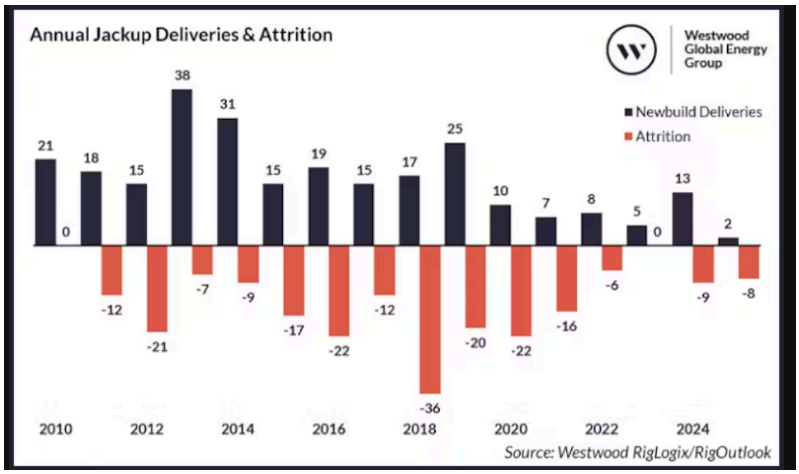
ExxonMobil's capex is essentially flat year-on-year, anchoring at $27–29 B, with Guyana and Brazil deepwater projects absorbing the bulk of spending. Chevron plans $14.5–15.5 B in 2025, focused mainly on U.S. Gulf of Mexico and Australia offshore development. BP is upping upstream capex to $14.5 B (from roughly $12 B), again with a heavy tilt toward deepwater. All this goes to show that major players are still investing heavily on off shore oil drilling and that Valaris has a big pool of opportunity to profit form.

However, even as these contractors build strong backlogs and a foreseeable revenue (as we'll see with Valaris soon), contractors are not expanding supply capacity. As discussed before, the cost of building a new ship is extremely high, reaching even $1 billion for top drillships, which means that, unless day-rates climb extremely fast or are projected to skyrocket, shipyards will not be having a full order book. The graph below, shows how demand for new ships has not picked up since 2014, highlighting how the extreme cost to buy new ships has suppressed economic reason for building new vessels

This is a rough sketch of how much time it would take to payback an investment in a new rig given today's day-rates. These rates were extracted from Valaris' recent 10-Q. It is clear to see that these current rates disincentivize the ordering of newbuilds and a stagnation of supply.

| Rig Type | Cost to build | Day-Rate (US $/day) | Utilization (days/yr) | Revenue/yr (US $M) | Opex/day (US $) | Net CF/yr (US $M) | Payback (yrs) |
|---|---|---|---|---|---|---|---|
| **Drillship** (e.g. DS-17) | 1 000 M | 447 000 | 0.70 × 365 ≈ 256 | 447 000×256=114.4 | 160 000 | (114.4–(160 000×256/1e6))≈73.0 | 1 000/73.0≈13.7 |
| **Jack-up** (modern) | 250 M | 133 000 | 0.80 × 365 ≈ 292 | 133 000×292=38.8 | 60 000 | (38.8–(60 000×292/1e6))≈21.2 | 250/21.2≈11.8 |

