Equity Research report
MARAFIQ AB Equity
8 Feb 2024

Target Price: SAR80/share
Current Price: SAR65.10/share
Upside: 23% (+3.4% div yield)
Rating: Overweight

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

Higher fuel prices likely to pass through; Power demand to rebound in 2024

- A revision in fuel prices is likely to be passed through via a tariff hike, with spreads mostly remaining stable. Earnings to improve notably in 2024e, aided by a rebound in Power demand, a likely margin expansion, and lower finance costs amid possible rate cuts.
- Multiple upside drivers include a) transition to the RAB model, b) upward revision to water/power tariffs, c) newer project wins, and d) KSA's industrial expansion plans.
- Based on DCF (8.6% WACC), we maintain our TP at SAR80/sh, considering a likely rebound in power demand and margin expansion but revise the rating to Overweight after the ~14% price correction since our last update. Marafiq currently trades at ~12x 2024e EV/EBITDA with an FCF yield of ~12% and a dividend yield of 3.4%, which is very attractive.

Stock data	
TASI ticker	2083
Mcap (SARmn)	16,275
Trd. Val (3m) (SARmn)	65.0
Free float	30.0%
QFI holding	5.6%
TASI FF weight	0.59%

Source: Bloomberg

Prices indexed to 100

Source: Bloomberg

Higher fuel cost likely to be passed on: While the company is yet to announce the impact from the recent notification from Aramco regarding the fuel cost hike, we expect a ~5% rise in costs in 2024e, although it would be pass-through in our view. We believe that, for consumers in Yanbu, the cost pass-on is expected to occur with some delay. This is because it needs to apply for a tariff increase to the regulator, and once approved, the impact will be passed on to the end consumers. Further, we expect Marafiq to immediately pass on the effects of higher fuel costs to its industrial buyers in Jubail (JWAP), given the long-term supply contracts in place, implying no impact on gross profits. Overall, we anticipate that the higher costs will ultimately be transferred to consumers through increased tariffs (as witnessed in 2016), effectively mitigating any adverse impact on the gross profit level (base-case scenario). However, in a worse case (no passthrough in Yanbu), our 2024e earnings may have a notable impact.

Power demand likely to rebound in 2024… Marafiq witnessed a decline in electricity demand (weaker-than-expected) during 9M23, primarily due to i) lower demand by major industries in Yanbu on account of unexpected shutdowns and ii) limited demand from principal buyers (who buy excess power during the summer on a need basis). Nonetheless, we expect a positive shift in power demand starting from 1Q24, mainly by new companies in Ras Al Khair and Yanbu, coupled with an improvement in demand from existing industrial operators on the back of an improving macroeconomic environment.

Figure 1: Key financial metrics

SARmn	2021a	2022a	2023e	2024e	2025e
Revenue	6,192	6,505	6,374	6,540	6,744
Revenue growth	*2%*	*5%*	*-2%*	*3%*	*3%*
EBITDA	2,167	2,268	2,282	2,370	2,445
EBITDA margin	*35.0%*	*34.9%*	*35.8%*	*36.2%*	*36.3%*
Net income	632	846	576	691	840
Net profit growth	*137%*	*34%*	*-32%*	*20%*	*22%*
Net profit margin	*10%*	*13%*	*9%*	*11%*	*12%*
EPS (SAR)	2.5	3.4	2.3	2.8	3.4
DPS (SAR)	0.7	2.2	2.2	2.2	2.7
P/E	25.8x	19.2x	28.3x	23.5x	19.4x

Source: Company, GIB Capital

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Overall, we expect electricity and water demand to rise at a CAGR of 3.5% and 3.0%, respectively, over 2022-27e, ensuing healthy top-line during the same period. Our forecast for the revenue is purely organic; any revision in tariff and new project award are key upside risks to our estimate.

… supporting margin expansion going forward. Improvement in demand, along with better operating leverage and easing inflation, are likely to support the margin expansion, with the GPM improving to 18.7% by 2025e and further to 19.2% by 2027e (vs. 17.7% in 2022, 18.2% in 2023e). Moreover, with a likely 75bps cut in the interest rate, we expect the financial burden (~80% of the floating debt) to ease out in the coming years, aiding the profitability. Overall, we expect earnings to recover in 2024, growing by ~20% y/y in 2024e and 22% in 2025e.

