Quarterly Results Update

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Middle East Paper Co.

Modest loss in Q1 on lower prices and higher cash costs. Despite NT challenges, we see significant opportunities.

- **MEPCO reported a loss of SAR 7m in Q1 23A, missing ACe of SAR 6m, on 4% lower-than-expected prices and 13% higher-than-expected cash costs.**
- **We decrease our EBITDA estimates by 13% in FY 23-25e on 6% lower selling prices due to the global slowdown and lower NG prices in Europe.**
- **We maintain our Hold at a 7% lower TP of SAR 32.0. We see MT upside from i) EBITDA CAGR of 23% in FY 23-26e, and ii) further government support (higher local market share, subsidized energy and tariffs).**

MEPCO turned to a loss of SAR 7m in Q1 23A, missing ACe, on lower-than-expected prices and higher-than-expected costs. GPM dropped 32 ppts y/y to 16% in Q1 23A (-11 ppts q/q, -7 ppts vs. ACe) as selling prices declined by 31% y/y on weak global demand, coupled with 13% higher-than-expected cash costs (+13% y/y, +7% q/q). Revenues fell 27% y/y to SAR 224m in Q1 23A (-3% q/q), in line with ACe, on 31% lower selling prices at USD 533/t, on our numbers, despite 7% higher sales volume y/y (+6% vs. ACe) at 105% of production (+6 ppts y/y, +18 ppts q/q). Volumes rebounded sequentially by 21% on exports at 39% of the total (+3 ppts vs. FY 22A).

We cut our EBITDA estimates by 13% in FY 23-25e on 6% lower selling prices due to the global slowdown and lower NG prices in Europe. We now assume an EBITDA margin of 24% in FY 23-25e (-226 bps vs. prev.) as we cut our selling prices by 6% at USD 588/t in FY 23-25e due to i) global slowdown with a slower than expected recovery in China (Asia represents around 49% of global demand), and slower growth in US and Europe, ii) lower global cost curve because of normalizing natural gas prices of USD 8/mmBtu in Europe, with energy costs representing 15-30% of total costs. In FY 22A, at least 200-250k tons of containerboard were removed from the market. We now expect a 31% y/y decline in prices to USD 530/t in FY 23e resulting in a 83% lower net income of SAR 46m in FY 23e, still eyeing a recovery in selling prices in H2 23e on a rebound in economic activity in China. We also expect some cost savings on raw material costs starting Q2 23e on re-pricing OCC prices – 44% of total costs- in the local market (comes with a lag).

The volume growth story is still intact on commercial production from Juthor in FY 23e and PM5 expansion. We expect incremental revenues of SAR 95m in FY 23e at a production volume of 18k tons (30% utilization rate in FY 23e) and GPM of 10% (vs. MGT guidance of 25-27%). We assume Juthor to contribute 20% of MEPCO's revenues (vs. management guidance at 15-20%) at 100% utilization. The company expects Juthor to break even in Q3 23e and targets 24% share of Saudi's tissue market. On PM5 expansion, the company plans to double its containerboard capacity by adding 400k tons in FY 26e at an investment cost of SAR 1.5bn, which could add 51% to our FY 26-27e EBITDA and SAR 9/share to our TP, at an IRR of 16%.

We maintain our Hold rating though decrease our TP by 7% to SAR 32. Significant opportunities ahead from antidumping and PIF ownership. We expect MEPCO to acquire further market share in Saudi on the potential extension of antidumping duties to Germany, Spain, and India – currently in appeal (existing on imports from Spain and Poland). MEPCO signed an MOU with PIF as the latter intends to subscribe to newly issued shares in MEPCO, planning to be a significant minority, for a price of SAR 31.5/share. This should come with further support from the government, in terms of allowing for a higher market share in the local paper market, supporting the PM5 expansion through competitive financing terms, and continuing to subsidize energy and utilities.

HOLD **SAR 32.0↓**

Industrials / Saudi Arabia

Bloomberg code	MEPC AB
Market index	TADAWUL
Target Price	32.0
Upside (%)	-5.2

Market data **5/28/2023**	
Last closing price	33.8
52 Week range	25.5-51.0
Market cap (SAR m)	2,253
Market cap (USD m)	601
Average Daily Traded Value (SAR m)	30.0
Average Daily Traded Value (USD m)	7.9
Free float (%)	81%

Year-end (local m)	**2022**	**2023e**	**2024e**	**2025e**
Revenues	1,187	932	1,202	1,346
EBITDA	424	190	317	351
Net income	271	46	173	207
EPS	4.06	0.69	2.59	3.11
EPS growth (%)	22.5	(83.1)	277.0	19.9
P/E (current price)	7.9	46.6	12.3	10.3
DPS	0.75	0.17	0.52	0.62
Div. yield (%)	2.3	0.5	1.6	1.9
FCF/share	1.6	(0.7)	1.6	2.6
FCF yield (%)	4.9	(2.2)	5.0	8.1
CAPEX	142	227	92	94
CAPEX/sales (%)	12.0	24.4	7.6	7.0
Net Debt/EBITDA (x)	1.0	2.7	1.5	1.0
EV/EBITDA (x)	5.9	13.2	7.9	7.2
RoAE (%)	25.0	3.8	13.4	14.4
RoIC (%)	20.5	5.1	11.3	12.5