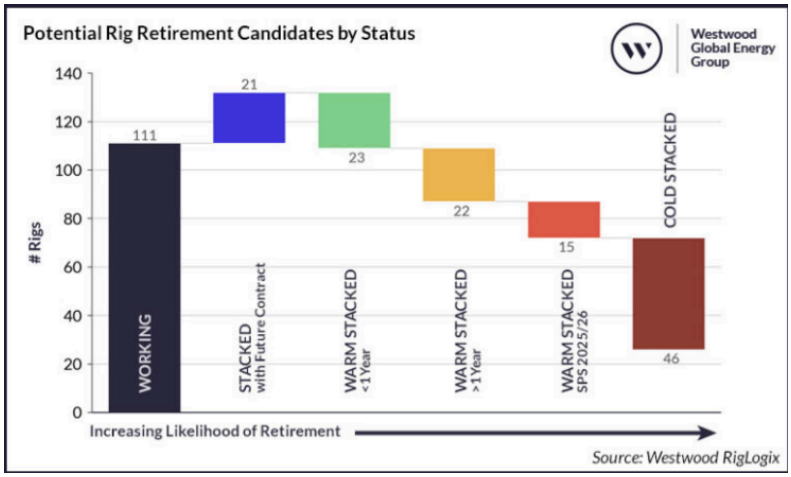


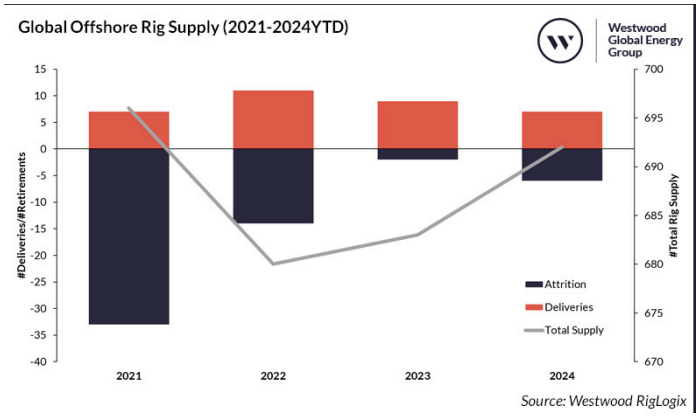

These two graphs show how the production of rigs have stalled for many years. Many of the many dozens of ships that were ordered in 2012 through 2014 were very much delayed as seen

by the years that orders didn't happen but deliveries did (as of 2022 there were 52 ships being built). It is also clear that the attrition (which is retiring a ship or scrapping it) has made the total supply of ships flat over the past years

So the question is: what about those that are stacked and in operations?



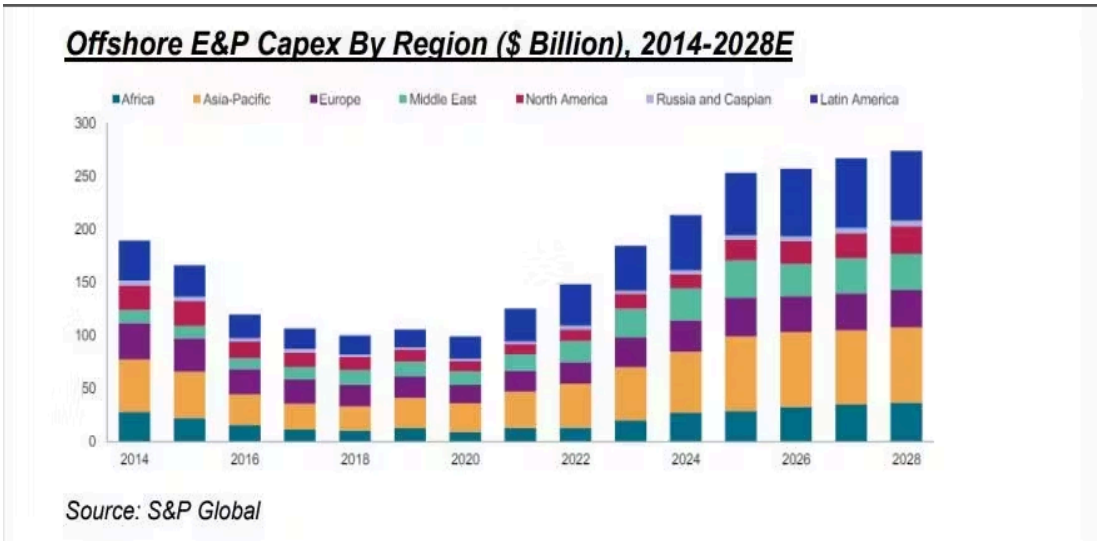

The graphs above, provided by Westwood, portray the current scenario with rigs. Of the 132 rigs around the major contractors worldwide, most of them are warm stacked or cold stacked. Given the costs and time to reactivate a stacked rig, it is safe to assume that the total supply of rigs will decrease over time as it is more profitable and easier to resell them at a huge discount to another competitor in the secondary market or just scrap them than to reactivate it. Many of these ships will never see the light of day again, and, combined with the low output of newbuilds, contributes to a stagnation or decline in the market.