Outlook for 4Q23: We expect the power and water demand to remain mostly under pressure in 4Q23, indicating a 0.7% y/y decline in revenues. However, we expect better cost efficiency, resulting in a likely margin expansion on an annual basis. Accordingly, we expect net profit to reach SAR121.5mn, although lower than the previous year's quarter, which witnessed a positive impact from the deferred tax reversal and shifting to zakat post listing.

Dividend commitment: The company has committed a DPS of SAR2.2/share in 2023 and an 80% payout from 2024e. Accordingly, we expect the company to maintain its annual DPS at SAR2.20/sh. for 2024e, implying a yield of 3.4%.

Upside triggers:

- **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.

- **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. Below is the likely revision in our target price in the case of the RAB model.

Figure 2: Potential impact of RAB implementation on annualized 9M23 annualized EPS

Sensitivity Analysis									
RAB	**6,000**			**7,000**			**8,000**		
WACC	6%	7%	8%	6%	**7%**	8%	6%	7%	8%
EPS (SAR)	2.5	2.7	3.0	2.7	**3.0**	3.3	3.0	3.3	3.6
Upside from existing	2%	12%	22%	12%	**24%**	35%	22%	35%	49%

Source: GIB Capital

- **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 implemented, this would likely boost the company's earnings notably.

Figure 3: Potential impact of water tariff revision on EPS

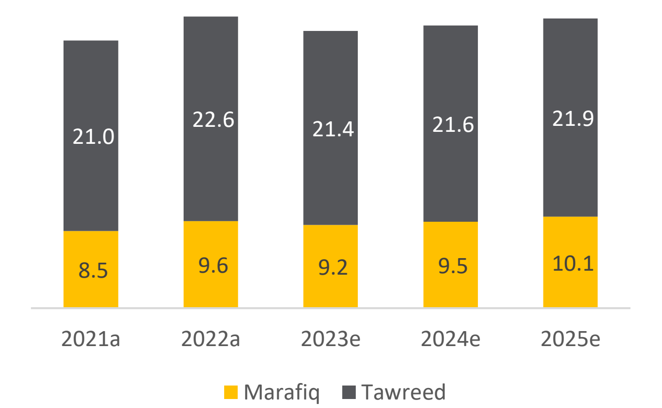
	2024e	2025e	2026e	2027e	2028e	2029e	2030e
Base case - EPS	2.77	3.36	3.72	4.10	4.48	4.75	5.05
Bull Case - EPS	2.83	3.43	3.79	4.18	4.56	4.84	5.14
Impact on EPS	2.4%	2.0%	2.0%	2.0%	1.9%	1.9%	1.8%

Source: Company, GIB Capital

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.

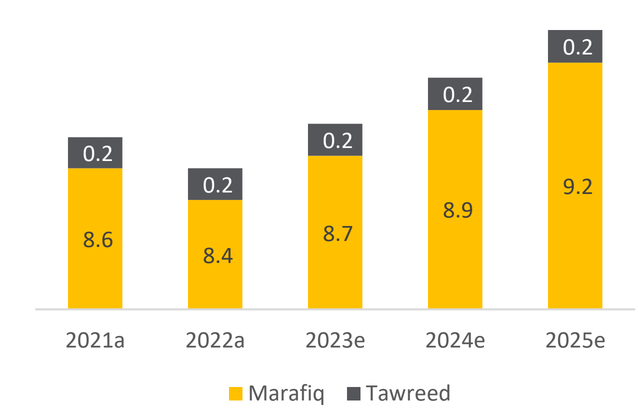
Financial analysis in charts

Figure 4: Electricity Sales Volume (TWH)



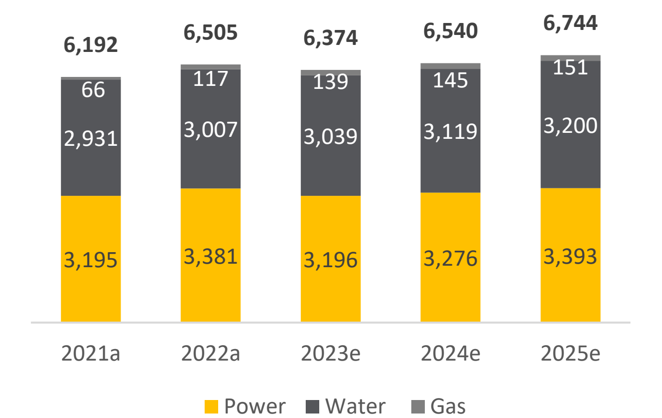
Source: Company data, GIB Capital

Figure 5: Water Sales Volume (bn cubic mtr)



