



US\$0.917bn Market cap

30% Free float

US\$2.92mn Avg. daily volume

Target price 164.00
Current price 135.80
20.8% above current as at 26/10/2022

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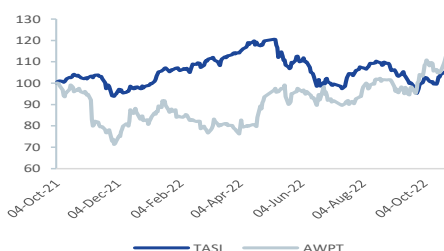
Existing rating

Underweight

Neutral

Overweight

Performance



Earnings

(SARmn)	2021	2022E	2023E
Revenue	569	841	1,416
Y-o-Y	9.3%	47.8%	68.4%
Gross profit	151	208	342
Y-o-Y	5.7%	37.0%	65.0%
Gross margin	26.6%	24.7%	24.2%
EBITDA	135	193	316
Y-o-Y	0.3%	42.6%	63.9%
EBITDA margin	23.8%	22.9%	22.3%
Net profit	103	118	207
Y-o-Y	-9.3%	14.2%	75.2%
Net margin	18.2%	14.0%	14.6%
EPS (SAR)	4.13	4.72	8.27
DPS (SAR)	3.00	-	-
Payout ratio	72.6%	0.0%	0.0%

Source: Company data, Al Rajhi Capital

Alkhorayef Water & Power Tech Initiating coverage with a TP of SAR164/sh

We initiate coverage on Alkhorayef Water and Power Technologies (AWPT) with a target price of SAR164/share based on 60-40% weight given to DCF (SAR183/sh), and PE (SAR136/sh) based valuation. AWPT is one of the leading O&M service providers in the Water, Wastewater, and Integrated Waster Solutions segment. In addition, the company also provides project services within the aforementioned segments. In line with Vision 2030, the water sector is set to undergo a major transformation in the upcoming years which involves an active effort to increase private sector participation, improvement in sanitation practices, and expansion in the use of desalination plants to ensure water security. AWPT is well-positioned to benefit from the upcoming stream of projects and is aiming to capture the project services market diversifying from its traditional O&M services. We expect the company to be awarded new contracts worth SAR2.2bn for the next 3 years (FY23-26) representing a 3-year revenue CAGR of 29%. The stock is currently trading at 135.8/sh providing an upside of 20.8% to our target price. Hence, we issue a **“Overweight”** recommendation on Alkhorayef Water and Power Technologies.

Shifting focus toward project services: AWPT is uniquely positioned to benefit from the ongoing developments in the utility sector of the Kingdom. This is reflected in the recent project additions for the company which has grown by 3.0x and 2.1x in 1HFY22 to SAR2.3bn when compared with year-end FY20 and FY21 respectively. Going forward, we have assumed that the company will be able to capture at least 10% of the upcoming SAR108bn NWC projects. In addition to the project services, the company will also benefit from the eventual O&M contracts from these projects. Our assumptions include O&M contract value at 10% of EPC contracts and a conservative 15% contract win rate.

Future Revenue to Swell: AWPT’s future revenues are dependent on the upcoming stream of projects which are to increase tremendously in the upcoming years. The company’s revenue is likely to grow at a 5-year CAGR of 20% from SAR 841mn in FY22e to SAR 2,087mn in FY27e. The increase in revenue in our assumptions is mainly stemming from NWC projects, however, the company is also actively looking at projects tendered by SWPC and other sources. Any such project contract, if awarded, presents a huge upside to our investment case.

Diversifying clientele by entering the BOT market: Entering the BOT market serves a dual purpose by presenting a unique opportunity whereby the company will be able to ensure a pipeline of project services revenue as well as a steady stream of O&M services. AWPT is actively participating in privatization proposals such as Independent Water Transmission (IWTP) and Independent Sewage Treatment Plant (ISTP) projects offered by Saudi Water Partnership Company (SWPC). SPC has announced 8 upcoming IWTP projects which will be procured by 2025 with a combined length of approximately 3,500km and a total capacity of 4.3mn m³/d.

Specialized knowledge key to consolidating its market share: AWPT’s future focus is on project services, however, the company will continue to milk the O&M segment where it has built a formidable reputation as an expert industry leader. O&M services are a recurring stream of revenue for the company as they make up 85% of the top line and the tenure of these contracts is usually for 3-5 years.

However, the specialized technical knowledge required to execute these contracts allows the company to win back these projects. The company is striving to win long-term O&M contracts with a duration of 10-15 years for sewage treatment plants across the Kingdom.

Relationship with clients: The company understands the importance of a strong and long-standing relationship with its clients especially when the bulk of its revenue i.e., more than 80% is generated from two clients. A healthy relationship with clients is also necessary to facilitate business development, tender participation, and contract extensions. The company is typically able to renew contracts with MEWA and NWC, given its historical track record and expert team.

Attractive valuation: We value AWPT using 60-40% weight given to DCF and PE-based relative valuation. Our DCF-based target price is SAR183/sh based on 2% terminal growth and 9.9% WACC. For PE-based valuation, we have used discounted FY23e earnings and applied a multiple of 18.2x resulting in a value of SAR136/sh. Thus, our weighted target prices stand at SAR 164/sh, providing an upside of 20.8% to the last close. The stock looks extremely attractive at current levels on the back of upcoming projects which AWPT is well-placed to benefit from. We expect revenue to grow at a 5-year CAGR of 24% from FY22-27e. Hence, we initiate coverage on AWPT with a “**Overweight**” recommendation.



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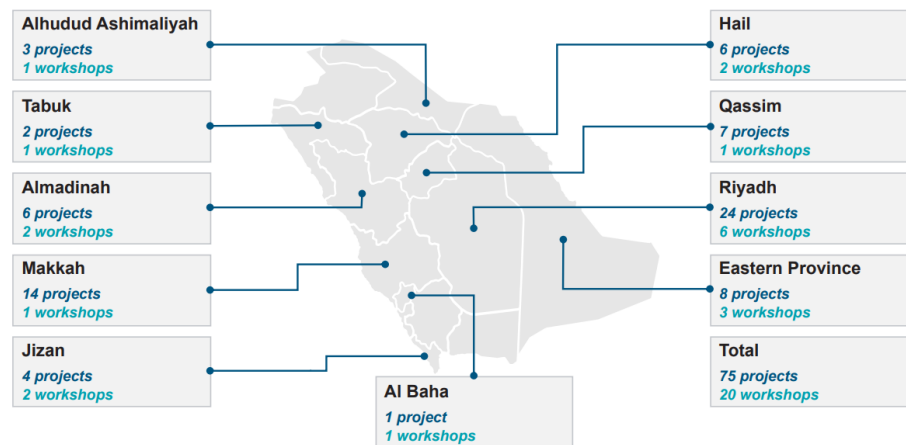
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Company overview

The company was founded in the year 1985 and is one of the largest subsidiaries of the Alkhorayef group. Alkhorayef Water & Power Technologies designs, constructs, operates, maintains, and manages water and wastewater projects in Saudi Arabia. The company operates through three segments: Water, Wastewater, and Integrated Solutions. It provides engineering, procurement, construction, and operation and maintenance services. The company's services cover domestic and industrial wastewater plants, water treatment plants, water desalination plants, water and wastewater pipelines & networks, brackish water treatment plants, water, sewer, and stormwater networks, pumping and lifting stations, transmission pipelines, deep water wells, electro-mechanical works, heavy civil and critical infrastructure, environmental services, scale design and value engineering, and conservation services. Its customers include government agencies and private customers. The company is based in Riyadh, Saudi Arabia.