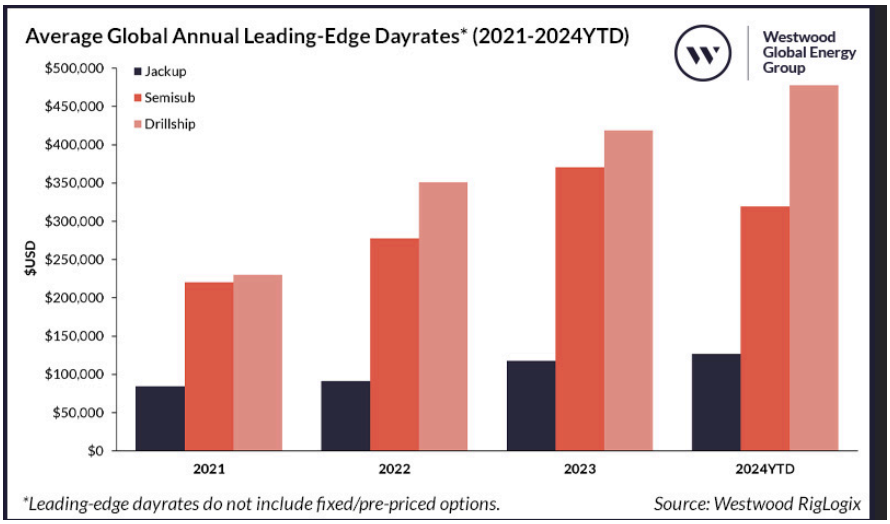

This perfect storm of impossibility to build new ships combined with a likelihood that stacked ships will not come back to operations points to a future where day-rates could spike sharply whenever demand for new drilling projects picks up. The question is: when will that happen?

<u>Demand:</u>

CapEx is expected to pick up again, with S&P projecting a stabilization of the total CapEx of around $250 billion per year from 2025 to 2028, corroborating to what we saw before with companies such as Petrobras and Aramco increasing their projections for the coming decade.



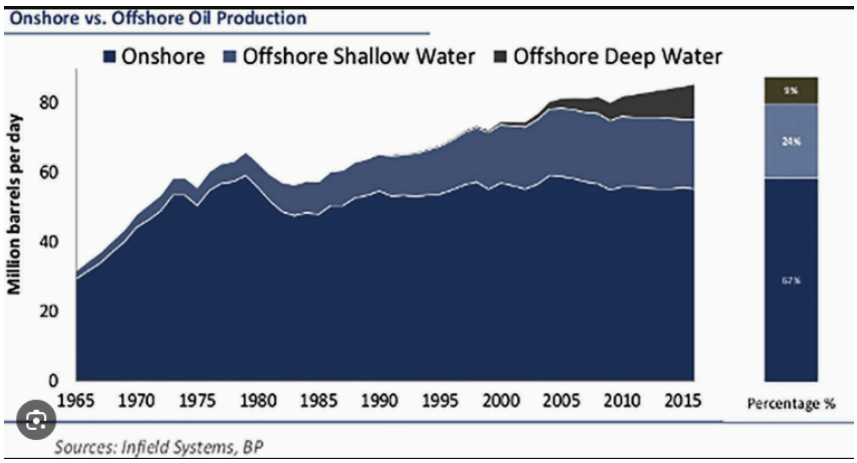

Petrobras' drilling projects are mostly in the pre-salt layer, a very deep extraction project that can only be done by drillships, which goes hand in hand to what is observed in the drillship day-rate.



