Alkhorayef Water and Power Technologies Co.

Investment Update

Strong growth to continue despite weaker-than-expected Q1-24; but growth seems factored in at current valuation

Alkhorayef Water & Power Technologies (AWPT)'s Q1-24 results came below our expectation as revenue was impacted by completion of some projects, while new projects are expected to start in Q2-24. On the other hand, the cost of materials was lower than our expectations, supporting the GP margin. Nonetheless, the company's huge backlog of SAR 8.9bn, continuous flow of new contracts and expected recovery in the margins over the long term point towards healthy growth prospects. The stock has risen significantly over the past six months (+62%). We believe the current market valuation of AWPT already factors in its future growth. Thus, we switch to a "Neutral" recommendation but revise our TP upwards to SAR 166.0/share.

Completion of existing projects weighed in the topline in Q1-24: AWPT's net income increased 31.6% Y/Y to SAR 43.1mn in Q1-24, missing AJC's estimate of SAR 48.9mn, as revenue of SAR 458mn (+42.5% Y/Y) was below our estimate of SAR 537mn. The revenue declined 8.8% Q/Q due to the completion of existing contracts, while the recently awarded contracts are set to start in Q2-24. However, the GP margin of 17.1% was above our expectation due to the lower cost of materials consumed. OPEX rose at a faster pace vs. revenue amid higher G&A expenses and provisions for credit loss, squeezing the operating margin to 13.3% vs. 14.5% in Q1-23.

Backlog of SAR 8.9bn to grow further with recent large contract signing: AWPT's backlog reached SAR 8.9bn as of March 2024, up 166% Y/Y, as the company signed multiple large contracts leading to gross addition of over SAR 7bn since the start of FY23. Moreover, the company recently signed a new contract (LTOM 7) amounting to SAR 1.7bn in May, a further addition to the backlog. We estimate AWPT's backlog to expand further as the company is expected to benefit from KSA's healthy project pipeline in the Water and Wastewater sector with NWC's planned investment of SAR 61.7bn over the next five years. AWPT's backlog is forecast to peak at ~SAR 10bn in FY25, before gradually decreasing later due to higher revenue recognition expected.

Higher revenue recognition expected in rest of FY24: AWPT's new projects are slated to start in Q2-24, that will boost the revenue in coming quarters. Additionally, the LTOM 7 contract is expected to start in Q3-24. Hence, we expect significantly higher revenue for the rest of the quarters of FY24 compared to Q1-24. We estimate total revenue of SAR 1.86bn during Q2 to Q4-24 (slightly below the company's guidance of SAR 2.03bn). Later, recognition of revenue is expected to continue to increase due to anticipated new contract wins and long term nature of existing contracts. We forecast the topline to record a CAGR of 16.2% during FY23-28E to reach SAR 3.6bn in FY28E.

Margin may remain below the historic average, but improvement expected going forward: The company's GP margins were hit by the higher cost of materials in FY23, particularly due to the increase in prices of asphalt and diesel. We assume increased diesel prices to keep gross margin below historic average, but normalization of prices of other materials and higher revenue generated from new projects will support GP margin expansion. We forecast the GP margin to expand from 15.4% in FY23 to 17.1% in FY24 and reach 20.9% in FY28E. Further, finance expenses are expected to increase in the MT as we see the need to raise debt amid negative free cash flows due to high CAPEX and working capital requirements. Recently, the company signed multiple new loan facilities with different banks. The high interest rates are likely to add to the pressure on net profit in the MT. Even so, net margin is estimated to expand from 8.2% in FY23 to 15.8% in FY28E, mainly benefiting from higher GP margin.

AJC view and valuation: AWPT's large backlog assures healthy revenue growth over the next few years. The huge pipeline of projects in KSA's Water and Wastewater segment bodes well for further growth in the company's backlog. We estimate the company's backlog to reach ~SAR 10bn by FY25E. However, the pressure on margins due to higher material costs and higher finance expenses continues to be a challenge for the company and is expected to limit its net profit growth. We valued AWPT with 50% weightage to DCF (WACC = 8.2% and terminal growth = 2.5%) and 50% weightage to P/E (20.0x) multiple based on FY2025 estimates to arrive at a blended TP of **SAR 166.0/share**. We revise our recommendation on the stock to "**Neutral**".

