Equity Research report
MARAFIQ AB Equity
10 Aug 2023

GIB CAPITAL جي آي بي كابيتال

Target Price: SAR80/share
Current Price: SAR75.8/share
Upside: +5% (+Div. Yield: 3.1%)
Rating: Neutral

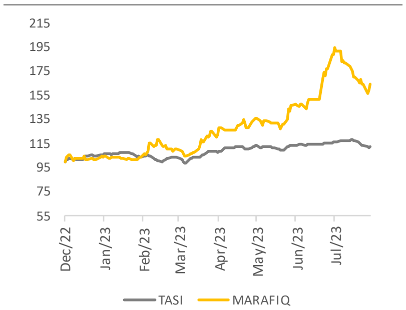
The Power and Water Utility Company for Jubail and Yanbu (Marafiq)

Likely inclusion in MSCI EM; Raise TP to SAR80/sh.

Stock data	
TASI ticker	2083
Mcap (SARmn)	18,950
Trd. Val (3m) (SARmn)	117.3
Free float	30.0%
QFI holding	4.6%
TASI FF weight	0.79%

Source: Bloomberg

Prices indexed to 100



Source: Bloomberg

- A strong contender for MSCI inclusions; may attract total passive inflows of ~SAR326mn
- Multiple upside drivers include a) transition into the RAB model, b) upward revision to water/power tariffs, c) newer project wins, and d) KSA's industrial expansion plans.
- We raise our TP to SAR80/sh. based on DCF (8.6% WACC) but revise the rating to Neutral post ~54% run-up in prices since our initiation.

Possible inclusion in MSCI EM/ACWI Indices: Marafiq is expected to be included in the MSCI EM Index during the August review, which will be announced today, with the effective date being 31st Aug. We believe that the company's mcap, as on the cut-off date (assuming 18th July), was well-above the reference cut-off (SAR10bn as per our calculations) and even above the upper threshold of 1.5x of the reference point. In addition, the company meets all the other inclusion criteria including liquidity, FOL, among others. Based on our calculations, the possible inclusion in MSCI EM/ACWI indices may attract total passive inflows of ~SAR326mn (US$87mn), with days to cover (DTC) of ~3 days (based on 3M ADV). We note that when Marafiq was added to the FTSE Global Equity Index on 19 June 2023, the stock rallied 31% and reached its highest level of SAR91.5 on 11 July 2023, but corrected by 17% thereafter, likely due to profit booking. This suggests that the inclusion in the MSCI EM Index could similarly impact the stock price. However, we believe most of the positive fundamentals are already priced in at the current level, providing limited upside.

Positive outlook intact: Despite a decline in 2Q earnings, we remain positive on Marafiq's medium-term growth prospects, mainly due to i) its monopoly status in the major industrial cities, ii) strong revenue visibility backed by the regulated business and long-term secured contracts, iii) improvement in margins, iv) high FCF yield (+10% for 2024e), iv) likely improvement in leverage position (net debt to EBITDA to reach 3.2x by 2026e) post the recent early repayment of SAR500mn worth of loans, and v) minimum dividend commitment of SAR550mn for 2023e and 80% payout thereafter. Overall, we expect a 3% CAGR for topline over 2022-25e and the EBITDA margin to reach 37% (35% in 2022) by 2025e.

Figure 1: Key financial metrics

SARmn	2021a	2022a	2023e	2024e	2025e
Revenue	6,192	6,505	6,685	6,877	7,077
Revenue growth	*2%*	*5%*	*3%*	*3%*	*3%*
EBITDA	2,167	2,268	2,369	2,493	2,602
EBITDA margin	*35.0%*	*34.9%*	*35.4%*	*36.3%*	*36.8%*
Net income	632	846	655	725	870
Net profit margin	*10%*	*13%*	*10%*	*11%*	*12%*
EPS (SAR)	2.5	3.4	2.6	2.9	3.5
DPS (SAR)	0.7	2.2	2.2	2.3	2.8
P/E	30.0x	22.4x	29.0x	26.1x	21.8x

Source: Company, GIB Capital

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Upside triggers:

- **Adoption of the RAB model:** The company's earnings are likely to have a positive impact from the possible implementation of the RAB-based framework for the power segment.
- **Benefit from new industrial projects:** The Royal Commission (RC) has selected the company to serve as the sole power and water service provider (JCPDI) and sole water service provider in RIC. These two industrial cities currently under development are expected to create significant demand for power and water services. The company is also expected to participate in the upcoming tenders across the KSA for water services and power generation and may win new contracts. This will likely fuel future growth.
- **Possible upside from power and water tariff revision:** The water tariff is set for an upward revision. Further, given that power tariffs were last revised in 2018 for commercial customers in Yanbu, we believe that power tariff reviews could happen in the near term. If this is implemented, then this would likely boost the company's earnings notably.

2Q23 results: Revenue fell 4% y/y in 2Q23, likely due to a decline in demand. Despite the lower top-line, gross profit remained largely stable (-1% y/y), with gross margin expanding by 49bps to 19.2%, indicating cost efficiencies. However, the operating margin weakened by 3ppts and reached 18% due to higher administrative expenses, impairment charges on trade receivables, and lower other income. Further, the increase in finance costs led to a 39% y/y decline in net income, partially countervailing lower zakat and tax provision. Net margin contracted 6ppt to 10%.

Dividend commitment: The company has committed to a DPS of SAR2.2/share in 2023e and an 80% payout from 2024e. It has already announced a cash dividend of SAR1.1/share (103% payout) for 1H23, implying annualized DPS in line with the guidance and our estimates.

Risks: Unexpected or unplanned breakdown of the company's facilities, a delay in tariff review, failure to fulfill licensing requirements leading to penalties, delay in expansions, customer concentration, dependence on Aramco for fuel and gas, and failure to commence operations as per plan, are some of the key risks to our valuation.

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