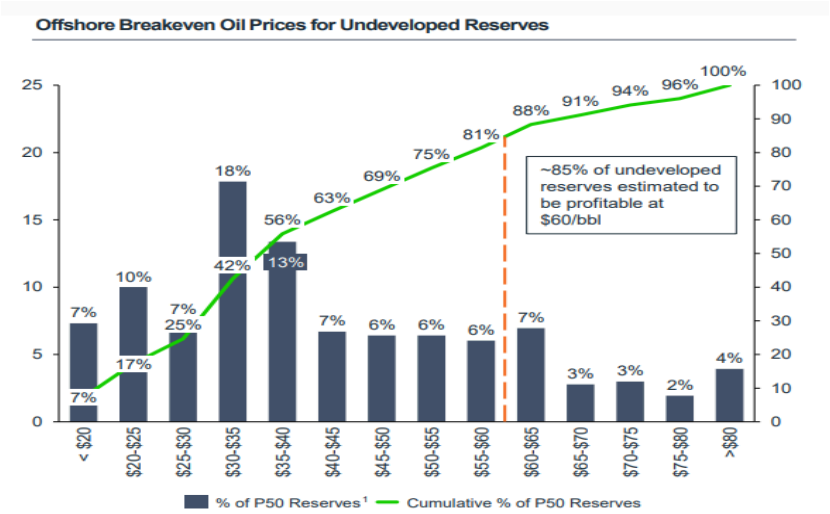

Additionally, OPEC, an organisation composed of many of the world's top oil producing countries, forecasts that an $18.2 Trillion investment in oil will be necessary by 2050 to sustain worldwide development. This figure represents an increase from last year and highlights the size of the demand for drilling contractors over the next decades.

According to FT analysis, deepwater projects now average breakevens around $43/barrel, compared to $45/barrel for U.S. shale, making offshore exploration not only viable but often preferable for firms seeking stable, long-dated cash flow. With oil prices staying above this level

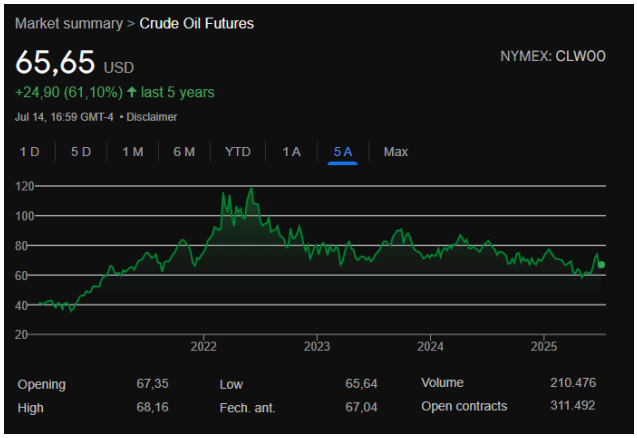
since 2021, it is reasonable to expect that the E&P companies will keep exploring these reserves for the foreseeable future.




On the topic of breakeven prices of oil, the price of a barrel has been above most companies' breakeven point for quite some time now. According to the same report by Valaris, about 85% of underdeveloped reserves are expected to be profitable when oil prices are above $60/bbl, indicating that if oil prices are expected to be sustained at these levels, it will be attractive for E&P companies to start new development projects and maintain those CapEx predictions shown earlier.




As observed in the price of crude oil futures, it has been hovering between $60 and $80 for the past year, coinciding with the increase in predicted CapEx.




## Liquidation value (valuation 1):

Recently I've been enjoying calculating the liquidation value for a capex/PP&E heavy company such as Valaris as a way to provide a baseline for the stock. If the company could sell all of its assets, pay all its liabilities and still provide a return for investors given today's stock price one of two things will happen: either an activist/private equity investment fund will buy a stake and apply pressure for asset sales or the management team of the company believes there's significant upside potential with the recurring revenues brought by the current assets of the company.

Turns out, Valaris' fleet and its low debt compared to competitors (their biggest competitor, RIG, trades at a Net Debt/EBITDA of 5.28x, compared to Valaris's 1.06x), which gives me a great margin of safety.

**INTRODUCTION**

**Our Business**

We are a leading provider of offshore contract drilling services to the international oil and gas industry with operations in almost every major offshore market across six continents. We own the world's largest offshore drilling rig fleet, including one of the newest ultra-deepwater fleets in the industry and a leading premium jackup fleet. As of February 20, 2025, we own 52 rigs, including 13 drillships, four dynamically positioned semisubmersible rigs, one moored semisubmersible rig, 34 jackup rigs and a 50% equity interest in ARO, our 50/50 unconsolidated joint venture with Saudi Aramco, which owns an additional nine rigs.

Ever since the release of the 10-K, which is where I got this image from, they retired 3 semisubmersibles, which combined with the one addition to the fleet adds up to 2.