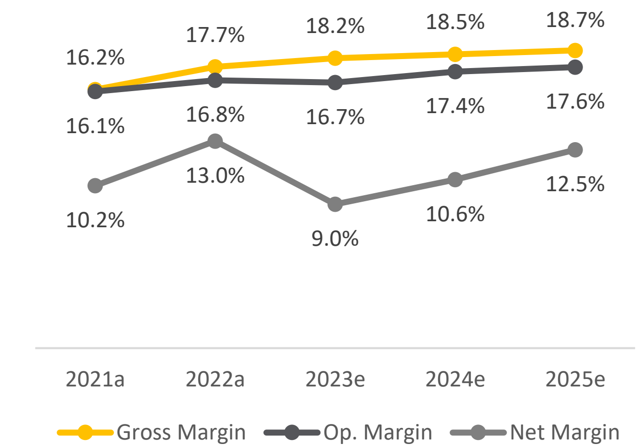
Source: Company data, GIB Capital

Figure 6: Revenue trend (SAR mn)



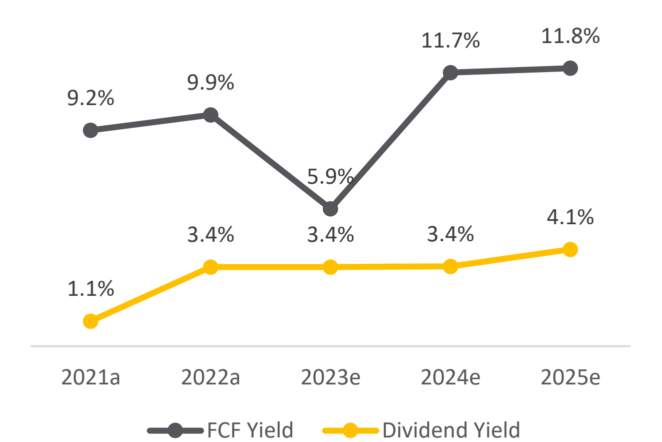
Source: Company data, GIB Capital

Figure 7: Margin trend



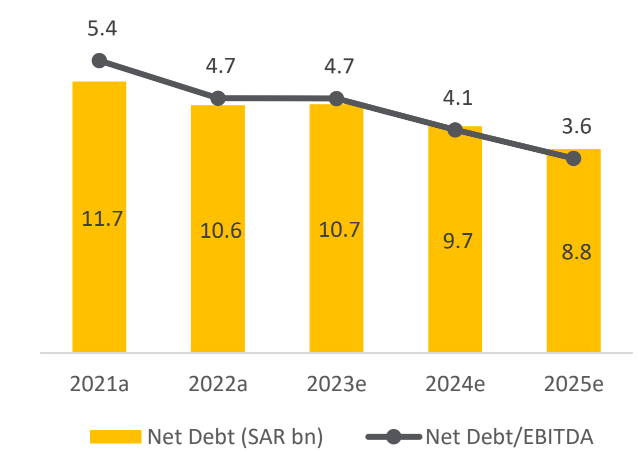
Source: Company data, GIB Capital

Figure 8: Yield trend



Source: Company data, GIB Capital

Figure 9: Leverage trend



Source: Company data, GIB Capital

Financials

Figure 10: Financial statement

Income statement	2021a	2022a	2023e	2024e	2025e
Revenue	**6,192**	**6,505**	**6,374**	**6,540**	**6,744**
revenue y/y	*2%*	*5%*	*-2%*	*3%*	*3%*
COGS	5,187	5,357	5,213	5,333	5,483
Gross Profit	**1,005**	**1,148**	**1,161**	**1,207**	**1,261**
Gross Profit margin	*16%*	*18%*	*18%*	*18%*	*19%*
Administrative expenses	246	271	261	262	270
Other operating income	246	223	187	203	211
Operating profit	**998**	**1,094**	**1,063**	**1,135**	**1,190**
Operating margin	*16%*	*17%*	*17%*	*17%*	*18%*
Finance costs	237	298	539	489	373
PBT	**782**	**852**	**624**	**752**	**913**
Zakat/tax	117	6	48	60	73
Net income (attributable to equity holders)	**632**	**846**	**576**	**691**	**840**
Net margin	*10%*	*13%*	*9%*	*11%*	*12%*
y/y	*137%*	*34%*	*-32%*	*20%*	*22%*
EPS	**2.5**	**3.4**	**2.3**	**2.8**	**3.4**
DPS	0.7	2.2	2.2	2.2	2.7
Payout	28%	65%	96%	80%	80%
EBITDA	**2,167**	**2,268**	**2,282**	**2,370**	**2,445**
Net debt (w/o IFRS liab.)	8,496	7,923	6,892	6,339	5,767
Net debt (w/ IFRS liab.)	11,669	10,647	10,691	9,738	8,766

Balance Sheet	2021a	2022a	2023e	2024e	2025e
Inventories	274	296	288	295	303
Trade receivables	834	868	886	896	924
Prepayments and other current assets	384	447	435	445	457
Short-term deposits	1,422	1,576	101	101	101
Cash and cash equivalents	483	686	1,290	1,372	793
Total Current Assets	**3,397**	**3,872**	**3,000**	**3,109**	**2,579**
Property, plant and equipment	20,412	19,991	20,023	19,189	18,346
Long-term receivables and prepayments	272	280	275	282	291
