

## Middle East Paper Co.

Strong beneficiary of ambitious growth plans and Saudi's Vision 2030; we initiate with a Hold on NT price pressure

- **MEPCO is a cost leader with cash costs 16% below the global cost curve on backward integration and low energy costs.** Local prices are 5-10% higher than import prices as Saudi Arabia prioritizes localization of production, with MEPC creating significant EVA even as selling prices normalize.
- **Anti-dumping duties are extended to Germany, France, and India, with law ratification expected in Q2 23e.**
- **We expect 55% lower EPS in FY23e due to 21% drop in prices y/y on a slowdown in global demand.** However, we pencil in a 10% revenue CAGR FY 23-26e aided by the inauguration of Juthor in Q2 23e.
- **Weaker near-term earnings outlook is fully discounted, with the stock trading at an EV/EBITDA 23e of 9x, in line with Saudi Market, but at a premium to the global peers on higher margins.** The upside for growth is substantial (PM5 expansion) with ROIC > WACC but would require sizable CapEx.

**MEPCO is the largest paper company in the Middle East, with a market share of 31% in Saudi** and a containerboard capacity of 475k tons. Saudi represented 61% of revenues in FY 20-22A. The company is committed to meeting growing local demand at a CAGR of 4.2%, reaching 1m tons in FY 24e. Exports represent 39% of revenues in FY 20-22A as the company capitalizes on its strategic location near Jeddah Islamic Port.

**MEPCO's cash costs are 16% below the global cost curve on backward integration and low energy costs.** We expect average cash costs of USD 353/t in FY 23-26e (ex. tissue costs), 16% below the global cost curve, thanks to backward integration as 85% of MEPCO's cash costs are based on recycled fiber pulp from WASCO (a wholly owned subsidiary), recycled water, supportive for its ESG rating. MEPCO's energy costs represent 5% of total costs, well below the global average of 15-30% on lower energy prices (HFO is procured at a 92% discount to global prices) and efficiency. The company produces 100% of its own power needs at a 35% discount to grid price thanks to a captive generation facility with a capacity of 49 Mwh.

**We expect EPS to fall by 55% y/y in FY 23e on 21% lower average selling prices.** We expect the EBITDA margin to drop by 10 ppts y/y to 26% in FY 23e on i) 21% lower selling prices as global growth slows down to c2% and ii) a GPM of 10% for the tissue plant, compared to 31% at the containerboard, on an initially suboptimal utilization rate of 30%. We expect net income to gradually recover to SAR 231m in FY 26e, growing at a CAGR of 23% in FY 23-26e, driven by a ramp-up of production to 60k tons in FY 26e (up from 18k tons in FY 23e) from the newly added tissue paper, manufacturing capacity at Juthor, and a slight pick-up in selling prices at a CAGR of 3%. We expect RoE and RoA to fall back to 13% and 8%, respectively, in FY 23-26e as we pencil in lower margins, from the record levels achieved in FY 22A (RoE: 25%).

**We expect FCFY expansion to 9% in FY 24-26e as CapEx normalize despite continued ambitious growth plans.** We expect a FCF yield of 9% in FY 24-26e (+3 ppts vs. FY 20-22A), despite working capital and CapEx requirements of SAR 148m p.a. on an 11% EBITDA growth at a resilient EBITDA margin of 27%. We expect CapEx to drop by 60% y/y in FY 24e, with most of Juthor's CapEx behind it. We expect DY to remain at 2% in FY 23-26e on growth opportunities, expanding containerboard capacity, and/or M&A.

**The stock trades in line with Saudi market but at a 29% premium to global peers on substantial growth in the medium term, and significantly higher margins.** MEPCO trades a 29% premium to peers on FY 24e P/E of 11x but generates an above-average EBITDA margin of 26% (+8 ppts vs. peers) and has a lower effective tax rate. Key upside risks are i) PM5 expansion that could increase containerboard capacity by 84% on adding 400k tons in FY 26e at an investment cost of SAR 1.5bn; the expansion could add 51% to our FY 26-27e EBITDA and SAR 9/share to our TP at an IRR of 16%, and ii) the extension of anti-dumping duties to Germany, Spain and India – pending law ratification (currently on imports from Spain and Poland) could result in 5-10% hike in local prices and 18-36% higher TP, as Saudi Arabia is prioritizing local manufacturing.

**HOLD**

**SAR 34.5**

### Industrials / Saudi Arabia

Bloomberg code	MEPC AB
Market index	TADAWUL
Target Price	34.5
Upside (%)	6.4

### Market data 4/5/2023

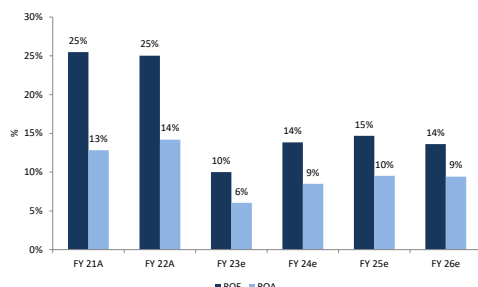
Last closing price	32.4
52 Week range	25.5-51.0
Market cap (SAR m)	2,160
Market cap (USD m)	576
Average Daily Traded Value (SAR m)	22.0
Average Daily Traded Value (USD m)	5.8
Free float (%)	81%

Year-end (local m)	2022	2023e	2024e	2025e
Revenues	1,187	1,043	1,234	1,379
EBITDA	424	273	331	367
Net income	271	123	187	222
EPS	4.06	1.84	2.80	3.33
EPS growth (%)	22.5	(54.6)	51.8	18.9
P/E (current price)	7.9	17.4	11.4	9.6
DPS	0.75	0.46	0.56	0.67
Div. yield (%)	2.3	1.4	1.7	2.1
FCF/share	1.6	(0.8)	2.2	2.8
FCF yield (%)	4.9	(2.6)	6.8	8.8
CAPEX	142	275	92	94
CAPEX/sales (%)	12.0	26.4	7.4	6.8
Net Debt/EBITDA (x)	1.0	2.0	1.4	0.9
EV/EBITDA (x)	6.0	9.4	7.7	7.0
RoAE (%)	25.0	10.0	13.8	14.7
RoIC (%)	20.5	9.5	11.6	12.9

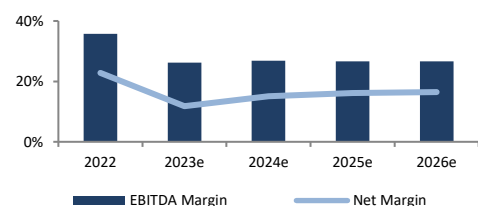
## Abacus

### Arqaam Capital Fundamental Data

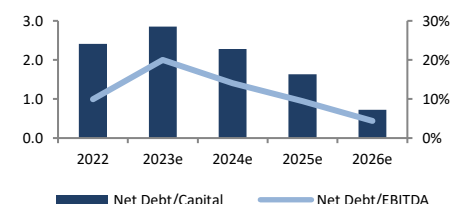
#### Profitability



#### Growth



#### Gearing



## Middle East Paper Co.

Year-end	2021	2022	2023e	2024e	2025e	2026e
<b>Financial summary</b>						
Reported EPS	3.32	4.06	1.84	2.80	3.33	3.46
Diluted EPS	3.32	4.06	1.84	2.80	3.33	3.46
DPS	0.75	0.75	0.46	0.56	0.67	0.69
BVPS	54.10	65.02	70.09	78.31	88.09	98.24

Year-end	2021	2022	2023e	2024e	2025e	2026e
<b>Valuation metrics</b>						
P/E (x) (current price)	9.7	7.9	17.4	11.4	9.6	9.2
P/E (x) (target price)	10.4	8.5	18.7	12.3	10.4	10.0
EV/EBITDA (x) (current price)	7.6	6.0	9.4	7.7	7.0	6.8
EV/EBITDA (x) (target price)	7.5	5.9	9.2	7.6	6.8	6.7
EV/FCF (x)	18.1	24.6	(46.9)	17.6	13.6	10.1
Free cash flow yield (%)	6.6	4.9	(2.6)	6.8	8.8	11.8
Dividend yield (%)	2.3	2.3	1.4	1.7	2.1	2.2

Year-end	2021	2022	2023e	2024e	2025e	2026e
<b>Growth (%)</b>						
Revenues	45.9	12.3	(12.2)	18.3	11.8	1.8
EBITDA	125.6	25.9	(35.6)	21.5	10.7	1.8
EBIT	448.5	36.2	(47.3)	33.8	15.2	2.2
Net income	995.5	22.5	(54.6)	51.8	18.9	3.9

Year-end	2021	2022	2023e	2024e	2025e	2026e
<b>Margins (%)</b>						
EBITDA	31.8	35.7	26.2	26.9	26.6	26.6
EBIT	22.5	27.2	16.3	18.5	19.0	19.1
Net	20.9	22.8	11.8	15.1	16.1	16.4

Year-end	2021	2022	2023e	2024e	2025e	2026e
<b>Returns (%)</b>						
RoAA	12.8	14.2	6.0	8.5	9.5	9.4
RoAE	25.5	25.0	10.0	13.8	14.7	13.6
RoIC	16.9	20.5	9.5	11.6	12.9	12.9
FCF margin	6.6	4.9	(2.6)	6.8	8.8	11.8

Year-end	2021	2022	2023e	2024e	2025e	2026e
<b>Gearing (%)</b>						
Net debt/Capital	25.3	24.1	28.5	22.8	16.3	7.3
Net debt/Equity	43.0	35.7	42.8	32.8	21.8	9.2
Interest cover (x)	16.4	17.5	7.2	11.9	16.6	22.3
Net debt/EBITDA (x)	1.3	1.0	2.0	1.4	0.9	0.4

## Abacus *Arqaam Capital Fundamental Data*

### Company Profile

Middle East Paper Co is the largest paper company in the Middle East, with a containerboard capacity of 475k tons. MEPCO's main market is Saudi, with around 31% market share, representing c.61% of revenues in FY 20-22A.

The company is committed to meeting growing local demand at a CAGR of 4.2% reaching 1m tons in FY 24e. Exports represent c.39% of revenues in FY 20-22A as the company capitalizes on its strategic location, near Jeddah Islamic Port.

### Investment thesis

**MEPCO's cash costs are 16% below the global cost curve**, thanks to backward integration as 85% of MEPCO's cash costs are based on recycled fiber pulp from WASCO (a wholly owned subsidiary) and recycled water. MEPCO's energy costs represent 5% of total costs, which is well below the global average of 15-30% on lower energy prices (HFO is procured at 92% discount to global prices) and efficiency.

**Local prices are 5-10% ahead of import prices** on anti-dumping duties as Saudi Arabia prioritizes local production.

**FCF should expand at 9% in FY 24-26e on normalizing CapEx.**

**MEPCO moves toward diversification** with the inauguration of 60k tissue paper plant in Q2 23e.

**PM5 should double production capacity** by adding 400k tons at an investment cost of SAR 1.5bn.

**WASCO is well-positioned to capitalize on Saudi vision 2030 and the KSA government's environmental ambitions.**

**We expect 55% lower net profit y/y to SAR 123m in FY 23e** as we assume EBITDA margin to drop by 10 ppts y/y at 26% in FY 23e on i) 21% lower selling prices as global slowdown looms and ii) a GPM of 10% for the tissue plant, compared to 31% at the containerboard, on a suboptimal utilization rate of 30%. This is slightly ahead of the annualized Q4 22A result.

**Gearing should drop significantly** on strong cash flow generation, despite high CapEx and working capital requirements.

**The PM5 expansion could add 51% to our FY 26-27e EBITDA, assuming a gradual pick-up in utilization rate. PM5 would add 26% to our TP or SAR 9/share.**

**The stock trades at EV/EBITDA 9x and P/E of 17x in FY 23e, in-line with Saudi market, but at a 29% premium to global peers on higher margins and growth prospects.**

### Middle East Paper Co.

Year-end	2021	2022	2023e	2024e	2025e	2026e
<b>Income statement (SARmn)</b>						
Sales revenue	1,057	1,187	1,043	1,234	1,379	1,403
Cost of sales	(663)	(684)	(721)	(833)	(923)	(938)
<b>Gross profit</b>	<b>394</b>	<b>503</b>	<b>322</b>	<b>401</b>	<b>456</b>	<b>465</b>
SG&A	-	-	-	-	-	-
<b>EBITDA</b>	<b>337</b>	<b>424</b>	<b>273</b>	<b>331</b>	<b>367</b>	<b>374</b>
Depreciation	(99)	(100)	(102)	(103)	(104)	(105)
<b>EBIT</b>	<b>237</b>	<b>323</b>	<b>170</b>	<b>228</b>	<b>263</b>	<b>268</b>
Interest expense	(14)	(18)	(24)	(19)	(16)	(12)
Share of results of associates & JV	-	-	-	-	-	-
Profit before tax	228	286	131	200	237	247
Taxes	(7)	(15)	(9)	(13)	(15)	(16)
<b>Other post-tax income/(expense)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
Net profit (group)	221	271	123	187	222	231
Minorities	-	-	-	-	-	-
<b>Net profit (parent)</b>	<b>221</b>	<b>271</b>	<b>123</b>	<b>187</b>	<b>222</b>	<b>231</b>
Arqaam adjustments (including dilution)	-	-	-	-	-	-
<b>Arqaam Net profit</b>	<b>221</b>	<b>271</b>	<b>123</b>	<b>187</b>	<b>222</b>	<b>231</b>

Year-end	2021	2022	2023e	2024e	2025e	2026e
<b>Balance sheet (SARmn)</b>						
Cash and equivalents	264	145	93	152	189	309
Receivables	307	314	319	377	429	437
Inventories	144	213	259	306	343	349
Tangible fixed assets	1,064	1,106	1,278	1,266	1,256	1,246
Other assets including goodwill	92	169	169	169	169	169
<b>Total assets</b>	<b>1,870</b>	<b>1,947</b>	<b>2,118</b>	<b>2,270</b>	<b>2,386</b>	<b>2,509</b>
Payables	135	124	131	155	174	177
Interest bearing debt	686	567	639	618	537	473
Other liabilities	66	74	74	74	74	74
<b>Total liabilities</b>	<b>887</b>	<b>764</b>	<b>844</b>	<b>846</b>	<b>784</b>	<b>723</b>
Shareholders equity	983	1,181	1,273	1,423	1,600	1,785
Minorities	-	1	1	1	1	1
<b>Total liabilities &amp; shareholders equity</b>	<b>1,870</b>	<b>1,947</b>	<b>2,118</b>	<b>2,270</b>	<b>2,386</b>	<b>2,509</b>

Year-end	2021	2022	2023e	2024e	2025e	2026e
<b>Cash flow (SARmn)</b>						
<b>Cashflow from operations</b>	<b>211</b>	<b>246</b>	<b>220</b>	<b>237</b>	<b>281</b>	<b>347</b>
Net capex	(70)	(142)	(275)	(92)	(94)	(96)
<b>Free cash flow</b>	<b>141</b>	<b>104</b>	<b>(54)</b>	<b>145</b>	<b>188</b>	<b>252</b>
Equity raised/(bought back)	-	167	-	-	-	-
Dividends paid	50	(50)	(31)	(37)	(44)	(46)
Net inc/(dec) in borrowings	108	(1)	70	(61)	(61)	(61)
Other investing/financing cash flows	(14)	(18)	(24)	(19)	(16)	(12)
<b>Net cash flow</b>	<b>214</b>	<b>(125)</b>	<b>(52)</b>	<b>58</b>	<b>37</b>	<b>120</b>
Change in working capital	(77)	(169)	(44)	(81)	(70)	(10)

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## Investment case

- MEPCO's cash costs are 16% below the global cost curve on backward integration and cheap energy feedstock. Local prices are 5-10% ahead of import prices on anti-dumping duties as Saudi Arabia prioritizes local production, producing significant EVA (ROIC > WACC).
- MEPCO scores well on ESG, as 85% of cash costs are based on recycled materials.
- FCF should expand at 9% in FY 24-26e on normalizing CapEx.
- MEPCO moves toward diversification; inauguration of 60k tissue paper plant in H1 23e. Meanwhile, PM5 should double its production capacity by adding 400k tons at an investment cost of SAR 1.5bn, offering a resilient IRR of 16%, well above its WACC.
- Nevertheless, we expect EBITDA margin to fall by ten ppts y/y in FY 23e on lower selling prices (global slowdown) coupled and lower margins from the tissue plant, with negative y/y EPS growth expected for Q1/2 23e.
- The soft NT earnings outlook is discounted in the share price, with the stock trading at EV/EBITDA 23e of 9x and P/E of 17x, ~ the overall Saudi market (P/E of c15x).