Figure 1. **Company's Geographic Presence in the Kingdom**



Source: Company Data, Al Rajhi Capital

Figure 2. **Shareholding Structure**

Countries	Shares Owned at End of 2021	Ownership (%)
Alkhorayef Group Co	12,750,000	51%
Alkhorayef Nama Co	1,250,000	5%
Others	3,500,000	14%
Public	7,500,000	30%
Total	25,000,000	100%

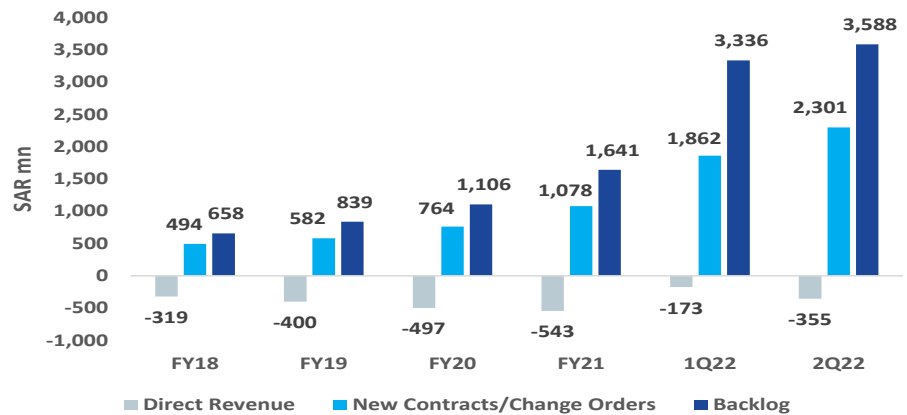
Source: Company Data, Al Rajhi Capital

Recent projects

Alkhorayef Water & Power has embarked on a growth journey reflected in their project additions each year. The company has managed to secure new projects worth SAR 2.3bn as of 1HFY22 as against SAR1.3bn in 2021. The value of backlog revenue (revenue from contracts yet to be booked) reached SAR 3.6bn by the 2QFY22 end, representing a massive jump of 3.2x and 2.2x when compared with year-end FY20 and FY21 respectively.



Figure 3. **Historical Backlog**



Source: Company Data, Al Rajhi Capital

Recently, the company secured contracts with several new clients further diversifying its client base. These projects include “Water Quality Projects” in the Eastern region amounting to SAR 1.6bn involving engineering, procurement, and construction of strategic storage, Transmission, and distribution system. Among other clients, the company managed to secure a contract with Riyadh Airports company project to develop wastewater systems at King Khalid International Airport and two projects from Jeddah Municipality governate to operate maintain and improve rainwater and storm systems. Furthermore, the company enters into a partnership with Veolia, a French water conglomerate for the management of O&M of water and environmental treatment services in the Riyadh region. One of the major projects awarded in FY22 includes O&M of all components of Zamzam water from the well, treatment, storage, pumping, transmission to the two holy cities, and bottling plants. The company also was awarded O&M of Jeddah water sector amounting to SAR228mn.

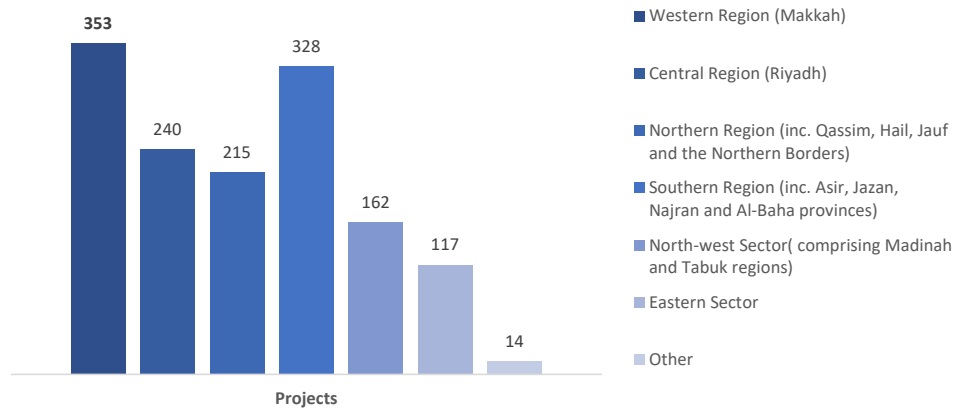
Opportunities going forward

National Water Company (NWC) has announced projects amounting to SAR108 bn to expand coverage of water and sewage networks, increase the capacity of treatment plants and raise the coverage rate for inhabitants connected to water & sewage networks. NWC intends to roll out 1,429 projects for tender in the next 5 years and AWPT is confident of capturing a decent chunk of these new projects. The projects are aimed to achieve the national water strategy and Vision 2030’s objectives.

The projects include 13 administrative regions comprising cities and governorates in all six sectors. NWC specified 353 projects worth SAR 39.0bn for the Western region (Makkah); 240 projects worth SAR 14.2bn for the Central Region (Riyadh); and 215 projects worth SAR 13.0bn for the Northern Sector comprising Qassim, Hail, Jauf and the Northern Borders. NWC will also launch 328 projects worth more than SAR 15.3bn for the Southern Sector including Asir, Jazan, Najran, and Al-Baha provinces; and 162 projects costing over SAR 7.7bn for the North-west Sector comprising Madinah and Tabuk regions. Additionally, the company plans to implement 117 projects worth SAR 16.2bn for the Eastern Sector (Eastern Province); and 14 projects worth more than SAR 2.7bn to support all sectors.



Figure 4. **Projects Layout**



Source: National Water Company (NWC), Al Rajhi Capital

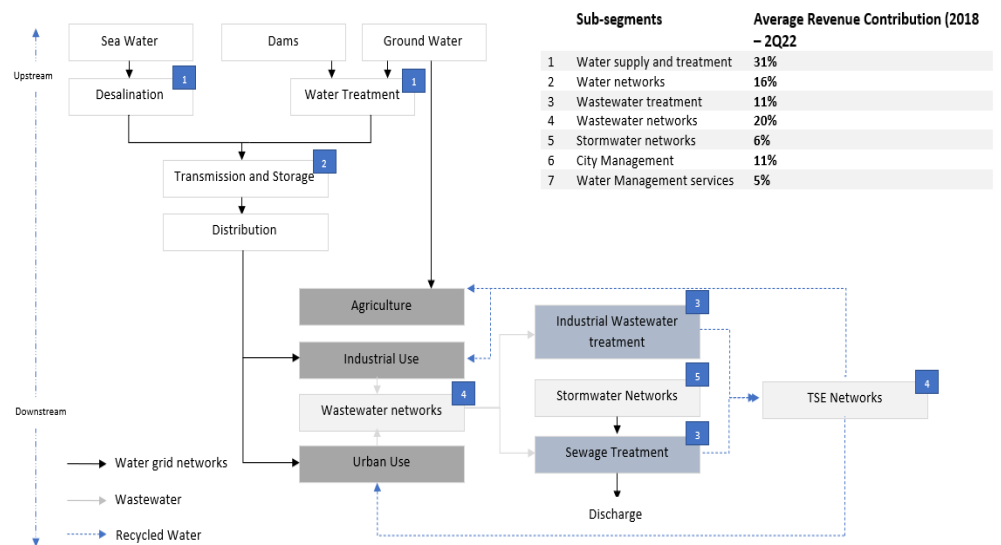
As per the company, according to details provided to them by NWC, these projects are similar to AWPT projects in Taif and Easter Region. Hence, AWPT feels that the majority of these projects require the expertise that they have and their extensive past record provides testimony to it.



Business model

Alkhorayef Water and Power Technologies (AWPT) is the largest subsidiary of Alkhorayef Group Company which has been operational for 60+ years. AWPT itself has been in operation for over 30 years having a significant footprint in the Water & Wastewater sector of the Kingdom and also operates in the Integrated water solutions segment. Simply put, the company is in the business of contracting for O&M and Project services across the water and wastewater segment.

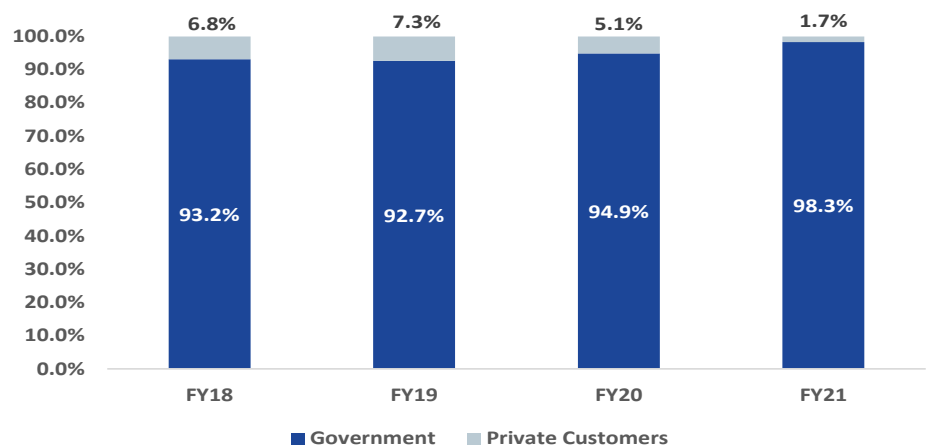
Figure 5. **AWPT Flow Chart**



Source: Company Data, Al Rajhi Capital

AWPT is heavily reliant on its top two clients namely MEWA and NWC to generate revenue. The majority of the water and wastewater infrastructure in which the company is currently involved is managed by MEWA and NWC which are state-owned entities accounting for more than ~80% of Alkhorayef's revenue in 2021.