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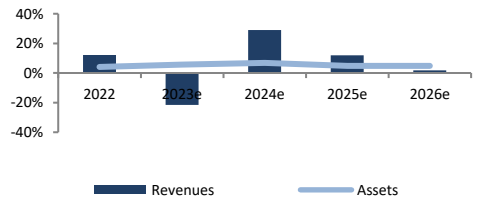
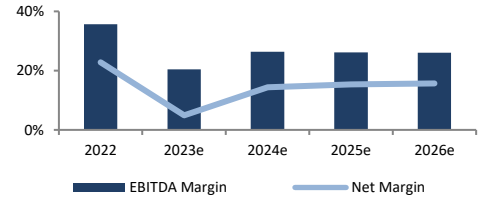
Abacus *Arqaam Capital Fundamental Data*

Middle East Paper Co.

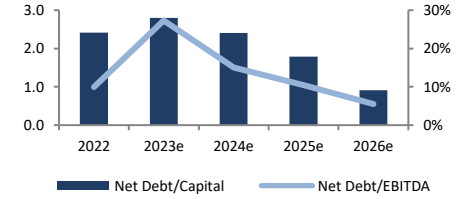
Profitability



Growth



Gearing



Year-end	2021	2022	2023e	2024e	2025e	2026e
Financial summary						
Reported EPS	3.32	4.06	0.69	2.59	3.11	3.22
Diluted EPS	3.32	4.06	0.69	2.59	3.11	3.22
DPS	0.75	0.75	0.17	0.52	0.62	0.64
BVPS	54.10	65.02	66.91	74.52	83.64	93.11

Year-end	2021	2022	2023e	2024e	2025e	2026e
Valuation metrics						
P/E (x) (current price)	9.7	7.9	46.6	12.3	10.3	9.9
P/E (x) (target price)	9.7	7.9	46.6	12.4	10.3	9.9
EV/EBITDA (x) (current price)	7.5	5.9	13.2	7.9	7.2	7.0
EV/EBITDA (x) (target price)	6.9	5.5	12.2	7.3	6.6	6.5
EV/FCF (x)	17.8	24.2	(52.5)	23.4	14.5	10.6
Free cash flow yield (%)	6.6	4.9	(2.2)	5.0	8.1	11.1
Dividend yield (%)	2.3	2.3	0.5	1.6	1.9	2.0

Year-end	2021	2022	2023e	2024e	2025e	2026e
Growth (%)						
Revenues	45.9	12.3	(21.5)	28.9	12.0	1.8
EBITDA	125.6	25.9	(55.1)	66.3	11.0	1.6
EBIT	448.5	36.2	(72.8)	142.4	15.8	1.9
Net income	995.5	22.5	(83.1)	277.0	19.9	3.8

Year-end	2021	2022	2023e	2024e	2025e	2026e
Margins (%)						
EBITDA	31.8	35.7	20.4	26.3	26.1	26.1
EBIT	22.5	27.2	9.4	17.7	18.3	18.4
Net	20.9	22.8	4.9	14.4	15.4	15.7

Year-end	2021	2022	2023e	2024e	2025e	2026e
Returns (%)						
RoAA	12.8	14.2	2.3	8.1	9.2	9.1
RoAE	25.5	25.0	3.8	13.4	14.4	13.4
RoIC	16.9	20.5	5.1	11.3	12.5	12.5
FCF margin	6.6	4.9	(2.2)	5.0	8.1	11.1

Year-end	2021	2022	2023e	2024e	2025e	2026e
Gearing (%)						
Net debt/Capital	25.3	24.1	28.0	24.1	17.9	9.1
Net debt/Equity	43.0	35.7	42.8	35.1	24.2	11.6
Interest cover (x)	16.4	17.5	3.7	11.1	15.6	20.9
Net debt/EBITDA (x)	1.3	1.0	2.7	1.5	1.0	0.6

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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.

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 8x in FY 24e and 14x in FY 23e, in-line with Saudi market, but at a 35% premium to global peers on higher margins and growth prospects.

Middle East Paper Co.

Year-end	2021	2022	2023e	2024e	2025e	2026e
Income statement (SARmn)						
Sales revenue	1,057	1,187	932	1,202	1,346	1,369
Cost of sales	(663)	(684)	(709)	(820)	(910)	(926)
Gross profit	**394**	**503**	**223**	**381**	**435**	**443**
SG&A	-	-	-	-	-	-
EBITDA	**337**	**424**	**190**	**317**	**351**	**357**
Depreciation	(99)	(100)	(102)	(103)	(104)	(105)
EBIT	**237**	**323**	**88**	**213**	**247**	**252**
Interest expense	(14)	(18)	(24)	(19)	(16)	(12)
Share of results of associates & JV	-	-	-	-	-	-
Profit before tax	228	286	49	185	222	230
Taxes	(7)	(15)	(3)	(12)	(14)	(15)
Other post-tax income/(expense)	**-**	**-**	**-**	**-**	**-**	**-**
Net profit (group)	221	271	46	173	207	215
Minorities	-	-	-	-	-	-
Net profit (parent)	**221**	**271**	**46**	**173**	**207**	**215**
Arqaam adjustments (including dilution)	-	-	-	-	-	-
Arqaam Net profit	**221**	**271**	**46**	**173**	**207**	**215**