### MEPCO's cash costs are 16% below the global cost curve on backward integration and energy costs.

MEPCO's cash costs have averaged USD 334/t in FY 17-21A, despite global fluctuations in OCC prices, thanks to backward integration as 85% of MEPCO's cash costs are based on recycled fiber pulp from WASCO (a wholly owned subsidiary) and recycled water.

The company produces 100% of its power needs at a 35% discount to grid price thanks to a captive generation facility with a capacity of 49 Mwh. The in-house electricity generation capacity provides low energy costs and a secured power supply. Energy represents only 5% of total costs, well below the global average of 15-30% on lower energy prices (HFO is procured at a 92% discount to global prices) and efficiency.

#### Exhibit 1: MEPCO is 24% below the global electricity usage at 0.7 Mwh/t on higher energy efficiency factor

Mwh/t	1991	2000	2010	2015	2019	2020	MEPCO % Change
Electricity consumption	1.2	1.1	1.1	1.0	0.9	0.9	0.7 -24%

Source: Cepi Statistics, Company Data, Arqaam Capital Research

#### Exhibit 2: MEPCO's cash costs are 16% below the global cost curve on backward integration and lower energy costs

USD/ton	FY 17A	FY 18A	FY 19A	FY 20A	FY 21A	FY 22A
Raw materials	256	279	253	220	270	284
Employees costs	45	49	45	39	48	50
Transportation costs	13	11	10	8	10	10
Rent	7	9	1	1	1	1
Other overheads	15	21	19	20	19	17
<b>Cost/ton</b>	<b>336</b>	<b>369</b>	<b>328</b>	<b>287</b>	<b>348</b>	<b>361</b>

Source: Company Data, Arqaam Capital Research

### WASCO plays a vital role in MEPCO's backward integration, securing raw materials at challenging logistical time

The Waste Collection and Recycling Co, WASCO, handles 50% of KSA's recyclable waste paper through landfill concessions, long-term supply contracts with major retailers, and direct collections. WASCO plays a vital role in MEPCO's backward integration, providing more than 75% of the raw material used in MEPCO production. WASCO secured a steady supply of raw materials for MEPCO, despite local curfews in Saudi and a drastic reduction in commercial and industrial waste volumes.

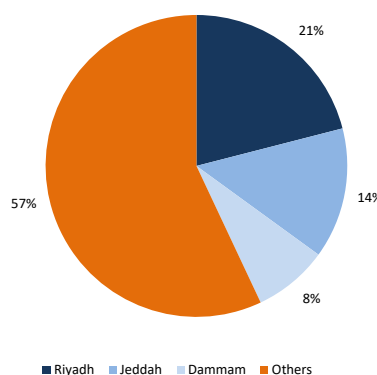
WASCO is well-positioned to capitalize on Saudi Vision 2030 and the KSA government's environmental ambitions. The Saudi government launched a National Centre for Waste Management that aims to force the principles of a circular economy and regulate the waste management sector to enhance environmental protection. Saudi Arabia produces about 53m tons of waste p.a. According to the National Center for Waste Management, the environmental degradation caused by solid waste in FY 21A was estimated at USD 1.3bn.

**Exhibit 3: Key regulatory bodies in Saudi's waste management sector**

Key Player	Role
Ministry of Environment, Water, & Agriculture (MEWA)	Regulates and implements all of the country's policies for the environmental, water and agricultural sectors.
National Center for Waste Management (MWAN)	Regulates and supervises waste management activities and promotes principle of circular economy in waste management to achieve sustainable development goals.
National Center for Environmental Compliance (NCEC)	Oversees issuance of licensing and accreditation services to organizations offering environmental services. The center issues service facilities and activities with impact on the environment.

Source: International Trade Administration, Arqaam Capital Research

**Exhibit 4: Nearly half of Saudi's total waste comes from Riyadh, Jeddah and Dammam**



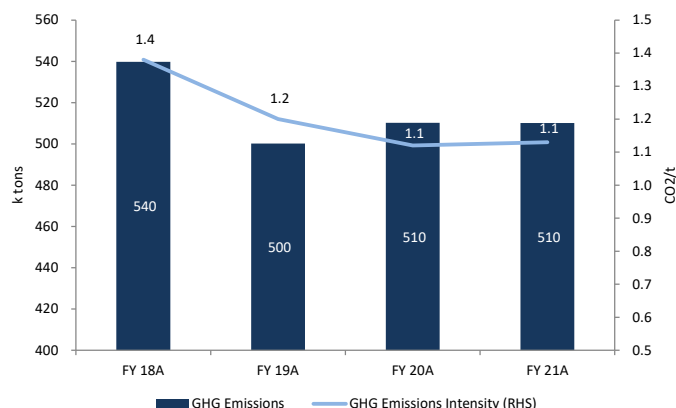
Source: International Trade Administration, Arqaam Capital Research

### MEPCO is environmentally friendly, as 85% of cash costs are based on recycled raw materials

Being a heavily regulated industry due to intensive depletion of natural resources namely water, forests, and electricity, MEPCO is well positioned thanks to the consumption of recycled materials, representing 85% of MEPCO's cash costs. The company has lowered its greenhouse gas (GHG) emissions intensity by 18% in FY 18-21A by installing flue-gas desulphurization technology, renovating the effluent treatment plant, and raising factory chimneys from 30 to 90 meters. The company also installed 66 high-powered fans to enhance air circulation.

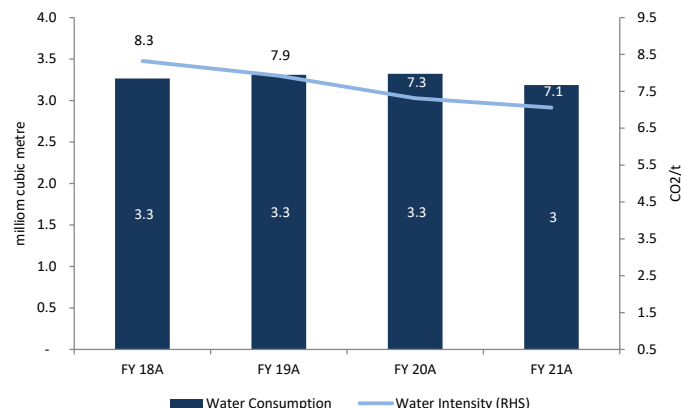
MEPCO relies on using recycled water from the municipal water treatment plant in Jeddah. The company invested in Effluent Treatment Plant (ETP) to increase volumes of recycled water and improve recycled water quality. Also, the company deployed and upgraded systems such as flash aeration tank, sedimentation tank, gas buffer and degasification tanks, which helped reduce water consumption by 3% in FY 20A and 4% in FY 21A as the ETP is fully operational. MEPCO uses recycled paper post-consumer/pre-consumer as inputs. The conversion from recycled paper to the end product is approximately 1.1 to 1.0x.

**Exhibit 5: GHG emissions intensity dropped a cumulative 18% in FY 18-21A on enhanced desulphurization technology and air circulation systems**



Source: Company Data, Arqaam Capital Research

**Exhibit 6: Water intensity fell a cumulative 15% in FY 18-21A on upgraded systems, allowing for conserving 0.75m m3 and reduce waste discharge by 15%.**



Source: Company Data, Arqaam Capital Research

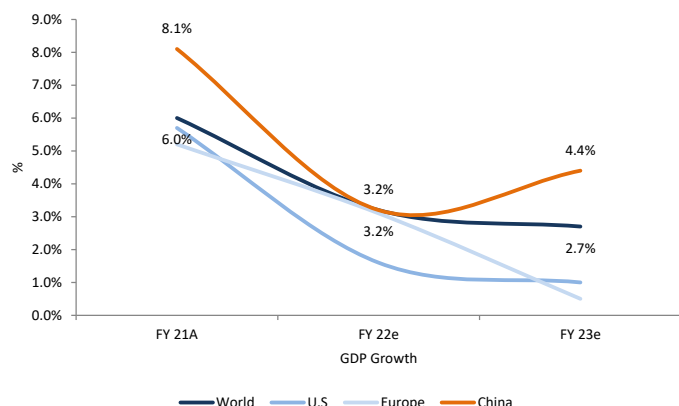
### Anti-dumping duties of 25-34% on Spain and Poland support local prices

The GCC's technical secretariat has decided to impose anti-dumping duties on imports of uncoated paper and paperboard (kraft liner or fluting or test liner) in rolls or sheets from Spain and Poland. The new duties came into effect in May-19 at 24.6-31.0% from Spain and 34.0% from Poland for CIF imports. Imports already represent a meaningful 36% of the Saudi market and imposing an import tariff supports local prices and Saudi's containerboard producers. Local prices are now 5-10% higher than global prices, thanks to tariffs, transportation, and clearance costs.

### Global slowdown and tightening monetary policy weigh on demand growth...

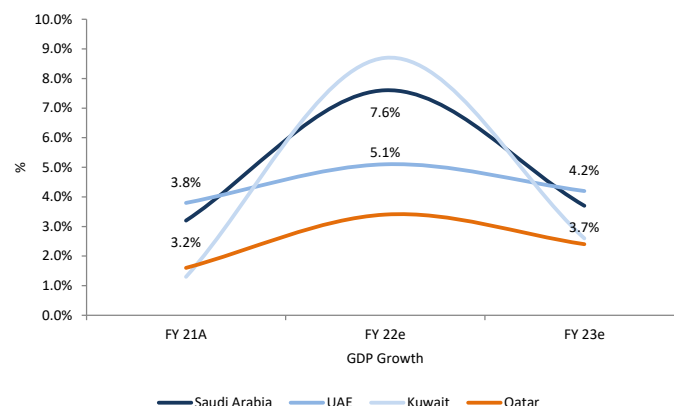
Global growth is expected to slow down to 2.7% in FY 23e (vs. 3.2% in FY 22e and 6.0% in FY 21A) driven by i) slowdown in Europe due to the energy crisis following the Russian invasion of Ukraine, ii) aggressive monetary tightening and a cost-of-living crisis on inflationary pressures in the US and iii) a slowdown in China due to the continued zero-covid policy and tumbling property market. The IMF growth to slow down to 2.7% in FY23e is 1 pts below the average growth rate in FY 20-21A. The world's three largest economies - China, the EU, and the US - should slow significantly in FY 22-23e. Global trade growth slows to 2.3% in FY 23e (vs. 4.3% in FY 22e and 10.1% in FY 21A), behind the historical average of 4.6% in FY 20-21A and 5.4% in FY 1970-2021. **The key upside to the outlook should come China re-opening**, with the earliest window in Q2 23, while EU and US should grow well below the trend in FY23/24e.

**Exhibit 7: Global GDP growth should normalize to 2.7% in FY 23e on a slowdown in US, Europe, and China, until China lifts its zero-covid policies (earliest Q2 23e)**



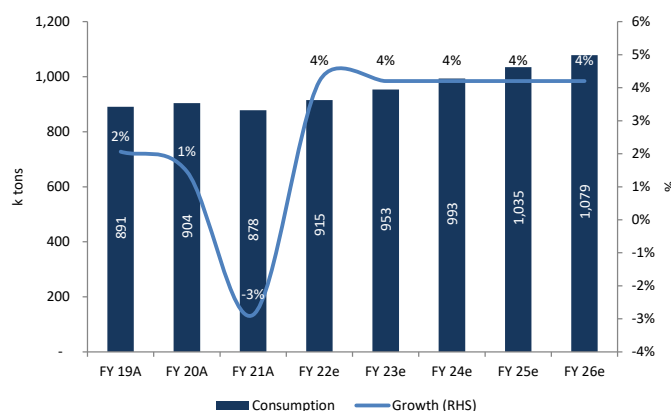
Source: IMF, Arqaam Capital Research

**Exhibit 8: GDP growth is also expected to slow down in the GCC, particularly in KSA and UAE, though this is largely partly explained by oil output dynamics**



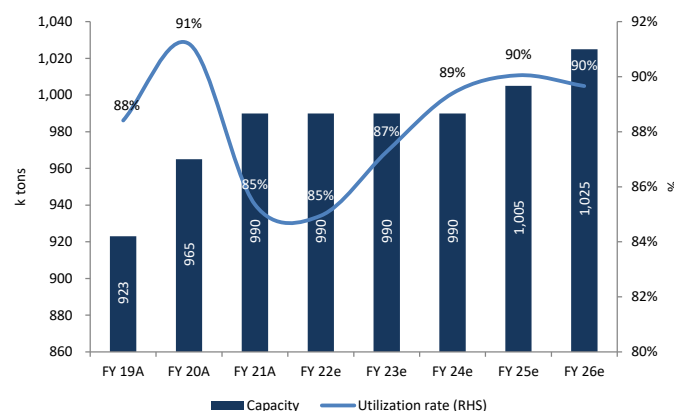
Source: Company Data, Arqaam Capital Research

**Exhibit 9: The Saudi recycled containerboard market should grow at 4% CAGR reaching 1m tons in FY 23e**



Source: Company Data, Arqaam Capital Research

**Exhibit 10: Resilient utilization rate of 85%+ in FY 22-26e for Saudi recycled containerboard producers**



Source: Company Data, Arqaam Capital Research

### ... resulting in 21% drop y/y in FY 23e containerboard prices

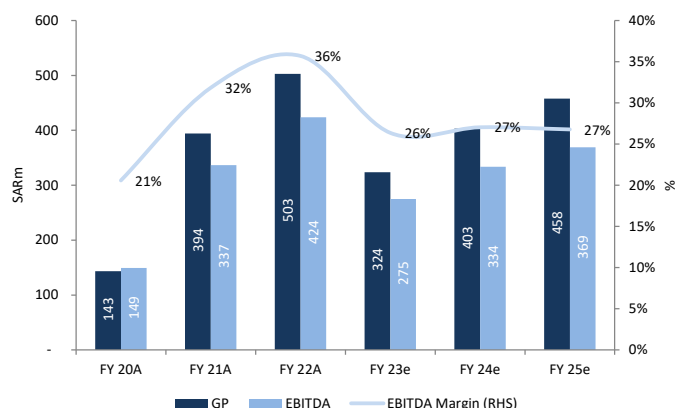
Demand for containerboard should fall back in FY 23e, with slow growth of the two largest consumer blocks namely Asia and Europe, representing 47% and 26% of total demand, respectively. In FY 23e, we expect MEPCO's selling prices to drop by 21% y/y to USD 600/t, following a 10% increase in FY 22A (+48% y/y in FY 21A), until China fully rolls back its zero-covid policies, while EU and US growth will remain well below trend for FY 23e and FY 24e. We expect prices to grow at a 3% CAGR in FY 23-26e as packaging, e-commerce, tissue papers, and hygiene products should drive the LT demand growth of the paper and paperboard market.