Figure 6. **Client-based revenue breakdown**



Source: Company Data, Al Rajhi Capital

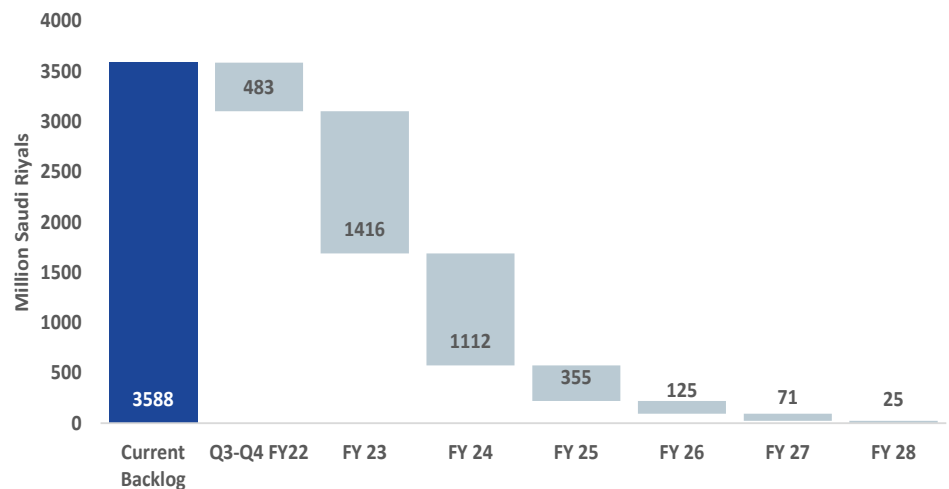


Tendering process: A large number of contracts awarded by the clients are through competitive bidding based on prequalification requirements. These are pre-requisite for each bidder and may include past experience, financial capability, and Saudi classification thresholds. The company prepares the bids for the suitable upcoming tenders by submitting two packages 1) technical, and 2) financial/commercial. Once the company clears the technical requirements of the tender then only the financial bid comes into play.

Life of contracts: The life of these awards is usually 3-5 years on average depending on the contract type. EPC contracts are usually of much higher value when compared with O&M, however, while EPC contracts may be seen as one-offs, O&M awards can provide a recurring source of revenue for the company. The technical knowledge and expertise AWPT have in O&M services are unparalleled in the Kingdom. Hence, the O&M revenue stream provides the much-needed safety buffer to the company as they stand a high chance of being renewed. The average renewal rate for O&M contracts for the last 3 years has exceeded an impressive 70%.

Revenue cycle: The company, as mentioned above, generates its revenue after winning contracts for project services or O&M services. The revenue is recognized from clients based on the stage of completion of the contracting activity and revenue of the contract of service is measured as or when service is rendered to the customer. Therefore, the company normally has a decent revenue backlog which currently stands at SAR3.6bn with the company expecting to recognize SAR1.4bn and SAR1.1bn in FY23 and FY24 respectively.

Figure 7. **Future Backlog**



Source: Company Data, Al Rajhi Capital

Expense cycle: For any new contract, the spending is usually frontloaded and is done on fixed assets which normally amount to 8-10% of the project value. The company usually expects positive cash flow within 4-6 months of the contract once the billing starts. The interest rate risk is highest for 1-2 months during the time between bidding and award of the contract. For the company, the variable cost usually involves fuels cost for equipment and transportation which is not a big component of the overall cost. The material supply duration is usually the first 6 months and AWPT locks in the material rates with the suppliers as per the bid. Therefore, the company does not try to benefit/lose from any fluctuation in prices.

Sustainable growth: The company in its key segments has been able to outperform (refer to the below figure) the industry's market size growth rate. Given the relatively inelastic demand for water, the O&M services market has greater revenue and earnings visibility and is resilient to volatility in the oil sector and economic cycles. Furthermore, the company's wide range of services enables its position as a strong player in the Integrated Water Solutions segment and also aids the diversification of its revenue streams. The company's agility in terms of

procurement of material and equipment, well-established processes, and continued focus on manpower training affords it the ability to scale quickly.

Figure 8. **Outperformed the overall market considerably**

CAGR%	Alkhorayef	Industry
Project Services market for wastewater networks	37.20%	4.50%
Project Servicesmarket for distribution network	46.60%	1.40%
O&M Services market in water wells and water treatment plant	67.70%	1.20%
O&M Services market in wastewater treatment plant	34.70%	4.50%

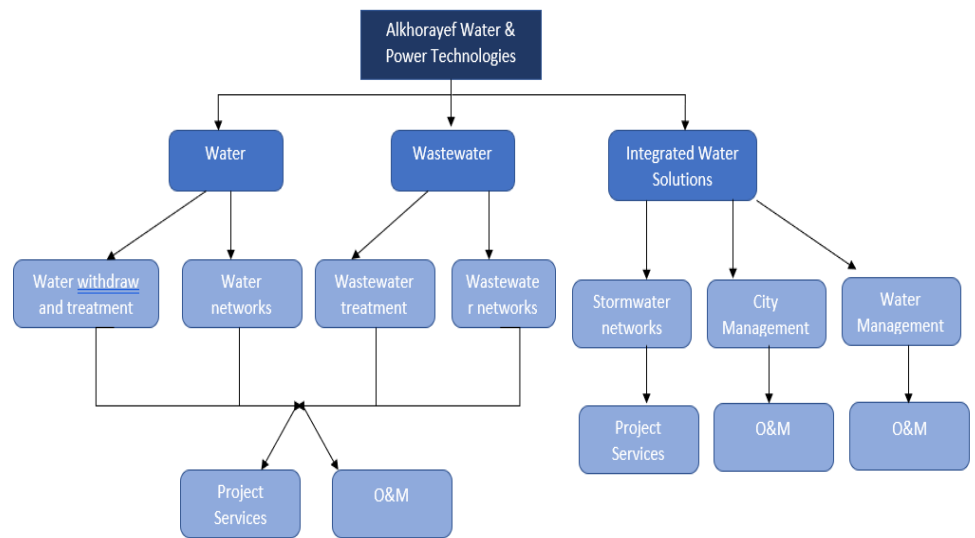
Source: Company Data, Al Rajhi Capital



Segments highlights

The company operates in three major segments including 1) Water, 2) Wastewater, and 3) Integrated Water Solutions (IWS). The water segment is where the company drives its major chunk of revenues. The said segment contributed 48% and 41% to the overall revenues in FY21 and 1HFY22. The next major contribution came from the Wastewater segment contributing 31% and 24% to the revenues in FY21 and 1HFY22. Lastly, the Integrated water solution segment, made up 21% and 35% of the total revenues in 2021 and 1HFY22. Overall, the topline for the company has grown at a decent 4-year CAGR of 23% led by the Water and Wastewater segment.

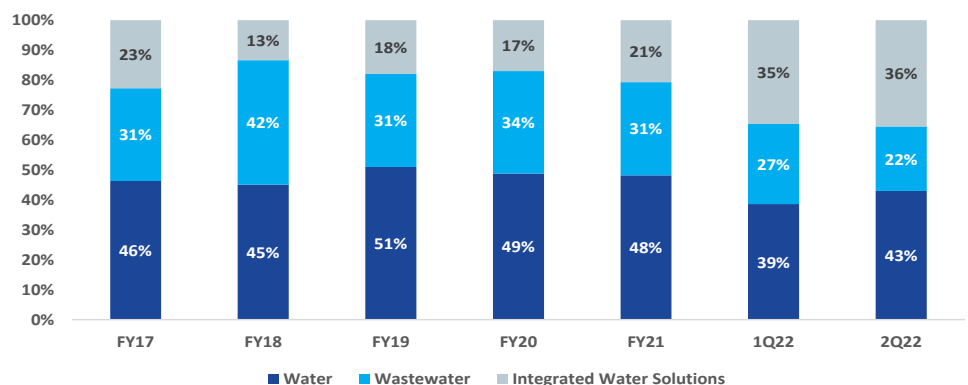
Figure 9. **Business Segments**



Source: Company Data, Al Rajhi Capital

The company has shown impressive gross profit growth rising from SAR 41mn in 2017 to SAR 151mn in 2021 representing a 4-year CAGR of 39%. The gross profit of the Water, Wastewater, and Integrated Water Solution segments has grown at a 4-year CAGR of 23%, 28%, and 10% respectively. When it comes to gross profit margins, the water segment takes the lead with GP margins at 29% levels as of FY21. For a similar period, GP margins for Wastewater and IWS segments were recorded at 28% and 19% respectively.