Total Non-Current Assets	**20,713**	**20,354**	**20,380**	**19,554**	**18,719**
Total Assets	**24,110**	**24,226**	**23,380**	**22,662**	**21,298**
Current Liabilities	2,197	2,413	2,368	2,383	2,401
Non-current Liabilities	14,362	13,568	12,742	11,871	10,320
Equity	7,551	8,245	8,270	8,409	8,577
Total Equity and Liabilities	**24,110**	**24,226**	**23,380**	**22,662**	**21,298**
BVPS	30.2	33.0	33.1	33.6	34.3

Cashflow	2021a	2022a	2023e	2024e	2025e
Cashflow from Operations	2,230	2,145	1,757	1,907	2,057
Cashflow from Investing	-972	-874	224	-400	-413
Cashflow from Financing	-1,370	-1,068	-1,376	-1,424	-2,223
Total Cashflows	**-112**	**203**	**605**	**82**	**-579**

Source: Company, GIB Capital

Figure 11: Key ratios

Key ratios	2021a	2022a	2023e	2024e	2025e
Profitability ratios					
RoA	3%	3%	2%	3%	4%
RoE	8%	10%	7%	8%	10%
Sales/Assets	26%	27%	27%	29%	32%
Net margin	10%	13%	9%	11%	12%
Liquidity ratios					
Current Assets/ Current Liabilities	1.5	1.6	1.3	1.3	1.1
Debt to Total Equity (w/ IFRS liab.)	1.8	1.6	1.5	1.3	1.1
Receivable Days	49	49	51	50	50
Inventory Days	19	20	20	20	20
Payable days	43	47	45	45	45
Cash conversion cycle	25	22	26	25	25
Debt ratios					
Net Debt/EBITDA (w/o IFRS liab.)	3.9	3.5	3.0	2.7	2.4
Net Debt/EBITDA (w/ IFRS liab.)	5.4	4.7	4.7	4.1	3.6
Debt/Assets (w/o IFRS liab.)	0.4	0.4	0.3	0.3	0.3
Net Debt/Equity (w/o IFRS liab.)	1.1	1.0	0.8	0.8	0.7
Valuation ratios					
P/E	25.8	19.2	28.3	23.5	19.4
P/B	2.2	2.0	2.0	1.9	1.9
EV/EBITDA	12.7	12.2	12.1	11.6	11.3
FCF Yield	9.2%	9.9%	5.9%	11.7%	11.8%
Dividend Yield	1.1%	3.4%	3.4%	3.4%	4.1%

Source: Company, GIB Capital

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We use a rating system based on potential upside, 1 year from today, based on our valuation models. For "Overweight" ratings, the estimated upside is >10%, for "Underweight", the estimated downside is <10%. For returns in between +/-10%, we have a Neutral rating.

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