### We expect the EBITDA margin to shrink by 10 ppts y/y in FY 23e on lower selling prices coupled with lower margins for the new tissue plant

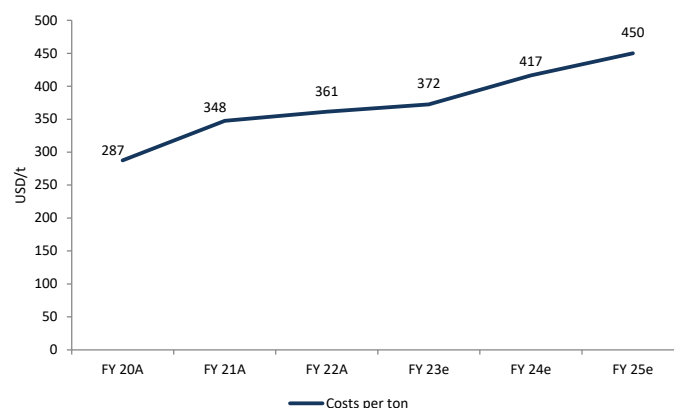
We expect EBITDA margin to drop 10 ppts y/y at 26% in FY 23e on i) 21% lower selling prices on demand destruction from the global slowdown and ii) a GPM of only 10% for the tissue plant, compared to 31% at the containerboard, on a suboptimal utilization rate of 30%. Yet, we expect 11% EBITDA CAGR in FY 23-26e on volume and price growth beyond FY 23e. As for Juthor, we expect GPM to expand to 25% in FY 25e (vs. 10% in FY 23e) on a higher utilization rate of 100% driving economies of scale. We assume an average EBITDA margin of 27% in FY 23-26e (vs. 34% in FY 21-22A) as Juthor's GPM should be c.25% (vs. 40% in FY 21-22A on MEPCO's level).

**Exhibit 11: We expect EBITDA margin to normalize at 26% in FY 23e on lower selling prices and slimmer margins at tissue plant**



Source: Company Data, Arqaam Capital Research

**Exhibit 12: Cash costs should increase 25% to USD 450/t in FY 25e, up from USD 361/t in FY 22A, on the expansion into finals products of higher costs per ton**



Source: Company Data, Arqaam Capital Research

**Exhibit 13: We assume cash costs to grow at 6% CAGR in FY 22-26e (vs. 3% in FY 19-22A) thanks to higher employees, transportation costs and the inauguration of tissue plant in FY 23e.**

USDm	FY 18A	FY 19A	FY 20A	FY 21A	FY 22A	FY 23e	FY 24e	FY 25e	FY 26e
Raw materials and OCC costs	98	87	89	110	116	109	115	117	119
Employees costs	17	15	16	19	20	21	22	23	23
Transportation costs	4	3	3	4	4	4	4	5	5
Rent	3	0	0	0	0	0	0	0	0
Other overheads	7	7	8	8	7	7	8	8	8
Tissue costs					-	23	45	66	66
<b>Total costs</b>	<b>129</b>	<b>113</b>	<b>117</b>	<b>142</b>	<b>148</b>	<b>165</b>	<b>195</b>	<b>218</b>	<b>222</b>
<b>Total costs (USD/ton)</b>	<b>369</b>	<b>328</b>	<b>287</b>	<b>348</b>	<b>361</b>	<b>372</b>	<b>417</b>	<b>450</b>	<b>458</b>

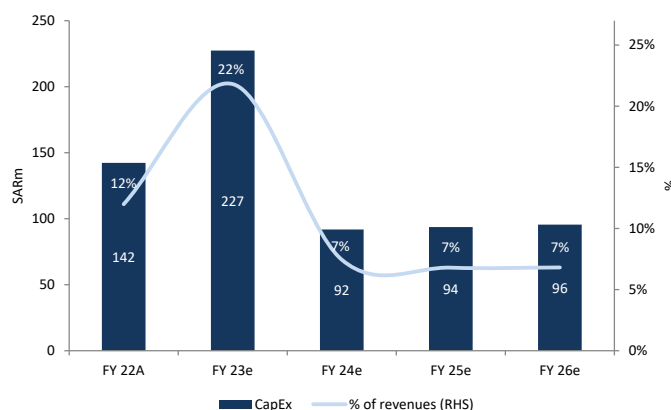
Source: Company Data, Arqaam Capital Research

### FCFY should expand to 9% in FY 24-26e on normalizing CapEx but DY is capped at 2% on ambitious growth plans.

We expect a FCF yield of 9% in FY 24-26e (+3 ppts vs. FY 20-22A), despite combined outflows of SAR 148m p.a from working capital and CapEx, on a 11% EBITDA growth at a resilient EBITDA margin of 27%. We pencil in a DY of 2% in FY 23-26e, on growth opportunities that could potentially stem from further greenfield projects (expanding containerboard capacity) or mergers and acquisitions.

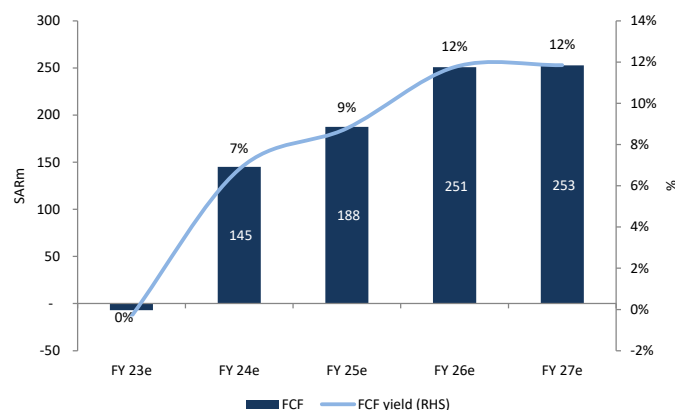
We expect CapEx to drop by 60% y/y in FY 24e, as most of Juthor's Capex should be digested by then. Juthor should be commercially operational in Q2 23e. We assume a maintenance CapEx of SAR 94m p.a on average in FY 24-26e at 7% of revenues.

**Exhibit 14: We expect CapEx to normalize in FY 24-26e after the completion of Juthor's CapEx**



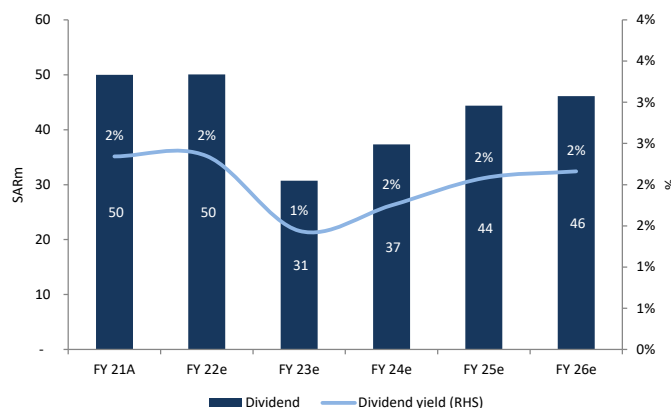
Source: Company Data, Arqaam Capital Research

**Exhibit 15: We expect a FCF yield of 9% in FY 24-26e as CapEx normalizes coupled with 11% EBITDA growth**



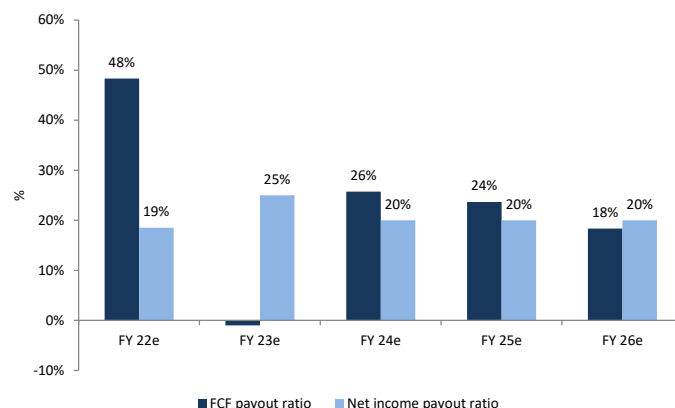
Source: Company Data, Arqaam Capital Research

**Exhibit 16: We expect a DY of 2% in FY 23-26e as the company remains focused on growth**



Source: Company Data, Arqaam Capital Research

**Exhibit 17: FY 23e dividends should be paid out from MEPCO's B/S, on expanding capacity and WC outflows**



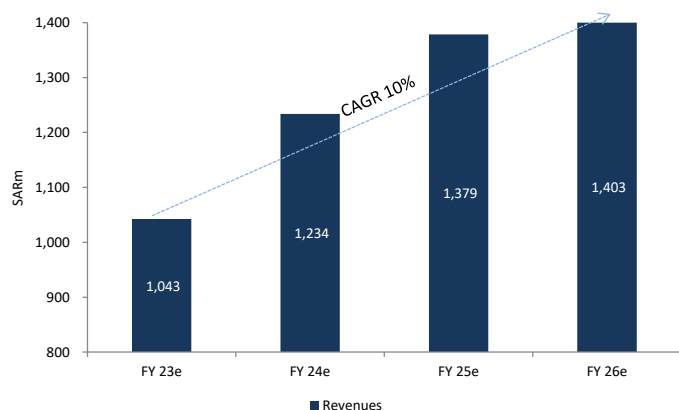
Source: Company Data, Arqaam Capital Research

## MEPCO moves toward product diversification; inauguration of 60k tissue paper plant in Q2 23e.

MEPCO established Juthor to produce tissue papers (jumbo rolls) at an annual capacity of 60k tons in FY 23e, mainly to cater to the domestic market. Tissue and hygienic paper represent MEPCO's first venture into consumer-oriented products. The tissue market is less volatile than containerboard, with a clear correlation with consumer spending and GDP growth. The new factory should be commercially operational in Q2 23e, built on an existing MEPCO land in the Industrial Valley in King Abdullah Economic City, and generating an estimated GPM of 25%.

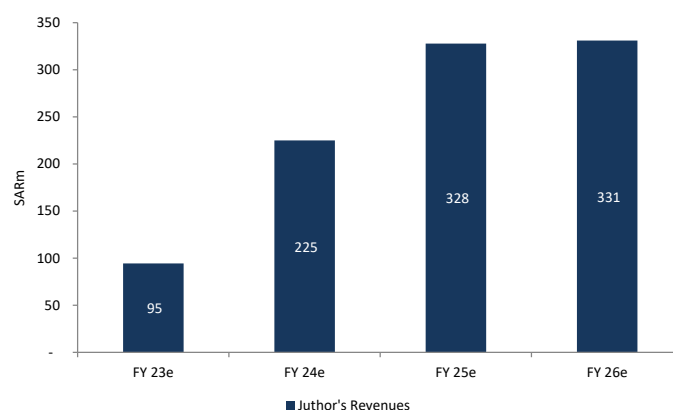
We expect revenues CAGR of 10% in FY 23-26e on the back of i) a gradual pick up in Juthor's utilization rate, starting at 30% in FY 23e and reaching 100% in FY 25e, capitalizing on import substitution and resilient local demand for hygiene products and ii) 3% growth in selling prices in FY 25-26e.

**Exhibit 18: We expect revenue CAGR of 10% in FY 23-26e on 3% growth in selling prices in FY 25-26e and...**



Source: Company Data, Arqaam Capital Research

**Exhibit 19: ... higher contribution from tissue paper plant on import substitution and resilient demand**



Source: Company Data, Arqaam Capital Research

### MEPCO plans to double containerboard capacity by adding 400k tons at an investment cost of SAR 1.5bn

MEPCO plans to add 400k tons of containerboard capacity at an investment cost of SAR 1.5bn at PM5. The project should cater to the growing demand in the local market (60% of volumes), and the balance should be exported (40% of volumes). MEPCO's board of directors approved proceeding to the final steps for the feasibility of its most significant expansion in the company's history. The facility will be designed to focus on lightweight containerboard grades at an estimated internal rate of return of 15%. The project relies on recovered paper as the key raw material, expanding MEPCO's sustainable practices and supporting investments in a circular economy.

Management expects to sign the final contracts in H1 23e, being at the final stages of its feasibility study, and targets a timeline of no more than 33 months from contract signing to operations. The project is expected to be financed by debt at 60-70% and equity at 40-30%.

In our view, the project is sizable and would require identifying targeted export markets and offering an import substitution product to replace current imported containerboard volumes representing 36% of the Saudi containerboard market. Also, given the sizable incremental capacity, the security of recycled raw material is crucial as WASCO's capacity is only 500k tons.