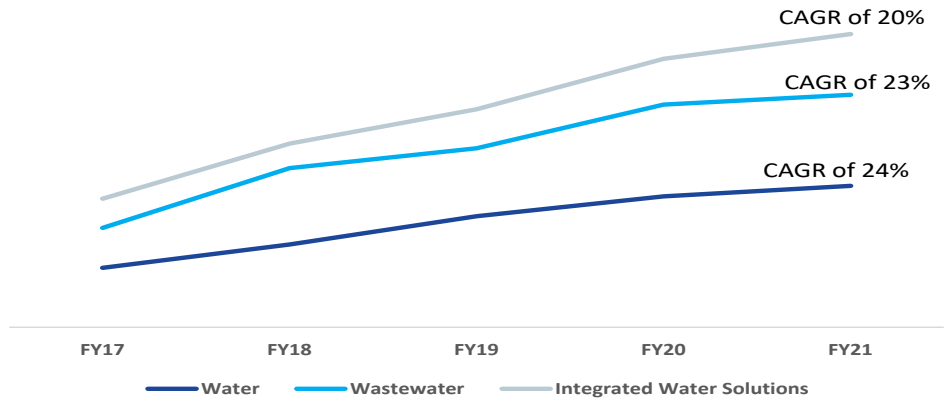
Figure 10. **Revenue mix**



Source: Company Data, Al Rajhi Capital

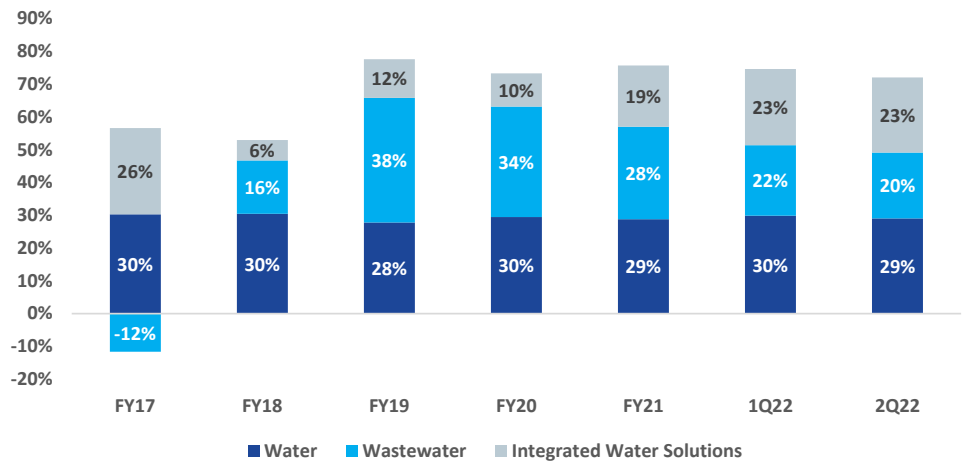


Figure 11. CAGR Revenue growth



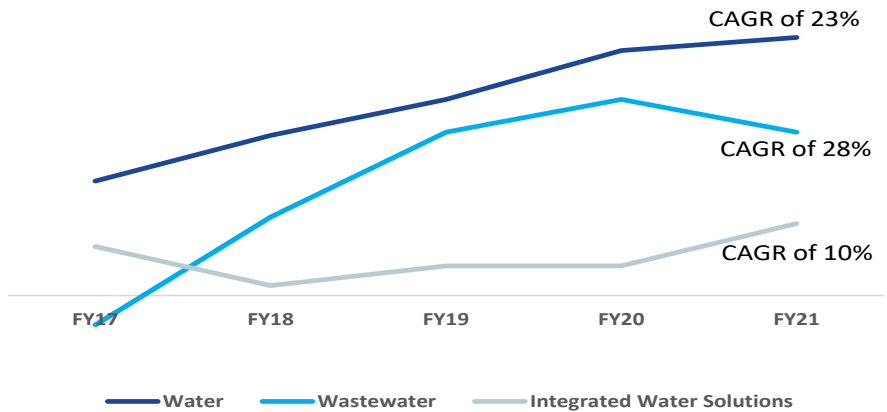
Source: Company Data, Al Rajhi Capital

Figure 12. Gross Profit Margin



Source: Company Data, Al Rajhi Capital

Figure 13. CAGR Gross Profit



Source: Company Data, Al Rajhi Capital



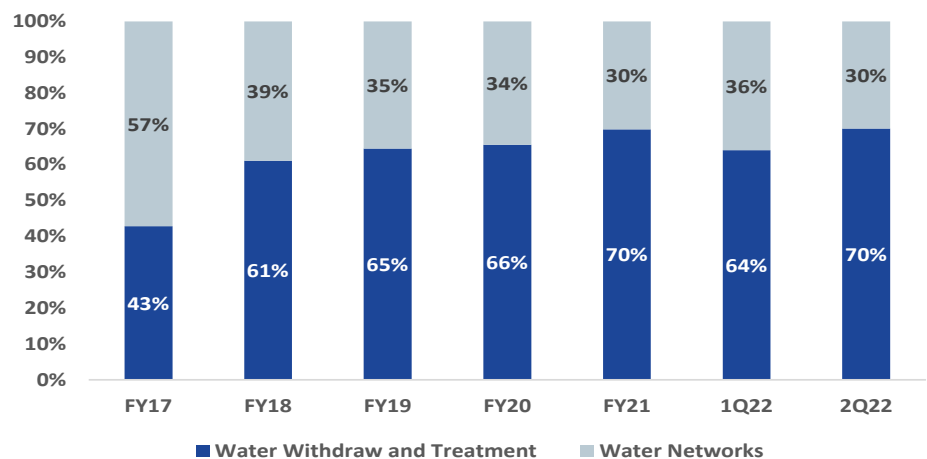
To dive a bit deeper, both the water and wastewater segment can be broken into further two sub-segments i.e., a) Water withdraw Treatment/Wastewater treatment and, b) Water/Wastewater networks.

Water segment

a) Water withdraw and treatment: The subsegment encompasses water treatment plants and deep-water wells. The company is responsible for engineering, procurement, rehabilitation construction as well as O&M of large capacity centralized seawater/brackish water reverse osmosis plants. Similarly, for the deep-water wells, AWPT offers services for drilling, installation, commissioning, and O&M for a depth range of 300-2500 meters. The segment contributes 70% of the total water segment revenues as of FY21 and 1HFY22.

b) Water networks: The subsegment entails engineering, procurement, and upgrading of potable networks. This includes pumping stations and network lines from the plant to stations and then to end consumers. The company also provides O&M services for water networks. The company also provides similar project and O&M services for firewater networks. The water network makes up 30% of the overall water segment revenues as of FY21 and 1HFY22.

Figure 14. **Revenue Mix for Water Segment**



Source: Company Data, Al Rajhi Capital

Wastewater segment

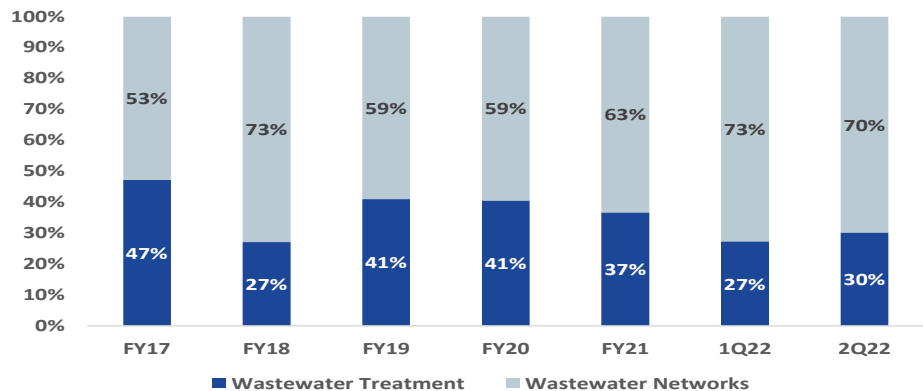
The company designs, constructs, operates, and manages wastewater projects like sewage and industrial wastewater treatment plants across the kingdom.

a) Wastewater treatment: The subsegment includes engineering, procurement, execution, commissioning, upgrading, and rehabilitation of sewage and industrial treatment plants. Similar to the water segment, the company also provides O&M services. The company also has to keep in mind environmental regulations when producing treated sewage effluent water. 37% and 30% of wastewater segment revenues are driven by wastewater treatment as of FY21 and 1HFY22 respectively.

b) Wastewater networks: The subsegment encompasses engineering, procurement, execution, commissioning, upgrading, and rehabilitation of long-distance wastewater trunk lines, collection networks within cities, lifting stations, tunnelling, wastewater connection, and treated sewage effluent (TSE) networks. Again, the company also provides O&M to the TSE networks. 63% and 70% of wastewater segment revenues are composed of wastewater network revenues as of FY21 and 1HFY22 respectively.