Year-end	2021	2022	2023e	2024e	2025e	2026e
Balance sheet (SARmn)						
Cash and equivalents	264	145	119	143	169	276
Receivables	307	314	285	368	419	426
Inventories	144	213	254	301	338	344
Tangible fixed assets	1,064	1,106	1,231	1,219	1,208	1,198
Other assets including goodwill	92	169	169	169	169	169
Total assets	**1,870**	**1,947**	**2,058**	**2,199**	**2,302**	**2,413**
Payables	135	124	129	152	171	174
Interest bearing debt	686	567	639	618	537	473
Other liabilities	66	74	74	74	74	74
Total liabilities	**887**	**764**	**841**	**844**	**782**	**721**
Shareholders equity	983	1,181	1,215	1,354	1,519	1,691
Minorities	-	1	1	1	1	1
Total liabilities & shareholders equity	**1,870**	**1,947**	**2,058**	**2,199**	**2,302**	**2,413**

Year-end	2021	2022	2023e	2024e	2025e	2026e
Cash flow (SARmn)						
Cashflow from operations	**211**	**246**	**180**	**199**	**267**	**332**
Net capex	(70)	(142)	(227)	(92)	(94)	(96)
Free cash flow	**141**	**104**	**(48)**	**107**	**173**	**236**
Equity raised/(bought back)	-	167	-	-	-	-
Dividends paid	50	(50)	(11)	(35)	(41)	(43)
Net inc/(dec) in borrowings	108	(1)	70	(61)	(61)	(61)
Other investing/financing cash flows	(14)	(18)	(24)	(19)	(16)	(12)
Net cash flow	**214**	**(125)**	**(26)**	**23**	**26**	**108**
Change in working capital	(77)	(169)	(8)	(105)	(70)	(10)

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Q1 23A Results Summary

Exhibit 1: Q1 23A Results Summary

SARm	Q1 23A	Q1 23e	vs. ACe	Q4 22A	q/q	Q1 22A	y/y
Revenue	224	221	1%	232	-3%	305	-27%
Gross profit	35	56	-37%	77	-54%	143	-75%
EBITDA	25	41	-40%	50	-51%	130	-81%
Net income	(7)	6	n/m	25	n/m	92	n/m
GPM	16%	25%	(960 bps)	33%	(1,757 bps)	47%	(3,117 bps)
EBITDA margin	11%	18%	(744 bps)	22%	(1,081 bps)	43%	(3,174 bps)
Net margin	-3%	3%	(607 bps)	11%	(1,388 bps)	30%	(3,346 bps)

Source: Company Data, Arqaam Capital Research

Summary of forecast changes

Exhibit 2: We cut our EBITDA estimates by 13% in FY 23-25e on 6% lower selling prices thanks to global slowdown

	FY 23e			FY 24e			FY 25e		
SAR m	**new**	**old**	**Δ**	**new**	**old**	**Δ**	**new**	**old**	**Δ**
Revenues	932	1,043	*-11%*	1,202	1,234	*-3%*	1,346	1,379	*-2%*
Gross profit	223	322	*-31%*	381	401	*-5%*	435	456	*-4%*
EBITDA	190	273	*-30%*	317	331	*-4%*	351	367	*-4%*
Net income	46	123	*-63%*	173	187	*-7%*	207	222	*-7%*
GPM	23.9%	30.8%	(691)	31.7%	32.5%	(75)	32.3%	33.0%	(70)
EBITDA margin	20.4%	26.2%	(575)	26.3%	26.9%	(53)	26.1%	26.6%	(51)
Net margin	4.9%	11.8%	(688)	14.4%	15.1%	(76)	15.4%	16.1%	(70)

Source: Company Data, Arqaam Capital Research

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Valuation Summary

Exhibit 3: DCF Summary

SARm	2023e	2024e	2025e	2026e	2027e
EBIT	88	213	247	252	251
(Taxes Paid)	(3)	(12)	(14)	(15)	(15)
+Depreciation	102	103	104	105	107
COPAT	***187***	***304***	***337***	***342***	***343***
Working capital changes	(8)	(105)	(70)	(10)	(7)
CAPEX	(227)	(92)	(94)	(96)	(97)
Free cash flow	**(48)**	**107**	**173**	**236**	**239**

PVOP	340
PVTV	1,984
Enterprise Value	**2,324**
Debt	566
Cash	186
Net Debt (Q1 23A)	**380**
Equity Value	**1,945**
Number of Shares	67
Target Price (SAR/share)	**32.0**

Source: Company Data, Arqaam Capital Research

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