**The expansion could add 51% to our FY 26-27e EBITDA, assuming a gradual pick-up in utilization rate. PM5 would add 26% to our TP or SAR 9/share.**

**Exhibit 20: We expect a gradual pick-up in utilization rate reaching 100% in FY 28e and an execution period of 3 years.**

USDm	FY 26e	FY 27e	FY 28e	FY 29e
Capacity (k tons)	400	400	400	400
Utilization rate (%)	50%	80%	100%	100%
Price/ton (USD/t)	662	675	689	702
<b>Revenues</b>	<b>132</b>	<b>216</b>	<b>275</b>	<b>281</b>
GPM (%)	35%	37%	37%	37%
EBITDAM (%)	29%	30%	30%	30%

Source: Company Data, Arqaam Capital Research

**Exhibit 21: PM5 would add 26% to our TP or SAR 9/share at an IRR of 16%, and SAR 15/share in FY 26e as CapEx should be behind them.**

USDm	FY 23e	FY 24e	FY 25e	FY 26e	FY 27e	FY 28e	FY 29e	FY 30e
EBITDA				38	64	82	84	85
WC				(2)	(3)	(4)	(4)	(4)
Taxes				(2)	(4)	(5)	(5)	(6)
CapEx	(145)	(145)	(150)	(5)	(9)	(11)	(11)	(11)
<b>FCF</b>	<b>(145)</b>	<b>(145)</b>	<b>(150)</b>	<b>28</b>	<b>48</b>	<b>62</b>	<b>63</b>	<b>64</b>
PV FCF	(131)	(120)	(113)	19	30	35	33	30
PVOP	(247)							
PVTV	399							
NPV	152							
<b>Equity (SARm)</b>	<b>572</b>							
<b>Equity (SAR/share)</b>	<b>9</b>							
<b>IRR (%)</b>	<b>16%</b>							

Source: Arqaam Capital Research

**Exhibit 22: Possible scenarios for PM5's commercial production start, CapEx and margins**

Event	Impact on potential EBITDA	Impact on IRR
Delayed inauguration to FY 27e	-2%	15%
20% higher Capex	0%	10%
33% higher annual Opex	-8%	9%

Source: Arqaam Capital Research

## Valuation is fair, in-line with Saudi market; upside for growth is significant but would require sizable CapEx

We initiate with Hold at a DCF-derived TP of SAR 34.5/share.

We use the DCF approach based on Free Cash Flow to Firm (FCFF) to value MEPCO. We discount MEPCO's FCFF at an average WACC of 10%. We use a cost of equity of 13%, including a risk-free rate of 4.5%, an equity risk premium of 7%, and a beta of 1.2x, with the cyclicalities of containerboard prices. We set a DCF-based TP of SAR 34.5/share. Our TP implies 12x P/E in FY 24e, vs. a sector average of 9x, explained by an above-sector-average EBITDA margin of 27% (+9 pts vs. peers) and EBITDA CAGR of 11% in FY 23-26e.

### Exhibit 23: Valuation Summary

SARm	2023e	2024e	2025e	2026e	2027e
EBIT	170	228	263	268	269
(Taxes Paid)	(9)	(13)	(15)	(16)	(16)
+Depreciation	102	103	104	105	107
<b>COPAT</b>	<b>264</b>	<b>318</b>	<b>352</b>	<b>357</b>	<b>359</b>
Working capital changes	(44)	(81)	(70)	(11)	(9)
CAPEX	(227)	(92)	(94)	(96)	(97)
<b>Free cash flow</b>	<b>(7)</b>	<b>145</b>	<b>188</b>	<b>251</b>	<b>253</b>
PVOP	429				
PVTV	2,087				
<b>Enterprise Value</b>	<b>2,515</b>				
Debt	567				
Cash	145				
<b>Net Debt (FY 22A)</b>	<b>421</b>				
<b>Equity Value</b>	<b>2,094</b>				
Number of Shares (m shares)	67				
Fair Value (SAR/share)	31.4				
<b>Target Price (SAR/share)</b>	<b>34.5</b>				

Source: Company Data, Arqaam Capital Research

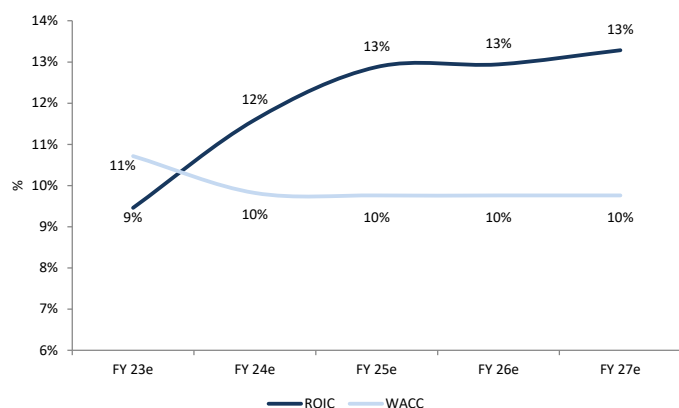
### ROIC is 3 pts above the WACC, and MEPCO creates substantial EVA

We expect an average ROIC of 13% in FY 23-27e, a 3 pts above our WACC of 10%, explained by i) 9% EBITDA CAGR thanks to the inauguration of tissue paper plant and ii) an EBITDA margin of 27% in FY 23-27e (9 pts above peers) on favorable cash costs of USD 357/t as energy represents only 5% of total costs (well below the global average of 15-30%) on lower energy prices (HFO is procured at 92% discount to global prices) and efficiency. This assumes RoE to normalize to 10% in FY 23e (-15 pts y/y) on 55% lower net income y/y at slimmer margins (-10 pts y/y) thanks to weaker selling prices and global slowdown.

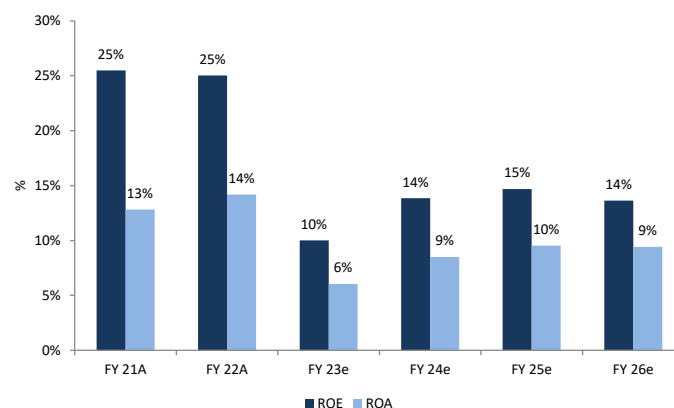
**Exhibit 24: WACC assumptions**

%	FY 23e	FY 24e	FY 25e	FY 26e	FY 27e
Weight of Equity	70%	61%	61%	61%	61%
Weight of Debt	30%	39%	39%	39%	39%
Ke	13%	13%	13%	13%	13%
Kd	6%	5%	5%	5%	5%
<b>WACC</b>	<b>10.7%</b>	<b>9.8%</b>	<b>9.8%</b>	<b>9.8%</b>	<b>9.8%</b>

Source: Arqaam Capital Research

**Exhibit 25: MEPCO create EVA as ROIC is 3 ppts ahead of WACC on favorable cash costs and EBITDA growth**


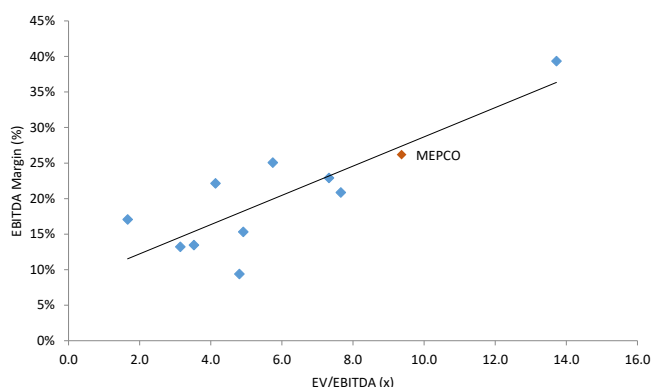
Source: Company Data, Arqaam Capital Research

**Exhibit 26: RoE should normalize to 13% in FY 23-27e (vs. 25% in FY 22A) on lower net income at slimmer margins**


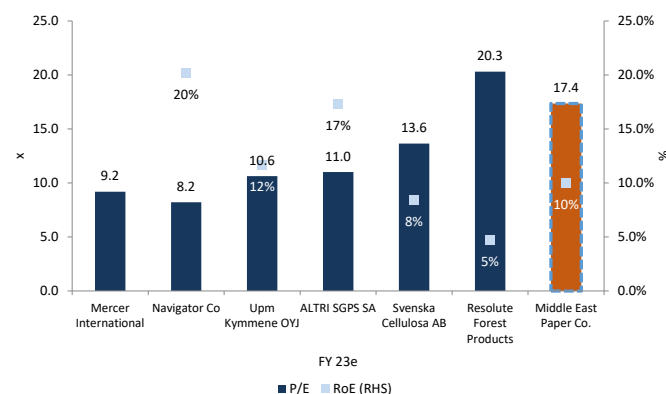
Source: Company Data, Arqaam Capital Research

## MEPCO trades in line with the Saudi market but at 29% premium to global peers, on higher-than-average EBITDAM, growth and lower taxes

MEPCO trades at a 29% premium to peers on FY 24e P/E of 11x, but generates an above-average EBITDA margin of 27% (+9 ppts vs. peers) in FY 23e and EBITDA growth of 11% in FY 23-26e, on capacity expansions and own production of power needs at 35% discount to grid price thanks to a captive generation facility with a capacity of 49 Mwh. The in-house electricity generation capacity maintains low energy costs and a secured power supply.

**Exhibit 27: MEPCO is fairly valued at the line, on higher-than-average EBITDA margin of 26%**


Source: Bloomberg, Arqaam Capital Research

**Exhibit 28: Despite sharply lower prices, MEPCO generates a RoE of 10% and trades at P/E of 17x in FY 23e**


Source: Bloomberg, Arqaam Capital Research

**Exhibit 29: MEPCO trades at 29% premium on FY 24e P/E of 11x, on 8 ppts higher EBITDA margin and 11% EBITDA growth.**

Company name	Country	Mkt Cap	P/E (x)		EV/EBITDA (x)		EBITDAM (%)		RoE (%)	DY (%)
		USD m	FY 23e	FY 24e	FY 23e	FY 24e	FY 23e	FY 23e	FY 23e	FY 23e
JK Paper	India	765	3.1	4.3	1.7	2.1	17%	21%	15%	
Canfor Pulp Products Inc	Canada	141	na	na	3.7	2.5	6%	-6%	na	
Hansol Paper Co	South Korea	212	3.2	2.7	4.8	4.4	9%	11%	6%	
ALTRI SGPS SA	Portugal	1,041	11.0	10.5	7.3	7.8	23%	17%	5%	
Mercer International Inc	US	635	9.2	5.7	4.9	4.2	15%	na	3%	
Resolute Forest Products	Canada	1,684	13.6	11.5	4.8	3.8	9%	8%	na	
Svenska Cellulosa AB	Sweden	9,078	20.3	19.0	13.7	12.9	39%	5%	2%	
Semapa Sociedade De Investim	Portugal	1,207	8.1	9.8	4.1	4.6	22%	10%	6%	
Upm Kymmene OYJ	Finland	17,761	10.6	10.6	7.7	7.2	21%	12%	5%	
Navigator Co	Portugal	2,512	8.2	12.1	5.7	6.6	25%	20%	8%	
Sappi Ltd	South Africa	1,530	4.3	5.8	3.1	3.8	13%	17%	6%	
Mpact Ltd	South Africa	241	5.4	5.3	3.5	3.4	13%	15%	4%	
<b>Median</b>		<b>1,124</b>	<b>8.2</b>	<b>9.8</b>	<b>4.8</b>	<b>4.3</b>	<b>16%</b>	<b>12%</b>	<b>6%</b>	
<b>Mean</b>		<b>3,067</b>	<b>8.8</b>	<b>8.8</b>	<b>5.4</b>	<b>5.3</b>	<b>18%</b>	<b>12%</b>	<b>6%</b>	
<b>Middle East Paper Co.</b>	<b>Saudi Arabia</b>	<b>569</b>	<b>17.4</b>	<b>11.4</b>	<b>9.4</b>	<b>7.7</b>	<b>26%</b>	<b>10%</b>	<b>1.4%</b>	
<b>Premium/(discount) to global peers</b>			<b>97%</b>	<b>29%</b>	<b>73%</b>	<b>46%</b>	<b>+8 ppts</b>	<b>-2 ppts</b>	<b>-5 ppt</b>	

Source: Bloomberg, Arqaam Capital Research

## Upside and downside risks to our valuation

**+ PM5 Expansion.** MEPCO plans to add 400k tons of containerboard capacity at an investment cost of SAR 1.5bn at PM5. The facility will be designed to focus on lightweight containerboard grades, at an estimated internal rate of return of 15%. Management expects to sign the contracts in Q2 23e, being at the final stages of its feasibility study, and targets a timeline of no more than 33 months from contract signing to operations. The expansion could add 51% to our FY 26-27e EBITDA, assuming a gradual pick-up in utilization rates. PM5 would add 26% to our TP or SAR 9/share.

**Exhibit 30: We expect an IRR of 16% with 26% upside to our TP at SAR 9/share and SAR 15/share in FY 26e as CapEx should be behind them.**

USDm	FY 26e	FY 27e	FY 28e	FY 29e
Capacity (k tons)	400	400	400	400
Utilization rate (%)	50%	80%	100%	100%
Price/ton (USD/t)	662	675	689	702
<b>Revenues</b>	<b>132</b>	<b>216</b>	<b>275</b>	<b>281</b>
GPM (%)	35%	37%	37%	37%
EBITDAM (%)	29%	30%	30%	30%

Source: Company Data, Arqaam Capital Research

**+ New anti-dumping duties.** The GCC's technical secretariat has decided to impose anti-dumping duties on imports of uncoated paper and paperboard (kraft liner or fluting or test liner) in rolls or sheets from Spain at 24.6-31.0% and Poland at 34.0% effective May-19. Imports already represent a meaningful 36% of the Saudi market and imposing an import tariff supports local prices and Saudi's containerboard producers. Assuming the extension of duties at 20-30% on average on Germany, France and India, this would result in a 5-10% premium to local prices and 18-36% higher TP.

**+ Higher-than-expected utilization rate/margins at new tissue plant.** MEPCO established Juthor to produce tissue papers (jumbo rolls) at an annual capacity of 60k tons in FY 23e, mainly to cater to the domestic market. The new plant should generate an estimated GPM of 25%. The new factory should be commercially operational in Q2 23e, built on existing MEPCO land in the Industrial Valley in King Abdullah Economic City. Management expects the plant to be operational in April-23. In our base case, we conservatively assume a utilization rate of 30% and GPM of 10% in FY 23e. Yet, if we assume a utilization rate of 60% and a GPM of 25%, our EPS and TP would be 11% and 3% higher, respectively.