Recommendation	**Neutral**
Target Price (SAR)	**166.0**
Upside / (Downside)*	**-8.3%**

Source: Tadawul *prices as of 10th of June 2024

Key Financials

SARmn (unless specified)	FY22	FY23	FY24E	FY25E
Revenues	822.0	1,709.3	2,316.3	2,861.1
Growth %	44.5%	107.9%	35.5%	23.5%
Gross Profit	187.1	262.5	395.4	510.1
Net Income	115.8	147.9	250.5	320.5
Growth %	12.1%	27.7%	69.3%	28.0%
EPS	3.07	4.00	6.89	9.16
DPS	1.1	0.0	0.0	3.7

Source: Company reports, Aljazira Capital

Key Ratios

	FY22	FY23	FY24E	FY25E
Gross Margin	22.8%	15.4%	17.1%	17.8%
Net Margin	13.1%	8.2%	10.4%	11.2%
ROE	28.5%	29.9%	36.6%	36.6%
ROA	11.1%	9.7%	12.2%	13.1%
P/E (x)	45.4	34.6	26.3	19.8
P/B (x)	12.3	9.0	8.1	6.5
EV/EBITDA (x)	30.4	21.4	19.3	15.2
Dividend Yield	0.8%	0.0%	0.0%	2.0%

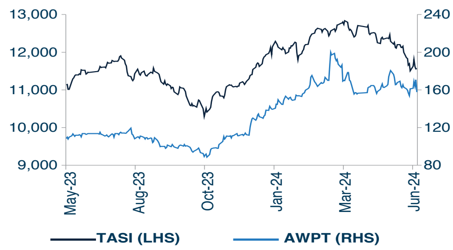
Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (SAR bn)	6.3
YTD%	30.9%
52 weeks (High)/(Low)	203.07/88.54
Share Outstanding (mn)	35.0