Being conservative with the prices of a new unit (a new drillship could easily cost $1B, a new semi-sub could cost around $700M and a jack up could go for $300M, and assuming the salvage value being 20% of the original one and taking 25 years for a ship to get there, we can assume these values for the fleet. Additionally, in case of a crisis or a large sale of rigs, Valaris

could never get 100% of the value of the fleet in proceeds, so I assumed that in a fire sale they could recoup 50% of the total fleet value.

| Rig Class | Units | Price/New Unit (USD M) | Average Age | Valaris Value | Value in fire sale (45% of value) |
|---|---|---|---|---|---|
| Drillships | 13 | 900 | 10 | 7956 | 3978 |
| Semisubmersibles | 2 | 500 | 13 | 580 | 480 |
| Jackups | 27 | 250 | 18 | 2835 | 765 |
| ARO Jackups | 9 | 250 | 6 | 1800 | 765 |
| | | | | TOTAL | 5988 |

This gets us to a $5,980M current fleet liquidation value.

Adding back $572M worth of receivables $368M of cash and short term investments, they would have a total of $6,920M in recoverable assets.

Taking away their $2,175M worth of liabilities, we end up at an equity value of almost $67 a share given their 71M shares outstanding.

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| | | | | TOTAL | 5988 |
| | | | | ASSETS (+) | 940 |
| | | | | LIABILITIES (-) | 2175 |
| | | | | LIQUIDATION | 4753 |
| | | | | PER SHARE | 66,94 |

Given today's price of $46.94, the "floor price" of $66.94 represents about 42% of upside. Since this is extremely unlikely to happen, there is no point in picking a period and calculating an CAGR, but, still, this serves as a great safety net for our investment.

This price doesn't even take into account their strong backlog and "locked in revenue" that they could still get if they were to sell the fleet little by little as contracts end.

**Free Cash Flow (Valuation 2)**

This thesis draws from two things: increasing backlog/new contracts for unused ships and increase in day-rates for future contracts.

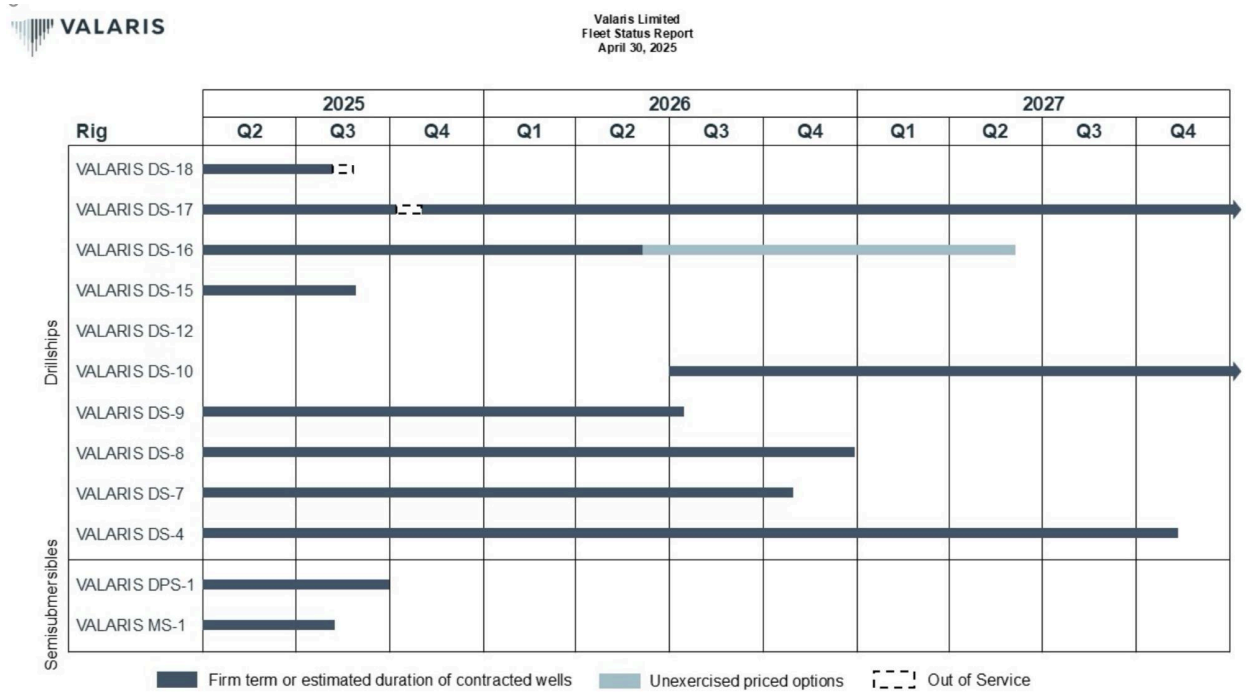
With the offshore drilling market expected to grow in the near future and E&P companies spending more in capex, it is very possible that Valaris could find contracts for a few of their unused ships soon.