Figure 15. Revenue Mix for Wastewater segment



Source: Company Data, Al Rajhi Capital

Integrated water solutions (IWS)

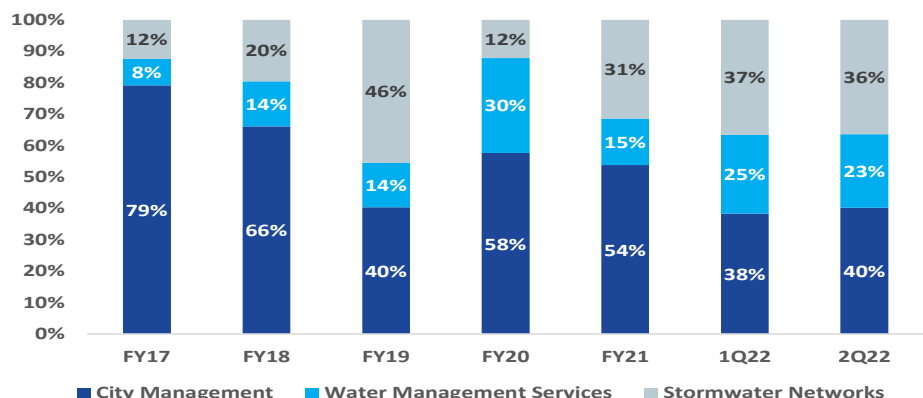
IWS includes stormwater networks, city management services, and water management services.

a) Stormwater networks: This includes project services and O&M of large-scale lifting stations, underground tunnelling, combined sewage overflow systems, underground stormwater detection systems, grit removal systems, pumping solutions, and emergency storm control systems. Stormwater networks contribute 31% and 36% to the total IWS revenues as of FY21 and 1HFY22 respectively.

b) City management: AWPT provides turnkey solutions involving full-scale strategic planning, capital investment, strategic operations, and maintenance of the water supply chain. The company has executed various city management projects including Dammam City water and wastewater systems, a project, managed by the company for the last 20 years. The city management subsegment provides the major chunk of revenue under IWS contributing 54% and 40% to total IWS revenues in FY21 and 1HFY22 respectively.

c) Water management: This subsegment provides complementary services to the core business activities, providing clients with a full spectrum of water and wastewater solutions. Services included are fabrication workshops, laboratories, leak detection, asset services, etc. to name a few. Water management services make up 15% and 23% of IWS revenues as of FY21 and 1HFY22 respectively.

Figure 16. Revenue Mix for Integrated Water Solutions



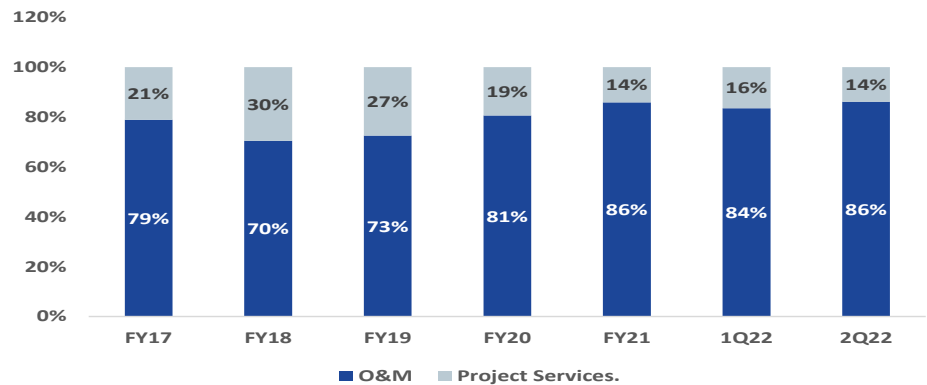
Source: Company Data, Al Rajhi Capital



Contract type highlights

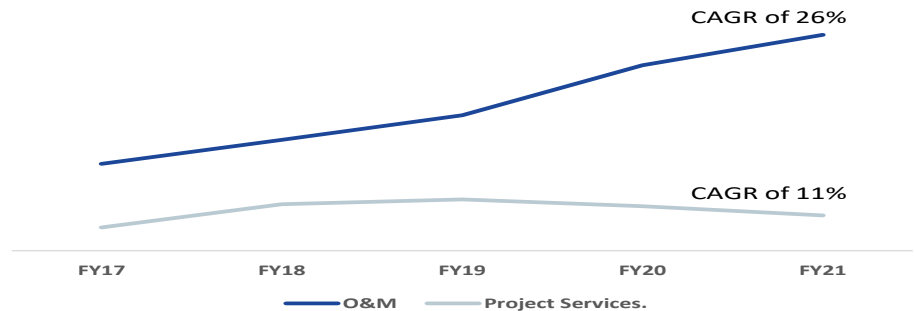
A more intuitive way to look at the company would be using contract types classification. AWPT largely provides two types of services 1) O&M, and 2) Project Services. As of 1HFY22, the revenue mix stood at 85% for O&M, and the rest 15% can be associated to project services. O&M services have remained the strong suit for the company with revenues growing at a 4-year CAGR of 26% while revenues for project services rose by only 11% during the same period. At gross profit levels, O&M contributed 85% while project services 15% while the GP margins stood at 26% and 27% respectively.

Figure 17. **Revenue Mix**



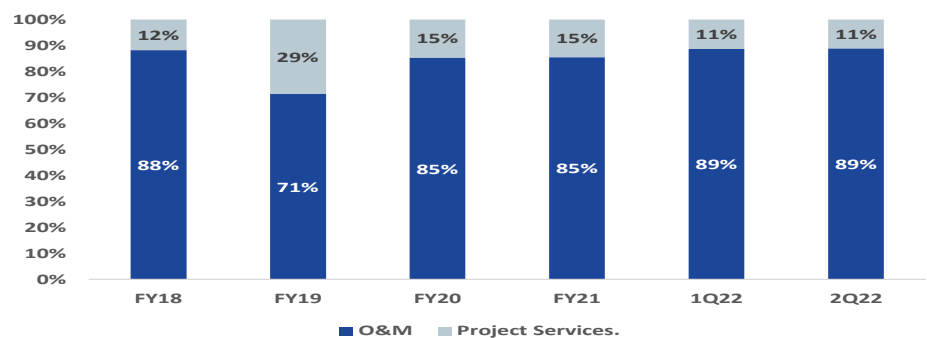
Source: Company Data, Al Rajhi Capital

Figure 18. **Revenue CAGR**



Source: Company Data, Al Rajhi Capital

Figure 19. **Gross Profit Contribution**



Source: Company Data, Al Rajhi Capital



Investment case

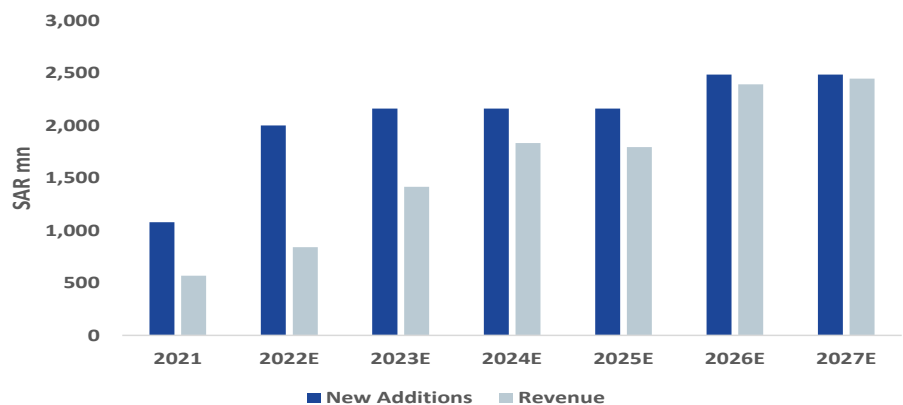
Shifting focus toward project services

AWPT is uniquely positioned to benefit from the ongoing developments in the utility sector of the Kingdom. This is reflected in the recent project additions for the company which has grown by 3.0x and 2.1x in 1HFY22 when compared with year-end FY20 and FY21 respectively. Going forward, we have assumed that the company will be able to capture at least 10% of the upcoming SAR108bn NWC projects. The timeline for the tendering of these 1,429 projects is 5 years, and we have assumed execution period of 3 years. Remaining conservative, revenue flows have been assumed with a lag of 1-year as against the industry norm of 6-months. This results in the addition of new contracts worth SAR2.2bn each year till FY27e. In addition to the project services, the company will also benefit from the eventual O&M contracts from these projects. The O&M contracts will be a lot less in value than the EPC projects. Our assumptions include O&M contract value at 10% of EPC contracts and a conservative 15% contract win rate.