**Exhibit 31: Possible scenarios for Juthor's commercial production start, CapEx and margins**

Event	Impact on FY 23e EBITDA	Impact on TP
60% utilization rate in FY 23e	+2%	+1%
25% GPM in FY 23e	+9%	+2%
20% higher Capex	0%	-5%

Source: Arqaam Capital Research



**+ Working Capital needs.** We expect a working capital outflow of SAR 125m in FY 23-24e (21% of COPAT) as we anticipate an increase in inventory of SAR 93m (outflows of SAR 47m p.a) and receivables of SAR 63m in FY 24e (outflows of SAR 32m p.a) mainly due to ramping up production at higher utilization rate of 70% in FY 24e for the new tissue paper plant which usually comes at higher receivables and inventory days on hand. If we assume lower-than-expected outflows from inventory and receivables of SAR 63m in FY 23-24e, our TP would be 5% higher.

**Exhibit 32: Our TP would be 5% higher if we incorporate a less conservative working capital assumptions**

Working Capital outflows	Impact on TP
<b>SAR 125m in FY 23-24e</b>	<b>0%</b>
25% lower outflows	2%
50% lower outflows	5%

Source: Arqaam Capital Research

**+ Utilization rate.** We expect resilient production volumes of 425k tons in FY 23-24e (flat y/y) at a stable utilization rate of 90%. We highlight the upside of undertaking efficiency or de-bottlenecking projects, which could elevate utilization rate to 95-100%.

**Exhibit 33: Enhanced efficiency could increase our TP by 4-8%.**

Utilization rate (%)	Impact on FY 24e EBITDA	Impact on TP
<b>90%</b>	<b>0%</b>	<b>0%</b>
95%	5%	4%
100%	10%	8%

Source: Arqaam Capital Research

**+/- Containerboard prices.** We expect normalizing prices of USD 600/t in FY 23e (-21% y/y) as global demand is expected to slow down amid aggressive US fed hikes, high inflation and China's lockdowns and property crisis. In FY 24-26e, we assume a 3% CAGR in selling prices reaching USD 662/t in FY 26e (vs. USD 763/t in FY 22A). Assuming 10% higher selling prices, our EBITDA and TP would be 23% and 36% higher, respectively.

**Exhibit 34: Our TP is sensitive to selling prices as each 5% change results in 18% change in TP**

FY 23e Price	Impact on FY 24e EBITDA	Impact on TP
USD 480/t (-10% vs. base case)	<b>-23%</b>	<b>-36%</b>
USD 570/t (-5% vs. base case)	-11%	-18%
<b>USD 600/t (base case)</b>	<b>0%</b>	<b>0%</b>
USD 630/t (+5% vs. base case)	11%	18%
USD 660/t (+10% vs. base case)	23%	36%

Source: Arqaam Capital Research

**+/- Cost of Equity.** We discount MEPCO's FCFF at an average WACC of 10.0%. We use a cost of equity of 13% including a risk-free rate of 4.5%, an equity risk premium of 7% and a beta of 1.2x. Our CoE assumption is at the upper end of the range thanks to global monetary tightening and elevated interest rate environment and risk-free rate. If we assume a 1 ppt lower CoE, our TP would be 12% higher.

**Exhibit 35: Sensitivity to CoE**

Cost of Equity	Change from base case (%)	Impact on TP (%)
11%	-17%	28%
12%	-8%	12%
<b>13%</b>	<b>0%</b>	<b>0%</b>
14%	+8%	-11%
15%	+17%	-19%

Source: Arqaam Capital Research

**+/- terminal growth.** We base our forecast on a terminal growth of 2% (roughly the long-term price escalation), given that MEPCO operates near nameplate capacity (89% utilization rate). We demonstrate the impact of different terminal growth rate scenarios on our valuation.

**Exhibit 36: Sensitivity to terminal growth**

Cost of Equity	Change from base case (%)	Impact on TP (%)
1.0%	-50%	-10%
1.5%	-25%	-5%
<b>2.0%</b>	<b>0%</b>	<b>0%</b>
2.5%	+25%	5%
3.0%	+50%	+12%

Source: Arqaam Capital Research

## Overview of our main assumptions

**We expect revenues to drop 12% y/y in FY 23e on lower prices, despite the inauguration of 60k tons tissue paper plant...**

We expect revenues to drop 12% y/y in FY 23e, following a 10% increase in FY 22A, on normalizing prices of USD 600/t (-21% y/y) as global demand is expected to slow down amid aggressive US fed hikes, high inflation, and China's economic uncertainty. We expect resilient production volumes of 425k tons in FY 23e (flat y/y) at an elevated utilization rate of 89%. We assume a utilization rate of 30% in FY 23e for Juthor, a 60k tons tissue paper plant, that should be operational in H1 23e. The new factory should be commercially operational in Q2 23e.

**Exhibit 37: We expect prices to normalize in FY 23e (-21% y/y) thanks to global slowdown resulting in 12% lower revenues y/y**

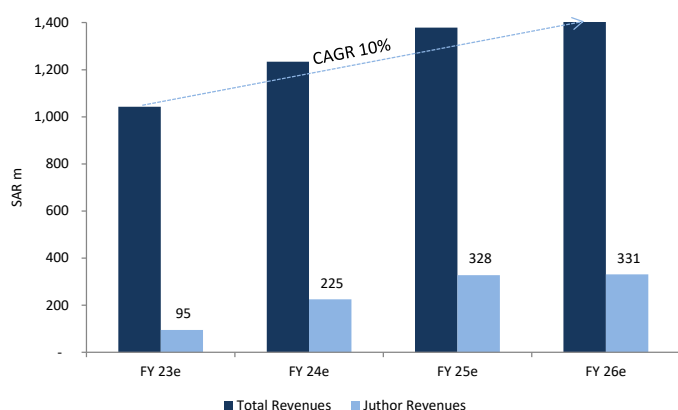
USD m	FY 17A	FY 18A	FY 19A	FY 20A	FY 21A	FY 22A	FY 23e	FY 24e	FY 25e	FY 26e	FY 27e
<b>Containerboard Capacity</b>	<b>475</b>	<b>475</b>	<b>475</b>	<b>475</b>	<b>475</b>	<b>475</b>	<b>475</b>	<b>475</b>	<b>475</b>	<b>475</b>	<b>475</b>
Utilisation rate (%)	81%	86%	82%	90%	89%	89%	89%	89%	89%	89%	89%
<b>Tissue Capacity</b>							<b>60</b>	<b>60</b>	<b>60</b>	<b>60</b>	<b>60</b>
Sold volumes (k tons)							18	42	60	60	60
Utilisation rate (%)							30%	70%	100%	100%	100%
<b>Revenues (USDm)</b>	<b>206</b>	<b>216</b>	<b>179</b>	<b>189</b>	<b>282</b>	<b>311</b>	<b>273</b>	<b>323</b>	<b>360</b>	<b>367</b>	<b>372</b>
Trading revenues	11	6	6	4	6	5	5	6	7	7	7
% of revenues	5%	3%	3%	2%	2%	2%	2%	2%	2%	2%	2%
<b>Total Revenues (USDm)</b>	<b>206</b>	<b>222</b>	<b>184</b>	<b>193</b>	<b>282</b>	<b>317</b>	<b>278</b>	<b>329</b>	<b>368</b>	<b>374</b>	<b>379</b>
<b>Total Revenues (SARm)</b>	<b>771</b>	<b>834</b>	<b>691</b>	<b>725</b>	<b>1,057</b>	<b>1,187</b>	<b>1,043</b>	<b>1,234</b>	<b>1,379</b>	<b>1,403</b>	<b>1,422</b>

Source: Company Data, Arqaam Capital Research

**... followed by a revenue CAGR of 10% in FY 23-26e on higher tissue volumes and recovery in selling prices**

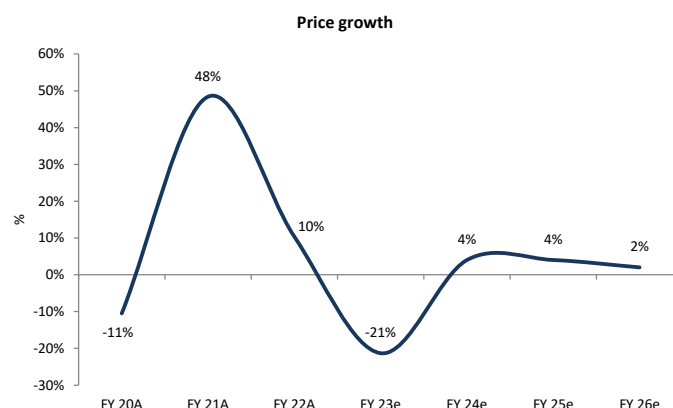
We pencil in a revenue CAGR of 10% in FY 23-26e on the back of i) gradually higher utilization rate for Juthor reaching 100% in FY 25e capitalizing on import substitution and resilient local demand for hygiene products and ii) 3% growth in selling prices in FY 24-26e.

**Exhibit 38: We expect revenue CAGR of 10% in FY 23-26e on volume growth at the tissue paper plant...**



Source: Company Data, Arqaam Capital Research

**Exhibit 39: ... coupled with 3% price CAGR in FY 23-26e, after a 21% drop in FY 23e, on recovery in demand**

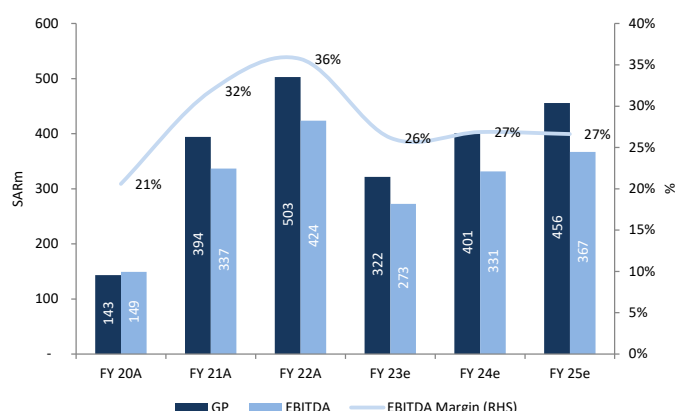


Source: Company Data, Arqaam Capital Research

## We expect EBITDA margin to shrink 10 ppts y/y in FY 23e on lower selling prices coupled with slimmer margins at the tissue plant

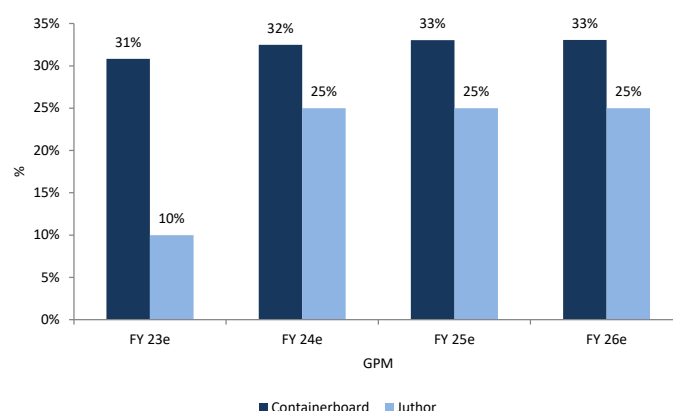
We expect EBITDA margin to drop by 10 ppts y/y at 26% in FY 23e on i) 21% lower selling prices thanks to global slowdown and ii) a GPM of 10% for the tissue plant, compared to 31% at the containerboard, on suboptimal utilization rate of 30%. Yet, we expect 11% EBITDA CAGR in FY 23-26e on volume and price growth beyond FY 23e. As for Juthor, we expect GPM to expand to 25% in FY 25e (vs. 10% in FY 23e) as higher utilization rate of 100% (vs. 30% in FY 23e) drives favorable economies of scale. We expect 16% lower SG&A y/y in FY 23e, on lower selling expenses and one-off consultancy fees in FY 22A, at SG&A/sales of 14.5% in FY 23e (-60 bps y/y). We assume an average EBITDA margin of 27% in FY 23-26e (vs. 34% in FY 21-22A) as Juthor's margins are naturally lower at around a GPM of 25% (vs. 41% in FY 21-22e on MEPCO's level).

**Exhibit 40: We expect EBITDA margin to normalize at 26% in FY 23e on lower selling prices...**



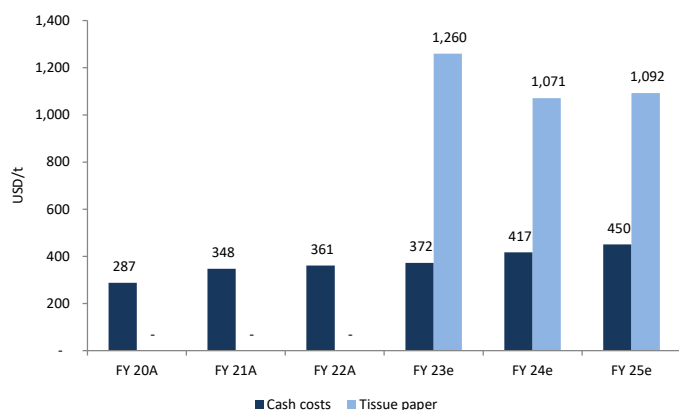
Source: Company Data, Arqaam Capital Research

**Exhibit 41: ... and slimmer margins at tissue plant, reaching 25% in FY 24-25e on higher utilization rate**



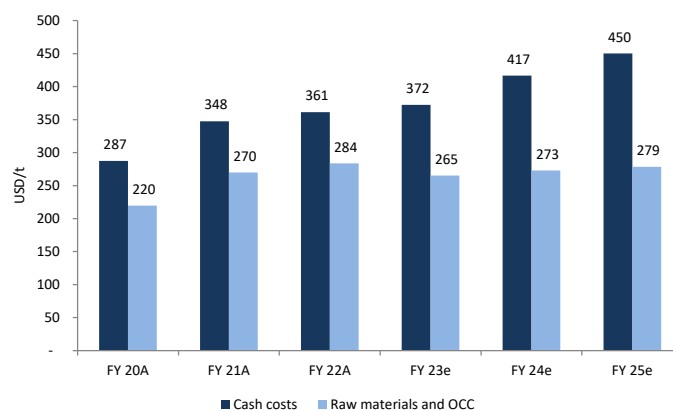
Source: Company Data, Arqaam Capital Research

**Exhibit 42: Cash costs should increase 25% to USD 450/t in FY 25e, up from USD 361/t in FY 22A, on the expansion into finals products of higher costs per ton**



Source: Company Data, Arqaam Capital Research

**Exhibit 43: Direct raw materials and OCC costs represent 65% in FY 23-25A (vs. 77% in FY 17-22A), thanks to the inauguration of Juthor**