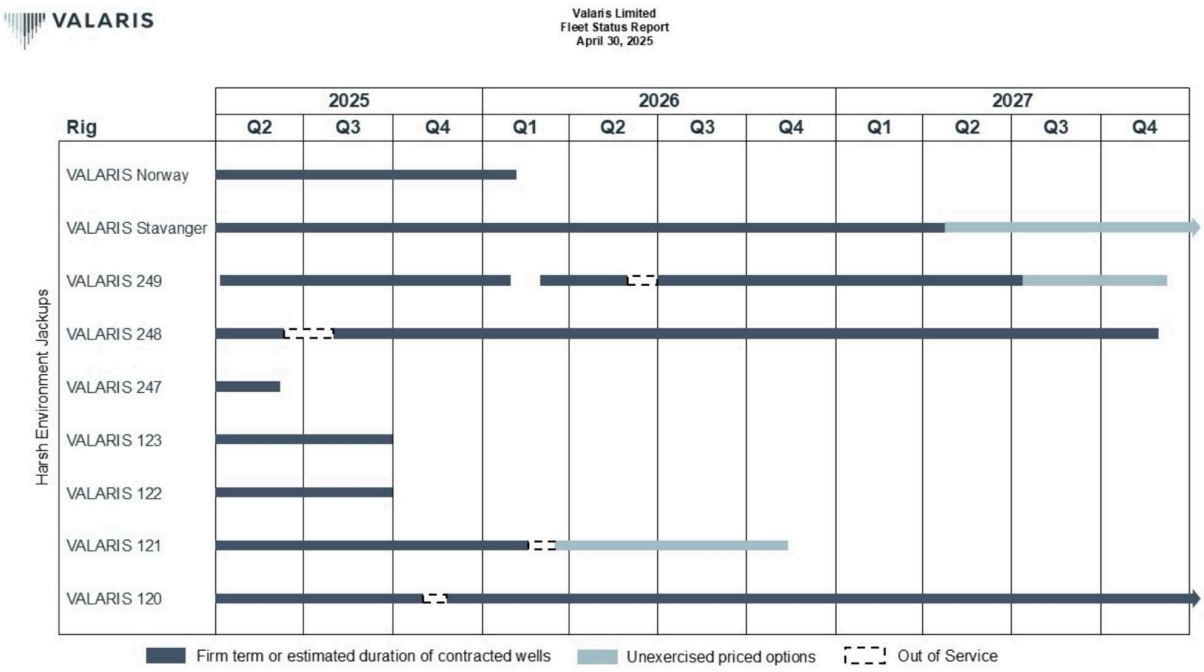
They currently have 2 drillships that are not being leased or projected to be leased anytime soon. That, combined with two other drillships, three other Jackups and their two semi-subs which are expected to be free for new leases in Q3 2025, means that Valaris could significantly

expand their revenues without relying on an increase in day-rates, only relying on new contracts.

Just in early July Valaris announced a multi-year contract with a subsidiary of Occidental for 2 drillships, adding around $760 million to their growing backlog.