Future revenue to swell

AWPT's future revenues are dependent on the upcoming stream of projects which are to increase tremendously in the upcoming years. Therefore, the company revenue is likely to grow at a 5-year CAGR of 24% from SAR 841mn in FY22e to SAR 2,447mn in FY27e. The increase in revenue in our assumptions is mainly stemming from NWC projects, however, the company is also actively looking at projects tendered by SWPC and other sources. Any such project contracts present a huge upside to our investment case. In addition to this, the company already has an impressive backlog of revenue amounting to SAR 3.6bn as of 1HFY22, representing an increase of 3.2x and 2.2x from year-end FY20 and FY21.

Figure 20. **Future Revenue and Additions**



Source: Company Data, Al Rajhi Capital

Diversifying clientele by entering the BOT market

Entering the BOT market serves a dual purpose by presenting a unique opportunity whereby the company will be able to ensure a pipeline of project services revenue as well as a steady stream of O&M services. AWPT is actively participating in privatization proposals such as Independent Water Transmission (IWTP) and Independent Sewage Treatment Plant (ISTP) projects offered by Saudi Water Partnership Company (SWPC). SPC has announced 8 upcoming IWTP projects which will be procured by 2025 with a combined length of approximately 3,500km and a total capacity of 4.3mn m³/d. AWPT is aiming to target these upcoming projects. The company has submitted prequalification for the 4 released IWTP projects so far as a JV with the Spanish Company COBRA having qualified for all 4 IWTP projects. Currently, AWPT and COBRA are preparing bids for the first two IWTPs.



Specialized knowledge is key to expanding its market share

AWPT's future focus is on project services, however, the company will continue to milk the O&M segment where it has built a formidable reputation as an expert industry leader. The company's market share in the O&M segment (related to MEWA & NWC) has risen significantly since the IPO. O&M services are a recurring stream of revenue for the company as they make up 85% of the top line. The tenure of these contracts is usually for 3-5 years. However, the specialized technical knowledge required to execute these contracts allows the company to win back these projects. This is reflected in the high renewal rate which in an average has exceeded 70% in the last three years. However, the company is striving to win long-term O&M contracts with a duration of 10-15 years for sewage treatment plants across the Kingdom. Specialized knowledge in O&M and project services along with a successful historical track record certainly gives AWPT an edge over its competitors. For any new entrant, the industry poses a high barrier to entry, enabling existing players to keep on expanding their market share.

Relationship with clients

The company understands the importance of strong and long-standing relationships with its clients especially when more than ~80% of its revenue is generated from two clients. A healthy relationship with clients is also necessary to facilitate business development, tender participation, and contract extensions. The company is typically able to renew contracts with MEWA and NWC, given its historical track record and expert team. In addition to this, having the government as your client also reduces default risk as payments from the government are swift and consistent. However, the company is looking to diversify its client base in the future.

Attractive valuation

We value AWPT using 60-40% weight given to DCF and PE-based relative valuation. Our DCF-based target price is SAR183/sh based on 2% terminal growth and 9.9% WACC. For PE-based valuation, we have used discounted FY23e earnings and applied a multiple of 18.2x resulting in a value of SAR135/sh. Thus, our weighted target prices stand at SAR 164/sh, providing an upside of 20.8% to the last close. The stock looks extremely attractive at current levels on the back of upcoming projects which AWPT is well-placed to benefit from. We expect revenue to grow at a 5-year CAGR of 24% from FY22-27e. Hence, we initiate coverage on AWPT with a "Overweight" recommendation.

Figure 21. **Valuation Table**

Valuation Methodology	Fair Value (SAR)	Weightage	Weighted value per share (SAR)	Upside/Downside
DCF	183	60%	110	35%
P/E	135	40%	54	-1%
Fair Value (SAR)		100%	164	111
CMP (as on 24th October 2022)			136	
Upside/(Downside)			20.7%	

Source: Al Rajhi Capital

Figure 22. **Sensitivity Analysis**

		WACC				
		7.9%	8.9%	9.9%	10.9%	11.9%
Terminal Growth	1.0%	225	186	156	133	114
	1.5%	241	197	164	139	119
	2.0%	259	210	173	146	124
	2.5%	281	224	184	153	129
	3.0%	307	242	196	162	136

Source: Al Rajhi Capital



Overview of the Saudi Arabian water market

Saudi Arabia is the leading economy in the GCC with a GDP of SAR 3.6 trillion as of 2021. The main driver of the Saudi economy is the exploration, refining, and export of petroleum products. The Kingdom ranks 4th among the most water-stressed countries in the world and is characterized by extreme scarcity of renewable water sources. According to the Market Consultant Report, in 2017 the freshwater demand per capita in KSA was 9 times higher than the supply per capita of renewable freshwater. This is 90x higher than the global average ratio of 0.1. Therefore, water is an even more prominent national strategic priority for short- and long-term economic growth and social stability, given the absolute scarcity. Four factors have driven the development of the water and wastewater sector in the Kingdom:

- **National transformation initiatives:** The Government's strategy to support economic growth and development of public service industries, Vision 2030, National Transformation Programme, and National Water Strategy 2030G, provides a clear direction to achieve a sustainable water supply. Among the main targets is the increase in the reuse rate of treated wastewater, water services coverage, and sanitation services coverage for the population. The private sector is a key player in achieving the water and wastewater targets through significant investment. While most investments are still dependent on government spending allocation, this is part of the transition process.

Figure 23. Company's Geographic Presence in the Kingdom

Target	2019 Values of Target	NTP 2020 Target	SNWS 2030 Target
Reuse rate of treated wastewater	18.2%	35.0%	70.0%
Water services coverage	81.5%	92.0%	95.0%
Sanitation services coverage to population	54.9%	63.0%	>75%
Water supply continuity rate	-	19h	-
Renewable water consumption in Agricultur	-	35.0%	-

Source: Company Data, Al Rajhi Capital

- **Economic factors:** Economic activity drives the demand for water resources and services across the Kingdom.
- **Fiscal factors:** The government's fiscal position enables subsidies and investments in the sector.
- **Demographic and social factors:** Population growth and distribution determines the need for water and wastewater supply.

Figure 24. Fresh water supply and demand

Countries	Freshwater Supply (m3/capita)	Freshwater Demand (m3/capita)	Demand to Supply Ratio
Egypt	10.0	660.0	66.00x
Bahrain	3.0	103.0	34.33x
UAE	16.0	273.0	17.06x
Saudi Arabia	73.0	644.0	8.82x
Qatar	21.0	95.0	4.52x
Jordan	70.0	93.0	1.33x
Germany	1,303.0	298.0	0.23x
USA	8,685.0	1,369.0	0.16x
France	3,078.0	407.0	0.13x
G7 Countries	14,217.0	586.0	0.04x
World Average	5,670.0	540.0	0.10x

Source: Company Data, Al Rajhi Capital

Water and Wastewater market in the Kingdom

The water and wastewater sector in the Kingdom can be divided into three sectors: Water, Wastewater, and Integrated Water Solutions. The following table shows the volume of the



water and wastewater sector in the Kingdom by industry from 2015G to 2019G and the relative CAGR.

Figure 25. **Water and Wastewater Sector in the Kingdom from 2015G to 2019G and the Relative CAGR**

Industry	2,015	2,016	2,017	2,018	2,019	CAGR
Water	6,365	5,823	8,038	10,743	15,270	24.5%
Water supply and treatment (SAR million)	2,504	1,892	2,837	3,700	6,382	26.3%
Sea water desalination (SAR million)	1,754	1,288	2,255	3,135	5,838	35.1%
Deep water wells & water treatment (SAR million)	750	604	582	565	544	-7.7%
Water networks (SAR million)	3,861	3,931	5,201	7,043	8,888	23.2%
Water transmission networks (SAR million)	584	585	1,439	4,008	5,411	74.5%
Water distribution networks (SAR million)	3,277	3,347	3,762	3,035	3,477	1.5%
Wastewater	2,921	3,003	3,075	3,011	4,397	10.8%
Wastewater treatment (SAR million)	1,516	1,206	1,217	1,412	2,688	15.4%
Sewage treatment plants (SAR million)	1,317	745	733	1,076	2,306	15.0%
Industrial wastewater treatment plants (SAR million)	199	461	483	336	383	17.8%
Wastewater networks (SAR million)	1,405	1,797	1,859	1,599	1,709	5.0%
Wastewater networks (SAR million)	1,293	1,673	1,723	1,451	1,527	4.3%
Treated wastewater networks (SAR million)	112	124	136	147	182	12.8%
Integrated water solutions	512	524	536	547	559	2.2%
Flood water networks (SAR million)	381	389	397	406	414	2.1%
Urban water management (SAR million)	131	134	138	142	145	2.7%
Total (SAR million)	9,798	9,350	11,649	14,301	20,226	19.9%

Source: Company Data, Al Rajhi Capital

Market overview

The utility sector is witnessing gradual subsidy reforms, active efforts to increase private sector participation, improvement in sanitation practices, and expansion in the use of desalination plants to ensure water security. To achieve the above-set goals, the general organization of the sector has seen a major shuffle in recent years.