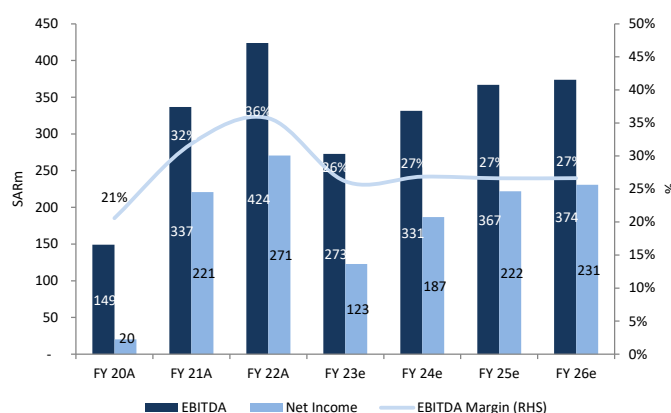


Source: Company Data, Arqaam Capital Research

## Net income to drop 55% y/y in FY 23e, followed by a CAGR of 23% in FY 23-26e

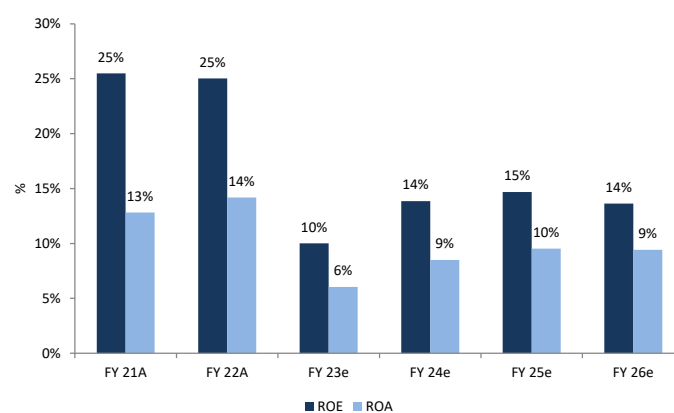
We expect net income to drop by 55% y/y to SAR 123m in FY 23e on 21% lower selling prices and a ten ppts contraction y/y in EBITDA margin. We expect net income to gradually recover to SAR 231m in FY 26e, growing at a CAGR of 23% in FY 23-26e, driven by a ramp up of production to 60k tons in FY 26e (up from 18k tons in FY 23e) from the newly added tissue paper manufacturing capacity at Juthor and a pick-up in selling prices at a CAGR of 3%. We expect RoE and RoA to fall to 10% and 6%, respectively, in FY 23-26e on lower net income and slimmer margins.

**Exhibit 44: We assume 55% lower net income y/y in FY 23e on lower selling prices**



Source: Company Data, Arqaam Capital Research

**Exhibit 45: RoE should normalize to 13% in FY 23-26e (vs. 25% in FY 22A) on lower net income at slimmer margins**



Source: Company Data, Arqaam Capital Research

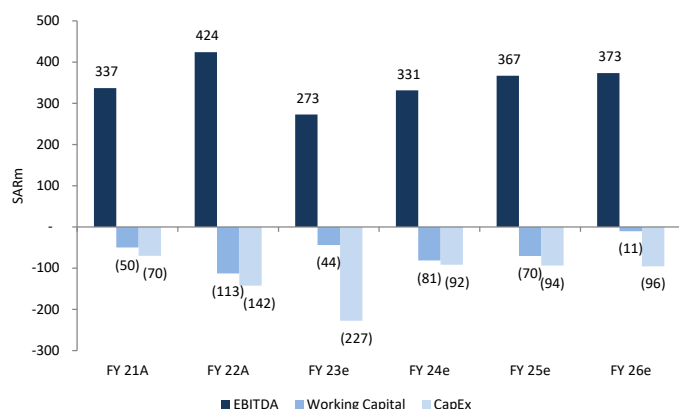
## Expect working capital outflow of SAR 125m p.a in FY 23-24e on inventory and receivables on ramping up production at the new tissue paper plant

We expect a working capital needs of SAR 125m in FY 23-24e (21% of COPAT) as we anticipate an increase in inventory of SAR 93m (outflows of SAR 47m p.a) and receivables of SAR 63m in FY 24e (outflows of SAR 32m p.a) mainly due to ramping up production at higher utilization rate of 70% in FY 24e for the new tissue paper plant. We conservatively assume receivables to remain elevated around the 113 days mark in FY 23-26e (vs. 97 days in FY 22A), as the addition of new plant usually coincides with longer days of receivables and inventory.

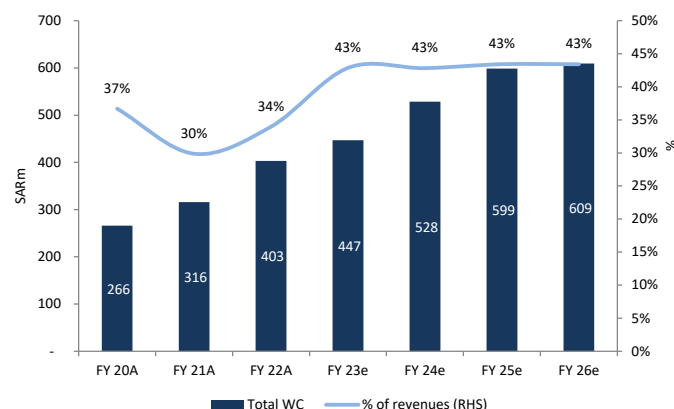
**Exhibit 46: We expect total outflows of SAR 206m in FY 23-26e on higher utilization rate at the new tissue paper plant**

SARm	FY 20A	FY 21A	FY 22A	FY 23e	FY 24e	FY 25e	FY 26e
Accounts Receivables	199	307	314	319	377	429	437
Inventory	167	144	213	259	306	343	349
Payables	101	135	124	131	155	174	177
<b>Total WC</b>	<b>266</b>	<b>316</b>	<b>403</b>	<b>447</b>	<b>528</b>	<b>599</b>	<b>609</b>
<b>% of revenues</b>	<b>37%</b>	<b>30%</b>	<b>34%</b>	<b>43%</b>	<b>43%</b>	<b>43%</b>	<b>43%</b>
<b>Changes in WC</b>		<b>50</b>	<b>87</b>	<b>44</b>	<b>81</b>	<b>70</b>	<b>10</b>

Source: Company Data, Arqaam Capital Research

**Exhibit 47: We expect outflows of SAR 63m p.a from WC in FY 23-24e**


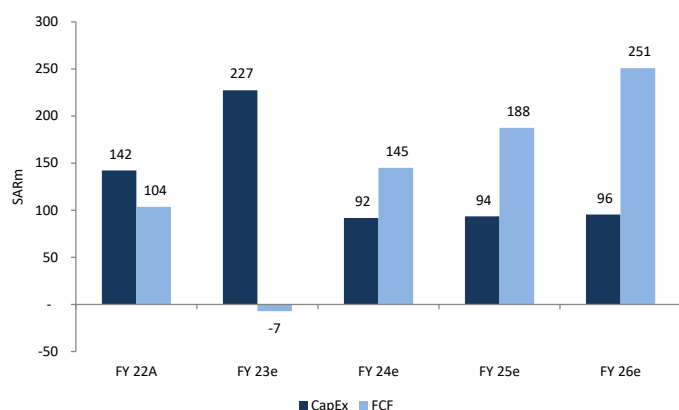
Source: Company Data, Arqaam Capital Research

**Exhibit 48: MEPCO is set to build a working capital base on adding a new plant in FY 23-25e**


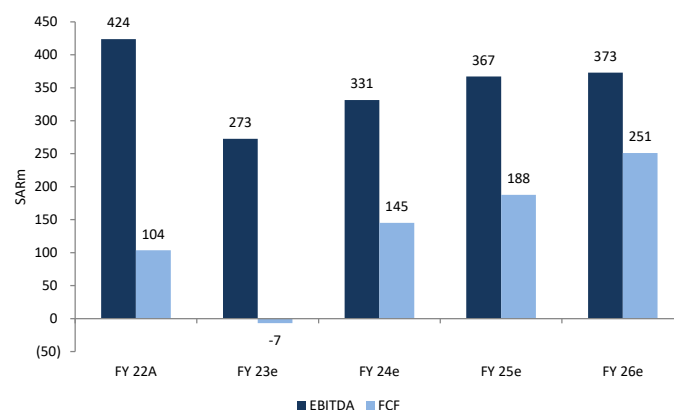
Source: Company Data, Arqaam Capital Research

### We assume a FCFY and DY of 9% and 2%, respectively, in FY 24-26e

We expect a FCF yield of 9% in FY 24-26e, despite a combined outflows of SAR 148m p.a from working capital and CapEx, on a 11% EBITDA growth with a resilient EBITDA margin of 27%. Yet, we expect a DY of only 2% in FY 24-26e as the company's strategy is focused on growth opportunities that could potentially stem from further greenfield projects (expanding containerboard capacity) or merger and acquisitions. We expect CapEx to drop by 60% y/y in FY 24e, as the majority of Juthor's Capex should be digested by then. Juthor should be commercially operational in Q2 23e. We expect a CapEx of SAR 227m in FY 23e mainly on the completion of Juthor project in FY 23e. We assume a maintenance CapEx of SAR 94m p.a on average in FY 24-26e at 7% of revenues.

**Exhibit 49: We expect FCF to recover in FY 24-26e as CapEx should normalize after the completion of Jurthor**


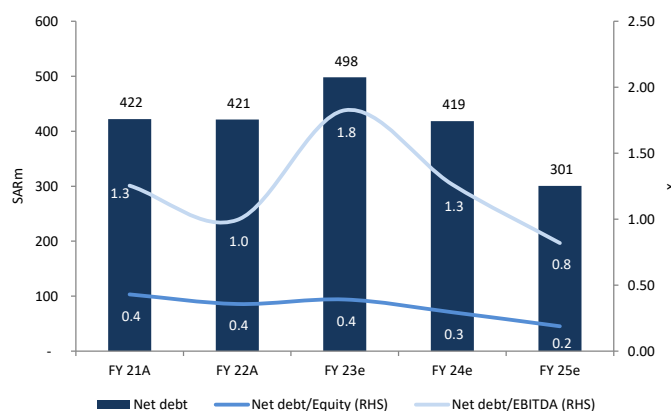
Source: Company Data, Arqaam Capital Research

**Exhibit 50: .. coupled with EBITDA CAGR of 11% in FY 23-26e thanks to recovery in prices and higher volumes**


Source: Company Data, Arqaam Capital Research

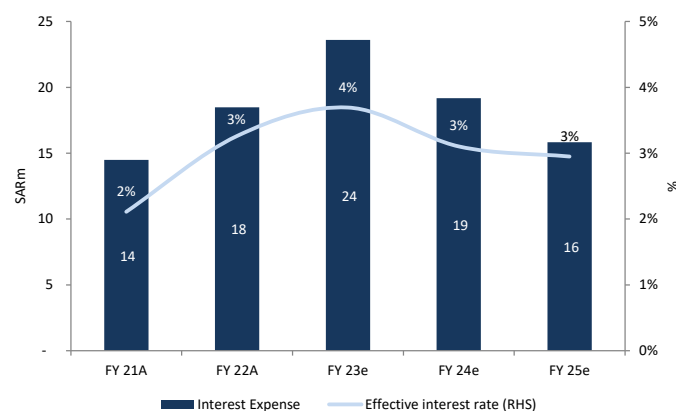
Net debt should come down to SAR 301m in FY 25e (vs. SAR 421m in FY 22A) thanks to EBITDA growth and normalizing CapEx on the completion of Juthor, reducing the net debt/EBITDA to just 0.8x in FY 24e (vs. 1.8x in FY 23e).

**Exhibit 51: Net debt/EBITDA should drop to 0.8x in FY 24e (vs. 1.8x in FY 23e) on normalizing CapEx and growth in production**



Source: Company Data, Arqaam Capital Research

**Exhibit 52: We expect higher effective interest rate thanks to higher benchmark rates on tightening monetary policy.**



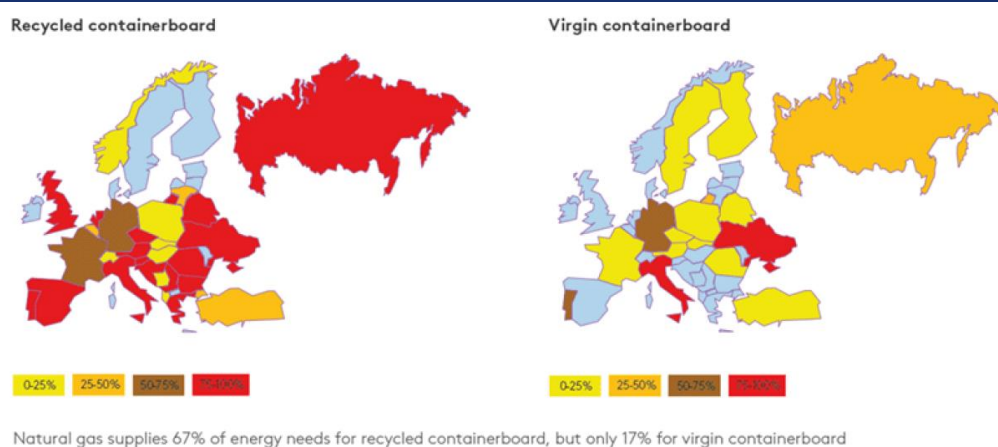
Source: Company Data, Arqaam Capital Research

## More on the paper and containerboard industry

### The global cost curve remains elevated on resilient energy prices...

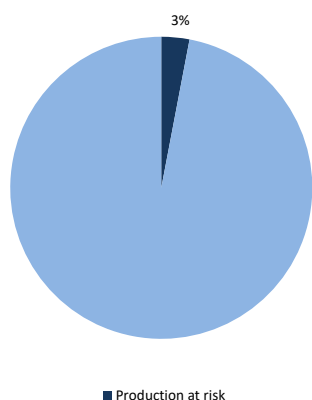
The global cost curve is elevated as energy prices represent around 15-30% of total costs. Around two-thirds of the energy used by the recycled containerboard comes from natural gas, with a higher dependency on Russian natural gas imports to Europe. Virgin containerboard producers, on the other hand, can take advantage of the energy synergies with their pulp mills, so less than 20% of their energy needs are fulfilled by natural gas.