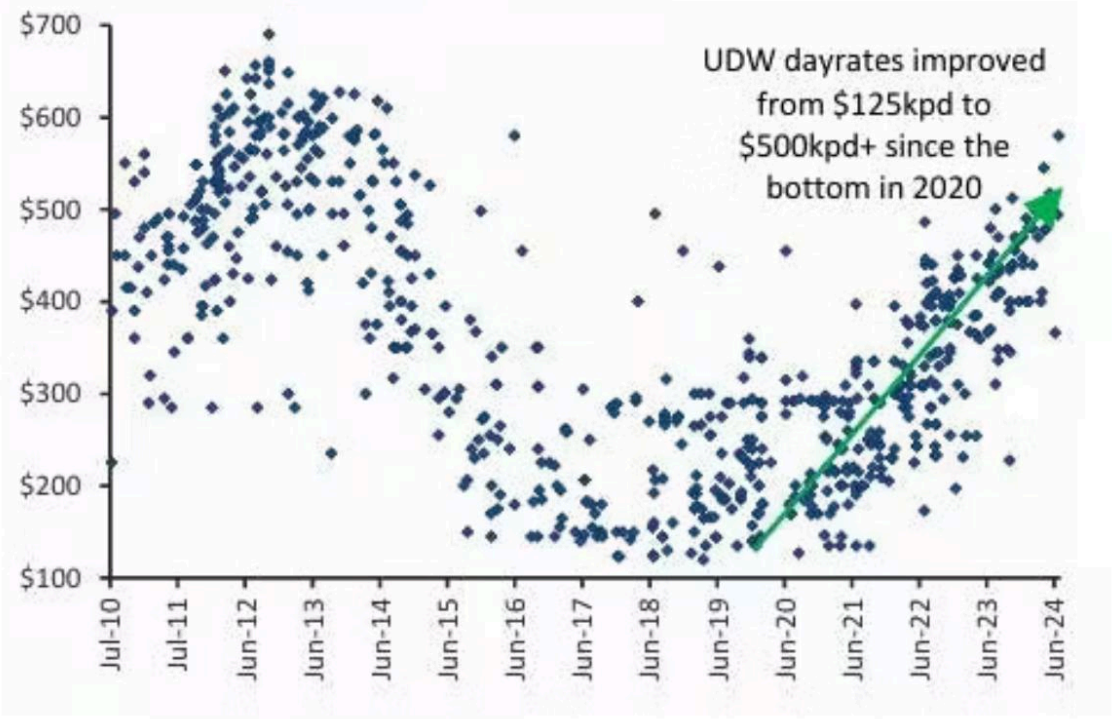
Three drillship contracts could easily yield an extra $1.2 million in day-rates a day in the current market and the extra two semi-subs could increase sales by $ 400,000 a day. This could lead to a significant growth in FCF even if day-rates stay the same.