The principal off-taker of water is Saudi Water Partnership Company (SWPC), previously known as Water and Electricity Company. SWPC is owned by the Ministry of Finance and procures desalinated purified, treated, and untreated water, as well as co-generational activities. In line with Vision 2030, SWPC has issued a strategy till 2025 which encompasses desalination plants, sewage treatment facilities, and strategic reservoirs. SWPC's roles also include tendering new desalination and cogeneration projects and water storage.

The National Water Company (NWC) is a wholly owned subsidiary of PIF with a water supply and sanitation operations in Riyadh, Makkah, and Taif. The other areas are managed by regional directorates of the Ministry of Environment and Agriculture (MEWA).

Apart from the above-mentioned entities, three government entities play complementary roles in defining and enforcing regulations, standards, and policies in the Saudi water and wastewater sector:

- The Ministry of Environment, Water, and Agriculture (MEWA) is responsible for formulating and implementing standards and policies and for regulating water and wastewater resources.
- The Electricity & Cogeneration Regulatory Authority (ECRA) regulates the electricity and water desalination industry in the Kingdom in addition to water and wastewater treatment services (except for water wells).
- The Saudi Arabian Standards, Metrology, and Quality Organization (SASO) is the national standardization body that oversees activities relating to standards and measurements, including establishing drinking water quality standards.

Typical contractual models across the value chain

The value chain segments are enabled by the following nodes namely:

- **BOT/BOOT/Concessions:** In a Build-Operate-Transfer (BOT) or Build-Own-Operate-Transfer (BOOT) contractual agreement, the developer is responsible for building, operating, and owning (as applicable) the asset for a determined period of time. This includes a set of activities related to the analysis, planning, design, financing, and construction of new assets required to meet growing demand or replace aging assets. Developers can choose to either perform the related operations and maintenance activities themselves or outsource them to O&M services providers. Concessions are contractual arrangements between the asset owner and the concession holder, also known as concessionaire, which regulate the rights to operate the asset for a stated period of time and under specified conditions.
- **Project services:** The project services cover the design, engineering, procurement, construction, testing, commissioning, upgrade, and rehabilitation of water and wastewater assets. These activities can be done in-house or contracted out to third-party service providers. Project Service contracts are most often issued by public developers, like NWC, as “Design and Build” or “EPC” (Engineering, Procurement, Construction) contracts. The contractual model takes the form of a lump sum fee based on a bill of quantity.
- **O&M services:** The O&M services include all activities required to operate, repair, restore, and maintain water and wastewater infrastructure so that it remains functional. In more detail, these activities encompass functional checks, servicing, repairing or replacing of necessary parts, and ancillary technical services intended to retain or restore functionality. O&M services can be defined as “preventive,” occurring periodically through inspections and replacements, or “corrective,” following the breakdown or malfunction of equipment. O&M activities can be performed in-house or outsourced to third-party service providers. O&M contracts are typically issued separately from the Project Services contract and are usually for 3-5 years. Contracts can be based on a lump sum fee per facility (i.e. for every treatment plant that is managed by the service provider, a fixed fee is payable, every month), or based on manpower contracts (i.e. hourly rate charged per person working on the projects), or based on material supply (i.e. for each unit of material supplied by the service provider, a specific unit charge is applied).

Spending on water

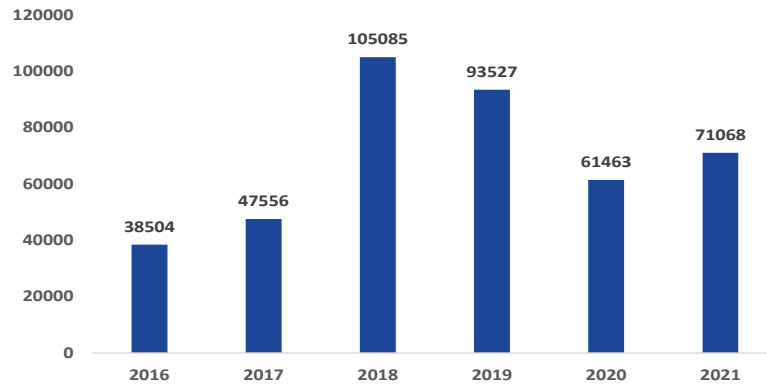
The growth of Saudi Arabia's water sector is pivotal in ensuring the availability of potable water and wastewater infrastructure to meet the country's rising needs. Economic expansion, unabated population growth, rapid urbanization, and the soaring demand for water and energy represent a massive environmental challenge for Saudi Arabia. The 2022 budget for the water sector in Saudi Arabia is USD 14.4 billion, which is a 34.4% decrease from 2021. However, this reduction in funding does not mean that the government is shifting its priorities away from water. Rather, it is in line with the government's objectives for increasing the private sector's contribution to this sector. Earlier in 2022, Saudi Arabia announced more than 60 water projects, worth SAR35 billion (USD 9.33 billion), that will cement the country's position as the world's largest water desalination market.

The economic resources and public programs expenditure category which includes water-related spending, had an increased provision in the budget from SAR 48bn in 2017 to SAR 131bn in 2019, representing a CAGR of 65.2% over the two years. The growth was driven primarily by mega projects and initiatives related to Vision Realization Programs. According to the Budget Statement 2019 reported by the Ministry of Finance, the sector's budget also encompasses new projects and increases in allocations for existing projects. Further, the budget covers projects that provide drinking water and develop water resources, sanitation services, dam construction, well drilling, water leak detection and rectification, water, and sewage networks replacement, water consumption rationalization, efficiency and performance



enhancement for desalination plants, infrastructure development for industrial cities in addition to the expansion of existing ones.

Figure 26. Annual Spend on Economic Resources (SAR mn)



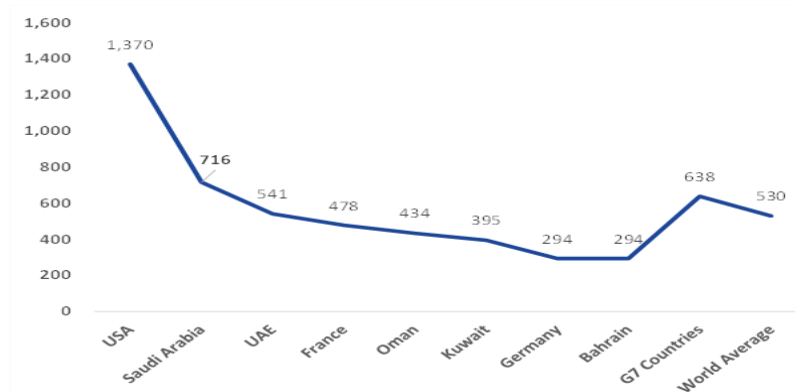
Source: Ministry of Finance, Data, Al Rajhi Capital

Water consumption in Saudi Arabia

Saudi Arabia is one of the highest water-consuming countries in the world, with a total per capita consumption of approximately 716 m³ per year, despite low renewable water supply resources. The Kingdom has hence identified “sustainability of water resources” as a key challenge in its National Transformation Program, to address high water consumption. The total water consumption within Saudi Arabia decreased by 0.7% from 68.0 million m³ per day in 2015 to an estimated 66.3 million m³ per day in 2019. Between 2015 and 2017, there was a decreasing trend which was then followed by an 11% increase in water consumption in 2018 in comparison to 2017. Three segments drive water consumption:

- **Agriculture:** 83.9% and 80.6% of total water consumption between 2015 and 2019, respectively
- **Urban:** 12.2% and 13.6% of total water consumption between 2015 and 2019, respectively
- **Industrial:** 3.9% and 5.8% of total water consumption between 2015 and 2019, respectively

Figure 27. Selected G7 and GCC Countries Total Annual Water Consumption in 2017G and G7 and World average