Source: Company reports, Aljazira Capital

Price Performance



Source: Bloomberg, Aljazira Capital

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Key Financial Data

Amount in SAR mn, unless otherwise specified	FY21	FY22	FY23	FY24E	FY25E	FY26E	FY27E	FY28E
Income statement								
Revenues	569	822.0	1,709.3	2,316.3	2,861.1	3,203	3,446	3,626
Y/Y	**9.3%**	**44.5%**	**107.9%**	**35.5%**	**23.5%**	**12.0%**	**7.6%**	**5.2%**
Cost	(418)	(635)	(1,447)	(1,921)	(2,351)	(2,592)	(2,761)	(2,870)
Gross profit	**151**	**187**	**262**	**395**	**510**	**611**	**685**	**756**
Operating Expenses								
Selling and distribution expenses	(2)	(1)	(1)	(1)	(3)	(3)	(3)	(4)
General and administrative expenses	(37)	(46)	(67)	(77)	(93)	(102)	(108)	(112)
Operating profit	**113**	**140**	**194**	**317**	**415**	**506**	**574**	**641**
Y/Y	**-3.6%**	**24.4%**	**38.9%**	**63.0%**	**30.8%**	**21.9%**	**13.4%**	**11.7%**
Gain on sales of PP&E	1	1	0	0	0	0	0	0
Financing Expense (net)	(4)	(19)	(40)	(51)	(63)	(61)	(54)	(47)
Other income/expenses	2	3	8	8	0	0	0	0
Income before zakat	**111**	**125**	**163**	**274**	**352**	**445**	**520**	**594**
Zakat	(8)	(10)	(15)	(24)	(32)	(40)	(47)	(53)
Net income	**103**	**115.8**	**147.9**	**250.5**	**320.5**	**405**	**473**	**541**
Y/Y	**-9.3%**	**12.1%**	**27.7%**	**69.3%**	**28.0%**	**26.4%**	**16.8%**	**14.3%**
EPS	**2.95**	**3.07**	**4.00**	**6.89**	**9.16**	**11.57**	**13.51**	**15.45**
DPS	**2.1**	**1.1**	**0.0**	**0.0**	**3.7**	**5.8**	**8.1**	**9.3**
Balance sheet								
Assets								
Cash and bank balances	42	85	69	112	57	119	128	168
Inventories	36	57	129	158	193	213	227	236
Prepayments and other assets	46	82	125	185	229	256	276	290
Contract assets	236	426	611	762	862	922	1,038	1,192
Trade and other receivables	241	216	437	571	698	772	821	854
Property and equiptment	147	299	308	452	585	697	765	804
Total assets	**751**	**1,187**	**1,702**	**2,263**	**2,647**	**3,002**	**3,279**	**3,569**
Liabilities & owners' equity								
Total current liabilities	288	586	961	1,181	1,323	1,426	1,488	1,537
Total non-current liabilities	107	203	204	304	353	403	428	454
Share capital	250	250	250	350	350	350	350	350
Reserves	110	142	282	423	616	818	1,007	1,224
Retained earnings	88	110	236	377	569	772	961	1,177
Total owners' equity	**357**	**398**	**538**	**779**	**971**	**1,173**	**1,363**	**1,579**
Total equity & liabilities	**751**	**1,187**	**1,702**	**2,263**	**2,647**	**3,002**	**3,279**	**3,569**
Cashflow statement								
Operating activities	(9)	32	4	(58)	121	361	411	465
Investing activities	(99)	(198)	(56)	(199)	(198)	(197)	(169)	(150)
Financing activities	68	209	37	300	22	(103)	(234)	(274)
Change in cash	**(39)**	**43**	**(15)**	**43**	**(55)**	**62**	**9**	**40**
Ending cash balance	**42**	**85**	**69**	**112**	**57**	**119**	**128**	**168**
Key fundamental ratios								
Liquidity ratios								
Current ratio (x)	2.1	1.5	1.4	1.5	1.5	1.6	1.7	1.8
Quick ratio (x)	2.0	1.4	1.3	1.4	1.4	1.5	1.5	1.6
Profitability ratios								
Gross profit margin	26.6%	22.8%	15.4%	17.1%	17.8%	19.1%	19.9%	20.9%
Operating margin	19.8%	16.8%	11.7%	13.5%	14.5%	15.8%	16.6%	17.7%
EBITDA margin	23.8%	21.2%	14.5%	15.9%	16.8%	18.4%	19.6%	20.7%
Net profit margin	18.2%	13.1%	8.2%	10.4%	11.2%	12.6%	13.7%	14.9%
Return on assets	15.9%	11.1%	9.7%	12.2%	13.1%	14.3%	15.1%	15.8%
Return on equity	31.8%	28.5%	29.9%	36.6%	36.6%	37.8%	37.3%	36.8%
Leverage ratio								
Debt / equity (x)	0.6	1.3	1.0	1.1	1.0	0.9	0.8	0.8
Market/valuation ratios								
EV/EBITDA (x)	28.7	30.4	21.4	19.3	15.2	12.4	10.9	9.8
EPS (SAR)	2.95	3.07	4.00	6.89	9.16	11.57	13.51	15.45
BVPS (SAR)	10.19	11.36	15.36	22.25	27.74	33.53	38.93	45.11
Market price (SAR)*	105.6	139.4	138.3	181.0	181.0	181.0	181.0	181.0
Market-Cap (SAR mn)	3,696	4,879	4,840	6,335	6,335	6,335	6,335	6,335
P/E ratio (x)	35.8	45.4	34.6	26.3	19.8	15.6	13.4	11.7
P/BV ratio (x)	10.4	12.3	9.0	8.1	6.5	5.4	4.6	4.0

Source: Company reports, Aljazira Capital Research

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RESEARCH DIVISION

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RATING TERMINOLOGY

1. Overweight: This rating implies that the stock is currently trading at a discount to its 12 months price target. Stocks rated "Overweight" will typically provide an upside potential of over 10% from the current price levels over next twelve months.
2. Underweight: This rating implies that the stock is currently trading at a premium to its 12 months price target. Stocks rated "Underweight" would typically decline by over 10% from the current price levels over next twelve months.
3. Neutral: The rating implies that the stock is trading in the proximate range of its 12 months price target. Stocks rated "Neutral" is expected to stagnate within +/- 10% range from the current price levels over next twelve months.
4. Suspension of rating or rating on hold (SR/RH): This basically implies suspension of a rating pending further analysis of a material change in the fundamentals of the company.

Disclaimer