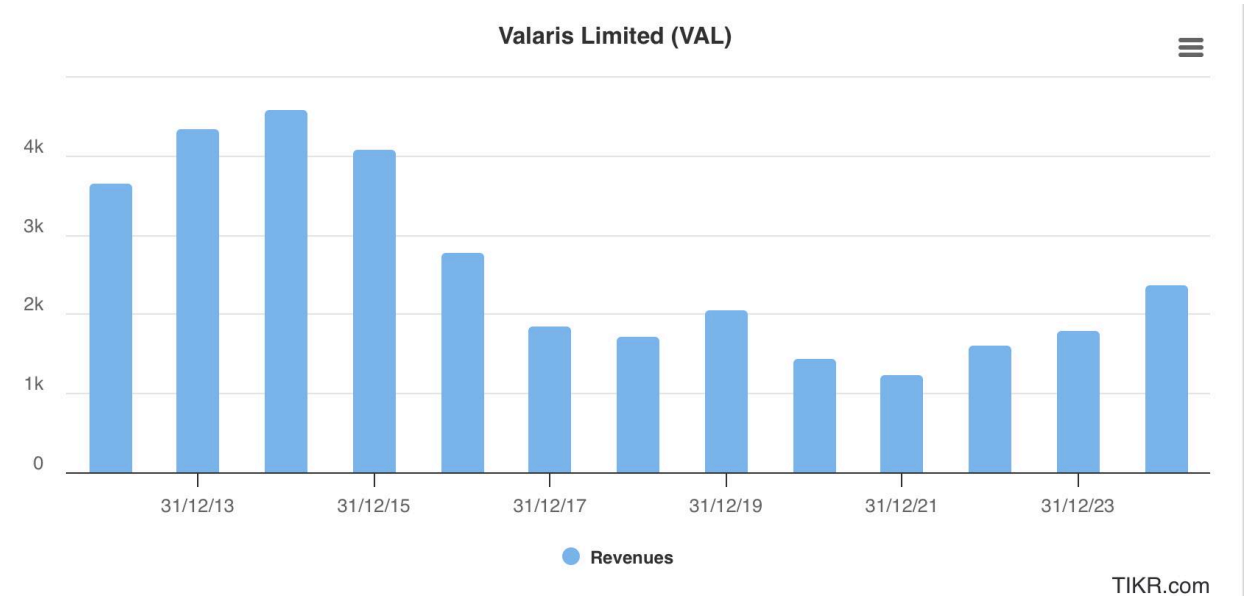

Additionally, as we covered in the macro section, day-rates should increase in the near future due to a sustained demand for oil, better economics for offshore drilling compared to shale and a strong capex from major oil companies.

**Figure 1: UDW Dayrates, 2010-Present**




*Source: Evercore ISI Research*

In the last cycle, drillship rates reached around $700,000 a day, and now we're shutting at around 400,000-500,000. Given the growing demand cited above and the shirking supply of vessels, as explained in the macro section, I believe rates could go up to historical heights in the future.




This rise in prices provides two options: either the company tries to renegotiate the current contracts, in case the price of oil drastically increases, or their vessels which are not being used will get contracted under more favorable terms, leading to great cash flow generation. Additionally, ARO's stable FCF generation and limited cost due to Aramco's stability and preference will also boost VAL's FCF in the future and provide them with a strong safety net.

### Significant earnings potential and cash flow from Valaris fleet

| Total Rigs[2] | Rigs Under Contract or with Future Contract | Illustrative Annual Earnings and Cash Flow from Valaris Fleet[1] | | | |
|---|---|---|---|---|---|
| | | **Illustrative Scenario** | **A** | **B** | **C** |
| 13 | 9 | Drillship Day Rates | $400K | $450K | $500K |
| 2 | 2 | Benign Semisubmersible Day Rates | $300K | $350K | $400K |
| 12 | 10 | HD Harsh Environment Jackup Day Rates[3] | $125K | $150K | $175K |
| 16 | 13 | HD & SD Modern Jackup Day Rates[3] | $100K | $125K | $150K |
| 43 | 34 | Fleet Utilization | 70% | 75% | 80% |
| | | **Operating Margin[4]** | **~$1,020M** | **~$1,550M** | **~$2,120M** |
| | | Onshore Costs (G&A and Support)[5] | ~$260M | ~$260M | ~$260M |
| | | **EBITDAR[6]** | **~$760M** | **~$1,290M** | **~$1,860M** |
| | | Other Cash Uses[7] | ~$460M | ~$540M | ~$620M |
| | | **Free Cash Flow** | **~$300M** | **~$750M** | **~$1,240M** |

According to their own estimates, in a world where drillship rates reach $500,000, Valaris should operate in very healthy margins, great fleet utilization and great free cash flow. Assuming more of their soon to be unused ships will get contracted, as their backlog keeps growing strong, and that day-rates will grow with a stronger demand for offshore from E&P companies, this is my FCF based valuation for the firm.

In a world where the firm will reach this $1,200 million in FCF proposed in scenario C in the next three years, which is when the cycle is expected to peak, and, given their great growth, low debt, ARO business and a strong fleet/EV that serves as a safety net for their stock, trades at a usual 6x FCF, this could be the stock price:

$1,200 x 6 = $7,200

$7,200m / 71m shares (being conservative and assuming no buybacks) = $101 per share

Compared to today's $46.94 price, this could represent a 29% CAGR for the next three years. Even better than the great returns projected by Valuation 1.

The thing I will be looking towards the most if the capex of big companies. Valuation 2 only makes sense if demand for offshore grows, stimulating more backlog and higher margins for the business. Regardless, that is why valuation 1 is still key, to serve as a backbone for the thesis even if the demand doesn't pick up as fast or as aggressively as we would like.

Conclusion: Valaris is a great company with some subtle yet powerful competitive advantages in a competitive business through their ARO business, strong and well positioned fleet and very conservative and reliable balance sheet. Given the market's growing demand for offshore oil drilling and E&P companies boosting their capex, Valaris' backlog is growing strong, which is powering them to a stable revenue stream for the next few years and, as they get new contracts in the coming years at higher rates, margins will also improve. This is a great business that could present great returns with a great margin of safety.