Source: Company Data, Al Rajhi Capital

Figure 28. **Water Consumption by Sector from 2015G to 2019G and Relative CAGR**

	2015	2016	2017	2018	2019	CAGR
Industrial (Million m3/day)	2.7	2.8	2.7	3.8	3.9	9.6%
Urban (Million m3/day)	8.3	8.6	8.6	9.3	9.0	2.0%
Agriculture (Million m3/day)	57.1	54.2	52.6	58.1	53.4	-1.7%
Total (Million m3/day)	68.1	65.6	63.9	71.2	66.3	-0.7%

Source: Company Data, Al Rajhi Capital

Vision 2030 boost to water

Vision 2030 was launched in 2016 consisting of long-term goals and expectations built upon the Kingdom's unique strengths and capabilities. It was designed to reduce the Kingdom's reliance on income from oil sales by diversifying the economy, boosting the role of the private sector, and developing public infrastructure. Vision 2030 had the following important themes for the water sector:

- Providing access to high-quality water services and further development of water infrastructure
- Promoting and encouraging increased participation from the private sector in building and operating waste and wastewater infrastructure
- Conserving and protecting vital resources such as water

Vision 2030 is supported by National Transformation Program (NTP). NTP has 8 themes as its pillars of which four of them are related to the water and wastewater sector:

- **Ensure Sustainability of Vital Resources Theme:** This is the most relevant theme for the water sector. Achieving integrated management of renewable and non-renewable water resources for sustainable use is a strategic objective. This includes planning for the effective use of water resources and maximizing the use of treated water.
- **Improve Living Standards and Safety Theme:** This aims at improving the quality of services provided in Saudi cities, including water utilities, as well as reducing all types of pollution, including water pollution.
- **Develop the Tourism and National Heritage Sectors Theme:** Aims at marketing the Kingdom as a tourist destination regionally and globally. A reliable and cost-efficient water supply is a critical component of several tourism infrastructures and attractions.
- **Contribute to Enabling the Private Sector Theme and Labour Market Accessibility and Attractiveness Theme:** These are enablers of the water sector.

Key challenges and risks

Less diversified client base: A major portion (~98% in 2021) of the revenue comes from contracts awarded by the government or government agencies. Also, the revenue coming from the top 2 clients namely MEWA and NWC account for more than ~80% of the total revenue.

Risk related to the revenue backlog: The company may experience variation in the realization of backlog due to project delays or cancellations, or external and economic factors beyond its control. This could have a significant impact on the top and bottom lines. Also determining the backlog is difficult and different companies may define it differently.

Risk related to sustaining growth: Key risks involved in sustaining growth include attracting new clients, successfully bidding for new projects, securing specialized equipment, expanding to the new geography, etc. Also, large projects are many a time dependent on external finance and if the client is not able to secure adequate finance it may reduce the scope of the project.

Risk to oil prices: Any dramatic fall in oil prices can lead up to a slowdown of projects rolled out by the government impacting the company's future revenues and profitability directly.

Risks related to the use of percentage-of-completion accounting: If the company fails to define the main stages of the project output and assess the value of each stage, this will lead to inaccurate revenues based on the method of measuring the project completion percentage, which would have a material adverse effect on the company's business.

Risks related to contract assets: If contract assets are not invoiced as a result of a client not accepting the executed works for any reason, the Company may have to adjust its revenues accordingly. In this case, gross profit may be affected due to the gap resulting from the adoption of the contract completion stage method for revenue recognition and the method of cost until project completion (on an "as and when incurred basis") to recognize costs.

Key financials

Figure 29. **Income Statement**

SARmn	2021	2022E	2023E	2024E	2025E
Sales	569	841	1,416	1,832	1,795
<i>y-o-y growth</i>	9.3%	47.8%	68.4%	29.4%	-2.0%
Cost of Sales	(418)	(633)	(1,074)	(1,398)	(1,379)
Gross Profit	151	208	342	434	416
<i>y-o-y growth</i>	5.7%	37.0%	65.0%	0.0%	0.0%
<i>margins</i>	26.6%	24.7%	24.2%	23.7%	23.2%
Selling and Distribution	(2)	(2)	(6)	(6)	(6)
General and administrative expenses	(37)	(48)	(78)	(101)	(90)
Impairment loss on trade rec	0	(10)	0	0	0
Operating Income	113	148	259	327	320
<i>y-o-y growth</i>	-3.6%	31.7%	74.6%	26.2%	-2.0%
<i>margins</i>	19.8%	17.6%	18.3%	17.8%	17.8%
Gain on sales of property and equipment	1	0	0	0	0
Finance cost	(4)	(13)	(34)	(54)	(50)
Other income, net	2	2	0	0	0
Share of loss from an associate	0	(5)	0	0	0
Profit before tax	111	132	225	273	270
Zakat & Tax	(8)	(14)	(18)	(22)	(22)
Net Income	103	118	207	251	248
<i>y-o-y growth</i>	-9.3%	14.2%	75.2%	21.4%	-1.0%
<i>margins</i>	18.2%	14.0%	14.6%	13.7%	13.8%
EPS	4.1	4.7	8.3	10.0	9.9
DPS	3.0	0.0	0.0	0.0	3.0

Source: Company Data, Al Rajhi Capital



Figure 30. **Balance Sheet**

SARmn	2021	2022E	2023E	2024E	2025E
Cash and bank balances	42	296	390	361	422
Inventories	36	52	88	115	113
Prepayments and other assets	46	67	113	147	144
Contract assets	236	346	582	753	738
Trade and other receivables	241	346	582	753	738
Total Current Assets	601	1,107	1,756	2,129	2,155
Non Current Assets					
Property and equipment	147	189	209	244	285
Right of use assets	3	3	3	3	3
Total Non-Current Assets	151	192	212	247	288
Total Assets	751	1,299	1,968	2,376	2,443
Current Liabilities					
Trade payables, accruals and other liabil	121	191	353	460	453
Current portion of term loans	159	405	615	650	580
Current portion of lease liabilities	0	0	0	0	0
Amounts due to related parties	0	0	0	0	0
Zakat payables	8	8	8	8	8
Total Current Liabilities	288	604	976	1,118	1,042
Non-current liabilities					
Employees' defined benefit liabilities	44	44	44	44	44
Non-current portion of lease liabilities	3	3	3	3	3
Non-current portion of term loans	60	174	264	279	249
Total Non-current liabilities	107	220	310	325	295
Total Liabilities	395	825	1,287	1,443	1,337
Shareholders' Equity					
Share capital	250	250	250	250	250
Statutory reserve	22	22	22	22	22
Retained earnings	88	206	413	664	837
Actuarial valuation reserve	(3)	(3)	(3)	(3)	(3)
Total Shareholders' Equity	357	475	681	932	1,105
Total Liabilities & Shareholder Equity	751	1,299	1,968	2,376	2,443

Source: Company Data, Al Rajhi Capital

Figure 31. **Cash Flow Statement**

(SARmn)	2021	2022E	2023E	2024E	2025E
Cash flow from Operations	(9)	(31)	(144)	2	331
Cash flow from Investing Activities	(99)	(74)	(61)	(81)	(95)
Cash flow from Financing Activities	68	359	300	50	(175)
Change in cash	(39)	254	94	(29)	61

Source: Company Data, Al Rajhi Capital

Figure 32. **Key Ratios**

	2021	2022E	2023E	2024E	2025E
ROA	13.7%	9.1%	10.5%	10.6%	10.2%
ROE	29.0%	24.9%	30.3%	26.9%	22.5%
Cash Conversion Cycle (Days)	232	220	210	210	210
Debt-Equity Ratio	0.62	1.23	1.29	1.00	0.75
Debt to Capital	38.4%	55.1%	56.4%	50.0%	42.9%
Interest coverage ratio (x)	35.9x	14.6x	9.2x	7.2x	7.9x

Source: Company Data, Al Rajhi Capital



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Al Rajhi Capital uses a three-tier rating system based on absolute upside or downside potential for all stocks under its coverage except financial stocks and those few other companies not compliant with Islamic Shariah law:

"Overweight": Our target price is more than 10% above the current share price, and we expect the share price to reach the target on a 12 month time horizon.

"Neutral": We expect the share price to settle at a level between 10% below the current share price and 10% above the current share price on a 12 month time horizon.

"Underweight": Our target price is more than 10% below the current share price, and we expect the share price to reach the target on a 12 month time horizon.

"Target price": We estimate target value per share for every stock we cover. This is normally based on widely accepted methods appropriate to the stock or sector under consideration, e.g. DCF (discounted cash flow) or SoTP (sum of the parts) analysis.

Please note that the achievement of any price target may be impeded by general market and economic trends and other external factors, or if a company's profits or operating performance exceed or fall short of our expectations.

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