### Exhibit 53: Natural gas supplies 67% of energy needs for recycled containerboard, and only 17% of virgin containerboard



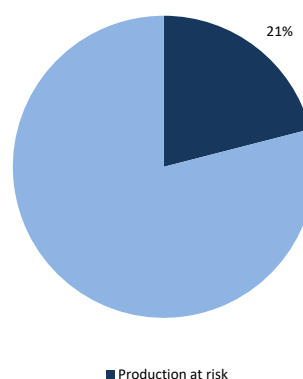
Source: Fastmarket Analytical Cornerstone, Fastmarket Economic analysis, Arqaam Capital Research

### Exhibit 54: Around 0.3m tons or 3% of virgin containerboard capacity in Europe is at risk in case of complete stop of natural gas supply from Russia



Source: Company Data, Arqaam Capital Research

### Exhibit 55: Around 8.0m tons or 21% of recycled containerboard capacity in Europe is at risk in case of complete stop of natural gas supply from Russia



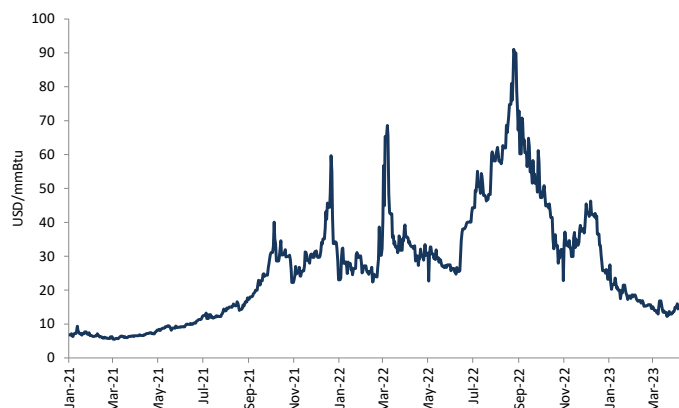
Source: Company Data, Arqaam Capital Research

According to PPI Europe's estimates based on official announcements and market reports, a total of at least 200-250k tons of containerboard was removed from the market in FY 22A, a majority of that from the brown recycled grades but also other segments.



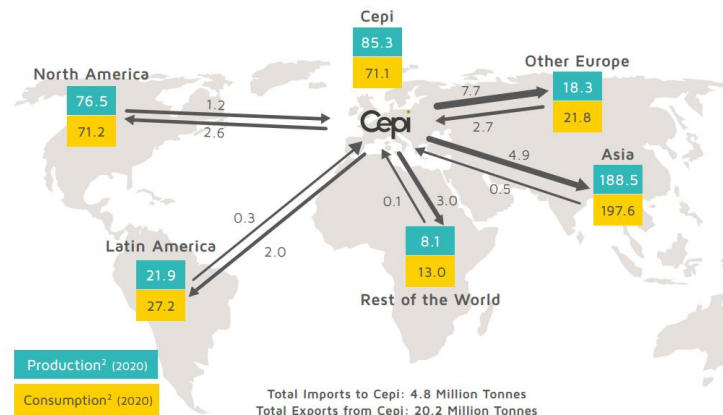
Among others, Hamburger plans to curtail production by some 40k tons due to the high energy prices. Julius Schulte Trebsen has also decided to reduce its output by around 45% in Sept-22, due to high manufacturing costs and weak demand. According to Fastmarkets RISI, up to 8.3m tons of containerboard production is at risk if Russian gas flows to Europe stop completely, mostly on the recycled side.

**Exhibit 56: Natural gas prices in Europe normalized to USD 15/mmBtu, but still well above mid-cycle levels**



Source: Bloomberg, Arqaam Capital Research

**Exhibit 57: Europe plays a vital role in global markets with total exports of 23m tons in FY 20A (incl. Cepi members)**



Source: Cepi Statistics, Arqaam Capital Research

### .. but prices are under pressure on subdued demand amid global slow-down

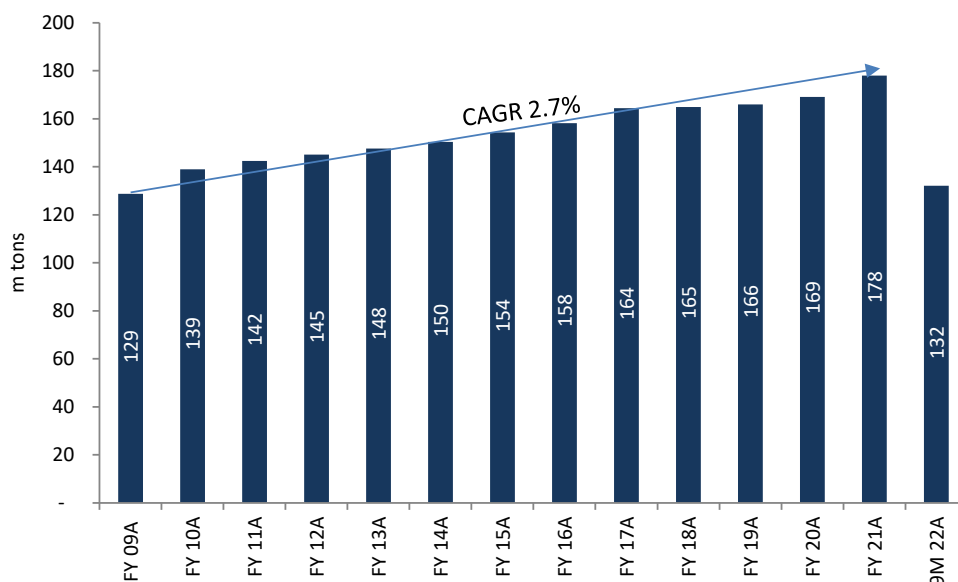
The paper industry should witness a slump in demand across all segments and all geographic areas, along with a lack of export opportunities, resulting in paper oversupply and record-high stocks at mills, especially on the recycled containerboard (RCCM) side. This should result in cutting global production either by lowering utilization rates or halting production.

### Demand growth in the medium term should be driven by packaging, e-commerce, and hygiene products on global population growth

Packaging, e-commerce, tissue papers, and hygiene products should continue to drive demand growth of paper and paperboard market, despite lower negative trends from newsprint, printing and writing thanks to digitalization, thanks to global population, GDP, and consumer spending growth. The containerboard market spearheaded the paperboard market growth, on a resilient CAGR of 2.7% in FY 09-21A, thanks to the move towards e-commerce and environmentally friendly packaging. More generally, the paper and paperboard market grew at only 1% CAGR over the last decade (in FY 10-18A), thanks to i) 2.7% growth in container board demand at around 170m tons (40% of total demand), ii) 3.6% growth in tissue demand at around 40m tons (10% of total demand), and ii) 1.7% growth in carton board at around 65m tons (15% of total demand). On the flip side, newsprint's demand witnessed a negative CAGR of 6.1% in FY 10-18A at around 20m tons (5% of total demand) while printing and writing demand dropped by a CAGR of 1.5% in FY 10-18A at around 90m tons (21% of total demand), thanks to digitalization.

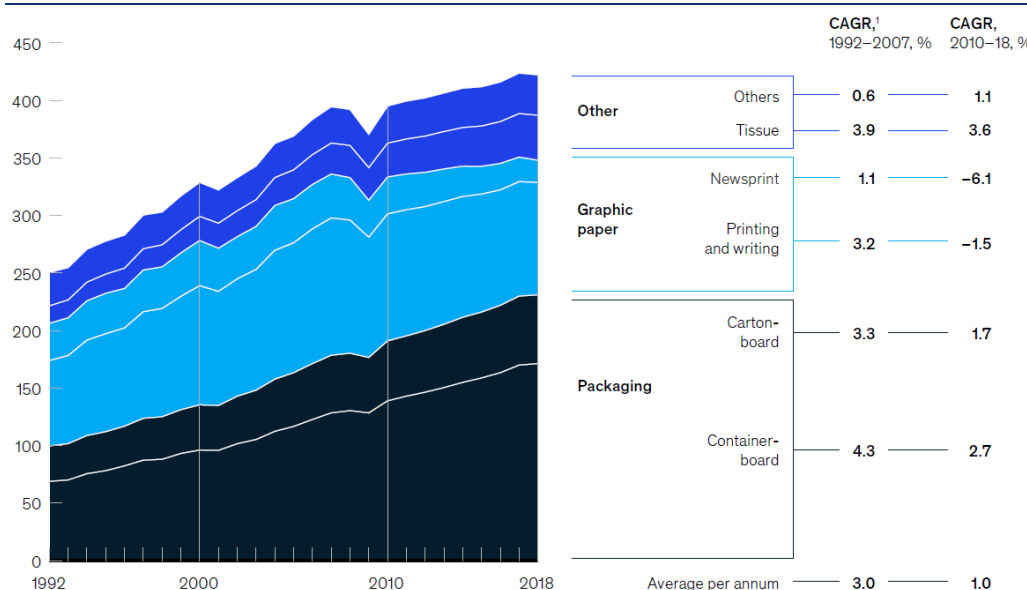
A structural shift towards paper-based packaging, instead of plastic-based, and online shopping (e-commerce), instead of physical stores, should drive an above-average CAGR of more than 2%. E-commerce has highlighted new packaging challenges to product characteristics such as improved product safety, the un-boxing experience, counterfeiting measures, and optimization for last-mile delivery.

**Exhibit 58: The containerboard market grew at 2.7% CAGR in FY 09-21A thanks to a move towards e-commerce and environmentally friendly packaging, replacing plastic.**



Source: The Pulp and Paper Products Council, Bloomberg, Arqaam Capital Research

**Exhibit 59: The paper and paperboard market grew at 1% CAGR in FY 10-18A on 2.7% growth in container board demand, 3.6% growth in tissue demand and 1.7% growth in carton board**

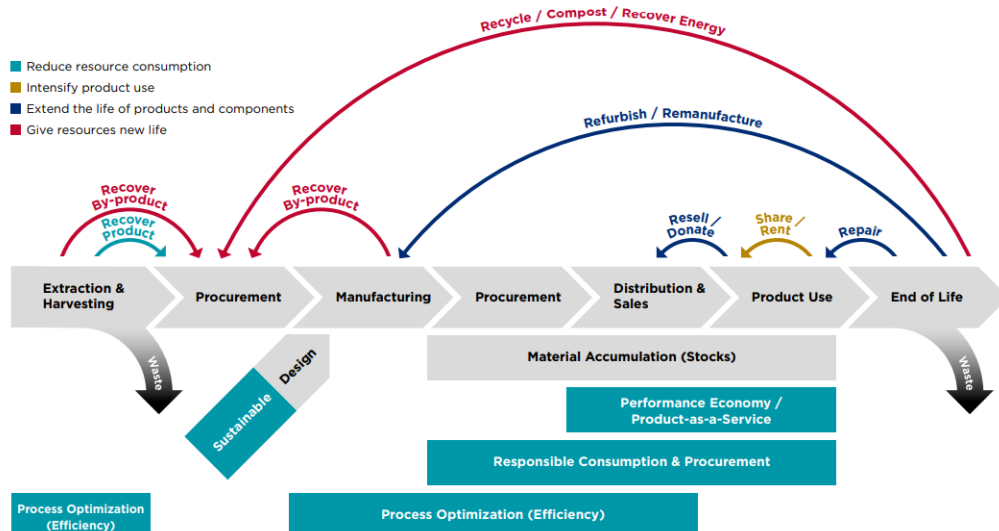


Source: Resource Information Systems, McKinsey & Company, Arqaam Capital Research

### The circular economy is front and center

Global economies are now focused on turning their linear economy model (depletion of economic resources) into circular economy with a systemic approach to economic development that is regenerative by design and aims to decouple growth from the consumption of finite resources. It also results in carbon emission reduction and maintain biodiversity.

## Exhibit 60: A circular economy is regenerative by design

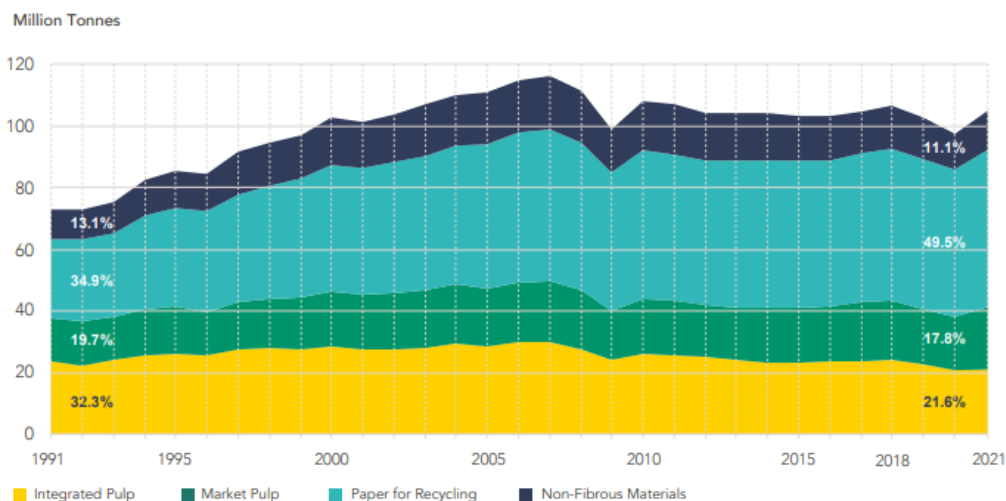


Source: Council of Canadian Academies, Arqaam Capital Research

## OCC recycling remain well-above paper recycling

The global industry trends show higher recycling rate for old, corrugated containers (OCC) than paper recycling. In the US, the paper-recycling rate was 66.2%, compared to 92.0% for old, corrugated containers (OCC) in FY 19A. The three-year average recycling rate for OCC is 92.3%. Packaging and pulp producers in the U.S. are committed to investing more than USD 4.1bn in manufacturing infrastructure, from FY 19-23e, to continue the best use of recovered fiber in manufacturing.

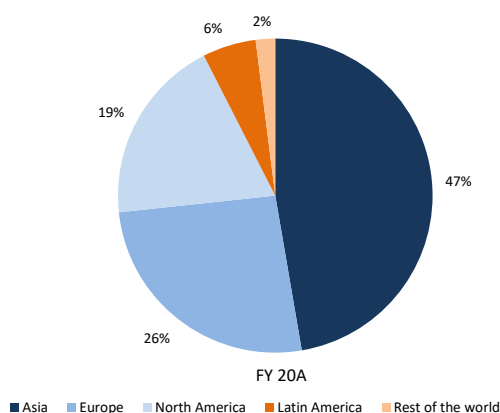
## Exhibit 61: Recycled materials now represent 50% of total raw material consumption for paper and board industry, gaining 15 ppts in 2021 vs. 1991



Source: Capi Statistics, Arqaam Capital Research

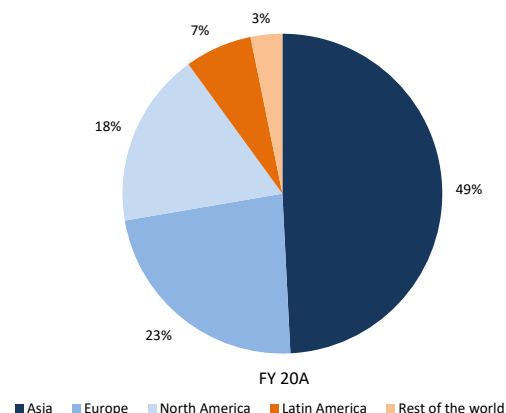
Asia is the largest consumer globally of paper and board given favorable demographics, sizable population, and above-average GDP growth, that should sustain in the medium term. Europe is the second largest consumer and should witness a slowdown in FY 23e thanks to geopolitical risks.

**Exhibit 62: Paper and board production is dominated by Asia at 47%, followed by Europe and North America**



Source: Capi Statistics, Arqaam Capital Research

**Exhibit 63: Asia is also the largest consumer of paper and board at 49%, followed by Europe and North America**



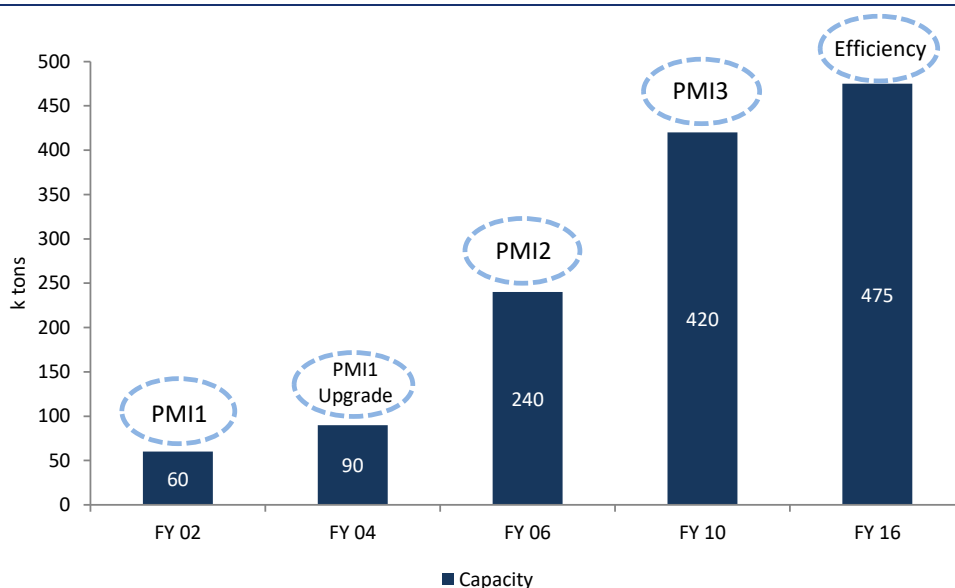
Source: Capi Statistics, Arqaam Capital Research

## More on Middle East Paper Co.

MEPCO was established in 2000 as a manufacturer of container board and industrial paper from recycled fiber pulp. MEPCO became a joint stock company in May-15, with paid in capital SAR 500m (now at SAR 666.7m). In FY 21A, the company had a production capacity of 475k tons per annum of container boards, up from 60k tons in FY 02A. The company obtains more than 75% of raw materials recycled fiber pulp from WASCO (a wholly owned subsidiary) and generates its own electricity and water.

WASCO is the Middle East's largest waste collection and sorting company with an annual capacity of 500k tons (planned to reach 600k tons). MEPCO formed an alliance with the Saudi government for waste management, recycling and collection through a new joint venture called Estidama with the municipality of Jeddah. The company is expanding vertically through the establishment of Juthor to produce tissue papers (final product) at an annual capacity of 60k tons in FY 23e as the majority of production should be targeted towards the domestic market.

**Exhibit 64: MEPCO's capacity expanded 8x to 500k tons since 2002 with 15 product lines**



Source: Company Data, Arqaam Capital Research

## Resilient average utilization rates, despite tough global dynamics in FY 20-21A, on local demand

MEPCO's utilization rate has averaged 82% in FY 15-19A at a production of 381k tons per annum, catering for local and export markets. Utilization rates jumped to 90% in FY 20-21A, at the time when the global sector was suffering from weak demand due to lockdowns and scarcity of raw materials, as the company capitalized on resilient domestic demand and an emerging activity of the e-commerce business. Production volumes grew by 10% y/y to 426k tons in FY 20A at a utilization rate of 90% (+8 ppts y/y).

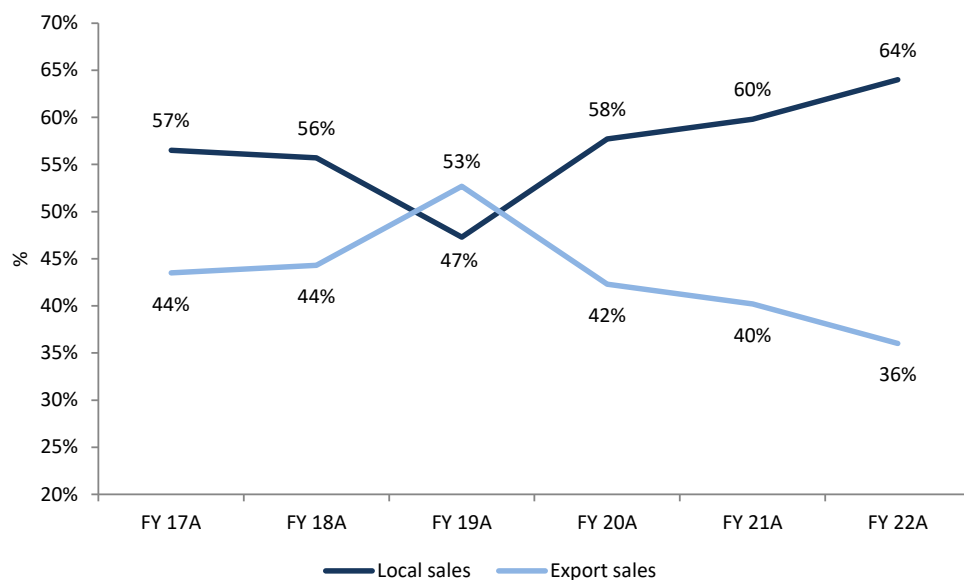
**Exhibit 65: Production volumes grew 10% y/y at 426k tons in FY 20A at a utilization rate on the growth of e-commerce business**

USD m	FY 15A	FY 16A	FY 17A	FY 18A	FY 19A	FY 20A	FY 21A	FY 22A
Installed Capacity (k tons)	420	475	475	475	475	475	475	475
Utilisation rate (%)	88%	75%	81%	86%	82%	90%	89%	89%
<b>Total Revenues (USDm)</b>	<b>182</b>	<b>169</b>	<b>206</b>	<b>222</b>	<b>184</b>	<b>193</b>	<b>282</b>	<b>311</b>

Source: Company Data, Arqaam Capital Research

**MEPCO has around 31% market share in Saudi while exports represent 39% of revenues**

MEPCO's main market is Saudi with around 31% market share, representing 61% of revenues in FY 19-22A. The company is committed to meet growing local demand at a CAGR of 4.2%, reaching 1m tons in FY 24e. Exports represent 39% of revenues in FY 17-9M 22A as the company capitalizes on its strategic location, near Jeddah Islamic Port, to supply its products to a wide range of customers throughout the five continents (e.g., Asia, Africa, Europe, and Americas). The company's paper production lines are located at Jeddah.

**Exhibit 66: Growth in domestic demand resulted in higher contribution to MEPCO's revenues**


Source: Company Data, Arqaam Capital Research

**WASCO plays a vital role in MEPCO's backward integration, securing 75% of MEPCO's raw material needs**

The Waste Collection and Recycling Co, WASCO, recycles 500k tons p.a of wastepaper and handles 50% of KSA's recyclable material through landfill concessions, long-term supply contracts with major retailers and direct collections. WASCO plays a vital role in MEPCO's backward integration, providing 75% of the raw material used in MEPCO production. It is worth mentioning that Saudi Arabia has the highest recovery rate in the GCC Region. WASCO is a wholly owned subsidiary of MEPCO with 19 centers across Saudi Arabia and Jordan.

WASCO operates 1 SPV (Estidama), 3 Material Recovery Facilities (MRFs), 19 Wastepaper Collection centers across KSA and operates in neighboring countries (Jordan). WASCO recovers other recyclable materials mainly Plastics and metals through its well-established infrastructure.

WASCO is well positioned to capitalize on Saudi vision 2030 and the KSA government's environmental ambitions. The Saudi government launched a National Centre for Waste Management that aims to force the principles of a circular economy and regulate the waste management sector to enhance environmental protection. WASCO developed a comprehensive strategy with consultant Roland Berger to help drive this initiative and become a pioneer of best practice for the country.

In FY 20A, WASCO played an important role in MEPCO's performance as it has ensured a steady supply of raw materials at a time when containerboard manufacturers worldwide struggled due to lockdowns. Despite local curfews in Saudi and a drastic reduction in commercial and industrial waste volumes, WASCO's regional reach ensured the supply of required fibre to maintain uninterrupted production. WASCO expanded its operational model beyond paper to encompass a wider range of recyclable material and to support tissue and hygienic paper manufacturing.

WASCO operates Estidama company as a special purpose vehicle, launched in Q4 21A in partnership between WASCO and (JDURC) Jeddah Development and Urban Regeneration Company, which is the investment arm of Jeddah municipality. The main objectives of establishing Estidama are the development of the waste management market in Jeddah city, promoting circular economy by maximizing the recovery rate of recoverable materials generated from commercial sector and securing feedstock for local industries.

#### **77% of cash costs are concentrated on direct raw materials and OCC procured from WASCO**

MEPCO's cash costs are concentrated in direct raw materials at 77% of total cash costs in FY 17-21A which is mainly driven by the procurement of old corrugated containers (OCC) from WASCO. Labor costs is the second largest contributor to total cash costs at 14% in FY 17-21A, followed by the overhead and transportation costs at a marginal 6% and 3% of total costs in FY 17-21A. Cash costs per tons were only 3% higher in FY 21A, compared to FY 17A, despite inflationary pressures on raw materials, labor and transportation costs, as MEPCO relies on local procurement.

#### **Exhibit 67: Direct raw materials represent most of cash costs at 77% in FY 17-22A**

<i>USD/ton</i>	<i>FY 17A</i>	<i>FY 18A</i>	<i>FY 19A</i>	<i>FY 20A</i>	<i>FY 21A</i>	<i>FY 22A</i>
<i>Direct raw materials (OCC)</i>	256	279	253	220	270	284
<i>Employees costs</i>	45	49	45	39	48	50
<i>Transportation costs</i>	13	11	10	8	10	10
<i>Rent</i>	7	9	1	1	1	1
<i>Other overheads</i>	15	21	19	20	19	17
<b>Cost/ton</b>	<b>336</b>	<b>369</b>	<b>328</b>	<b>287</b>	<b>348</b>	<b>361</b>

*Source: Company Data, Arqaam Capital Research*

#### **Juthor is a diversification expansion into tissue papers with a capacity 60k tons**

MEPCO established Juthor to produce tissue papers at an annual capacity of 60k tons in FY 23e mainly to cater for the domestic market. Tissue and hygienic paper represents MEPCO's first venture into consumer-oriented products. The tissue market is less volatile than containerboard, with clear correlation with consumer spending and GDP growth. The new factory should provide a cost-effective domestic tissue supply meeting rising consumer spending in Saudi Arabia.

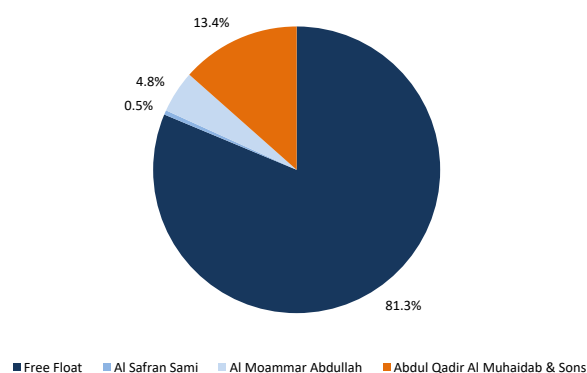
The new factory should be commercially operational in Q2 23e, built on an existing MEPCO land in the Industrial Valley in King Abdullah Economic City, that should generate GPM of 25%. The plant should be operational in H1 23e. In Feb-21, MEPCO signed an agreement with Toscotec, a leading Italian manufacturer, to design and install the machinery of high-speed line. The new plant's competitive advantages are i) lower logistics costs, ii) competitive energy costs, iii) access to cost-effective raw materials and iv) advanced automation and digitalization.

#### MEPCO's strategy is focused on growth and diversification

- Consolidation to build scale: M&A activity in the industry is on the rise as manufacturers consolidate to build significant production scales and become cost efficient.
- Backward and forward integration along the value chain: As part of the global drive towards cost efficiencies, paper manufacturers have established operations in forestry and waste collection to secure a consistent supply of raw material. Players have also moved downstream into packaging conversion to achieve better margins and mitigate risks associated with price volatility of raw materials inventory.
- Diversification into high-margin product categories: exploring new product categories that command higher prices and better margins. New categories results in higher customer synergies and explore additional growth opportunities.
- Increasing reliance on technology to optimize costs and create innovative products: As a comparative advantage, advanced technology is essential in optimizing costs and introducing innovative products.

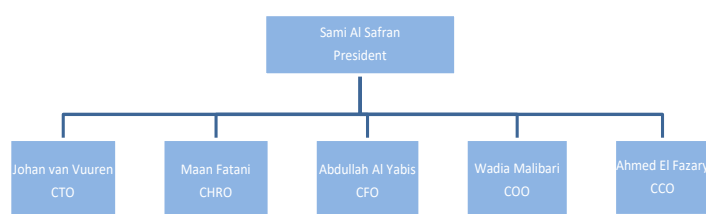
#### Shareholder structure of MEPCO and management team

**Exhibit 68: Major shareholders hold only 19% of outstanding shares**



Source: Company Data, Arqaam Capital Research

**Exhibit 69: The management team has the expertise to expand MEPCO's footprint at the paper industry**



Source: Company Data, Arqaam Capital Research



## MEPCO's products are mainly container boards and industrial papers

**Exhibit 70: MEPCO serves three key sectors namely packaging, furniture, building and construction offering containerboards (high-performance fluting, test liner, semi-chemical fluting, kraft liner board, dual use and white top test liner) and industrial papers (core board, plasterboard liner and absorbent kraft)**



### PACKAGING SECTOR

**Cardboard Paper:** Used in producing cardboard boxes for packing foodstuff, electronics and many other uses.

### Cardboard Pipe Paper:

Used in a wide range of industries, including textile rolls, paper mills, etc.



### FURNITURE SECTOR

#### High Impregnated Formica

**Paper:** Used on furniture surfaces, including offices, kitchen cabinets and doors.



### BUILDING AND CONSTRUCTION SECTOR

#### Gypsum Board Paper:

This product is used to manufacture gypsum board which is used for walls and suspended ceilings.

Source: Company Data, Arqaam Capital Research

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