Oman Utility Sector, *green energy in focus…*

23 July 2023

Company	Rating
Phoenix Power Company (PHPC)	**Accumulate**
Sembcorp Salalah Power & Water (SSPW)	**Hold**
Sharqiyah Desalination Company (SHRQ)	**Buy**
Musandam Power Company (MSPW)	**Buy**

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Neetika Gupta
Head of Research
neetika@u-capital.net
Tel: +968 24 94 90 36

- **Oman's power demand on average has been revised lower by OPWP for a second time, partly impacted by some policy and structural changes**
- **Water demand to remain resilient, led by population and network growth**
- **Development of Renewable Energy projects remains at the centerstage**
- **The outlook for thermal power producers remains uncertain**

We review our coverage of four Omani utility companies – **Phoenix Power (PHPC), Sembcorp Salalah Power & Water (SSPW), Sharqiyah Desalination (SHRQ),** and **Musandam Power (MSPW).** We hold a neutral view on SSPW owing to uncertainty about the renewal of its PWPA. For the remaining three utilities, we have a positive stance.

- **Oman's power & water generation continues to expand, but power demand growth is set to decelerate.** Oman's average power demand growth has largely replicated real economic growth and this correlation is expected to hold going forward, given that Oman's economy is estimated to expand further by 1.3% in 2023 and by 2.7% in 2024, according to the IMF estimates. However, the World Bank forecasts a sharply higher growth rate of over 4.0% for the Sultanate's 2023 real GDP growth, and hence electricity production growth could also be higher. Nevertheless, OPWP has largely revised lower its average power demand growth estimate for Oman, partly due to the impact of some policy changes like subsidy reduction, and some structural changes like adoption of more energy efficient assets, deployment of solar energy by households and industries, etc. Duqm, though, is estimated to continue registering strong demand growth due to economic zone-related development. Water demand, on the other hand, is estimated to remain resilient.
- **Non-firm resources to play a greater role in ensuring the nation's energy security.** OPWP's latest planning statement shows that outgoing thermal power capacities will increasingly be replaced by non-firm resources like wind and solar power, import from other systems or countries, spot market, etc. Accordingly, the share of renewable energy in total energy generation is expected to reach 11% in 2025 and 24% by 2028 from a mere 2% in 2021.
- **SSPW's outlook is a bit uncertain, but we are optimistic about the other three.** We are slightly concerned about SSPW's business continuity, as OPWP has said it do not see any need for securing new supply once SSPW's contract expires in early Apr'27. On the other hand, with a long-term contract period remaining and a relatively advantageous position in their respective systems, we retain our favorable stance on SHRQ and MSPW. We are also optimistic about PHPC securing an extension once its contract expires on 31 Mar'29, as it will account for a significant share (between 35% and 40%) of MIS' firm electricity capacity by FY 2028, and we believe OPWP will certainly require reliability of thermal power supply to meet its 24 LOLH requirement.

Name	Last Px (OMR)	Target Price (OMR)	Upside / (Downside) (%)	P/E'23e, (x)	P/B'23e, (x)	EV/EBITDA' 23e, (x)	ROE'23e, (%)	TTM Cash Div Yield, %
Phoenix Power	0.067	**0.074**	10.5%	4.7	0.4	5.2	8.7%	7.8%
Sembcorp Salalah	0.100	**0.091**	-9.3%	4.6	0.6	3.5	13.4%	9.5%
Sharqiyah Desalination	0.130	**0.161**	24.1%	14.7	0.8	12.9	5.2%	11.5%
Musandam Power	0.280	**0.340**	21.3%	8.3	1.6	8.9	19.9%	10.6%
Average				**8.1**	**0.8**	**7.6**	**11.8%**	**9.9%**

Source: Bloomberg, Company filings, U Capital Research; Last price as of 23 July 2023

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Oman Utility Sector

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Risks to Valuation

Key downside risks to our valuations include:

- A deterioration in the domestic macroeconomic environment that can weigh on the prospective electricity and/or water demand in the country.
- Plant availability falls below the required level due to unexpected breakdowns, impacting the availability-based capacity charge.
- Decrease in plant utilization due to reduction in offtake from OPWP, which can curb variable revenue and cash flows.
- Less-than-estimated dividend payouts.

Key upside risks to our valuations include:

- Improvement in the macroeconomic conditions, leading to a higher-than-expected increase in the average electricity and/or water demand. This could boost plant utilization of utilities, boosting their variable revenues.
- Dividend payouts have largely been maintained near the average historical levels. However, any increase in the same by the management is an upside risk to our valuation.

Sensitivity Analysis

Our overall TP for **PHPC** changes in the range of 0.5%-1.5% to +/- 0.25% change in terminal growth or cost of equity (CoE) assumptions. Further, our overall **TP** varies in the range of 3%-4% to +/-0.5% change in the target Dividend Yield.

PHPC

	Terminal growth				
CoE	**0.00%**	**0.13%**	**0.25%**	**0.38%**	**0.50%**
8.8%	0.075	0.075	0.076	0.076	0.076
9.1%	0.074	0.074	0.075	0.075	0.075
9.3%	0.073	0.073	**0.074**	0.074	0.074
9.6%	0.072	0.072	0.073	0.073	0.073
9.8%	0.071	0.071	0.072	0.072	0.072

	2023e DPS (OMR)				
Target dividend yield	**0.004**	**0.005**	**0.005**	**0.006**	**0.006**
6.1%	0.072	0.076	0.080	0.084	0.088
6.6%	0.069	0.073	0.076	0.080	0.084
7.1%	0.067	0.070	**0.074**	0.077	0.080
7.6%	0.065	0.068	0.071	0.074	0.078
8.1%	0.063	0.066	0.069	0.072	0.075

Our overall TP for **SSPW** remains largely flat to +/- 0.25% change in terminal growth or cost of equity (CoE) assumptions. Further, our overall **TP** varies in the range of 4.5%-5.5% to +/-0.5% change in the target Dividend Yield.

SSPW

	Terminal growth				
CoE	**0.00%**	**0.13%**	**0.25%**	**0.38%**	**0.50%**
8.0%	0.091	0.091	0.091	0.091	0.091
8.3%	0.091	0.091	0.091	0.091	0.091
8.5%	**0.091**	0.091	0.091	0.091	0.091
8.8%	0.090	0.090	0.090	0.090	0.090
9.0%	0.090	0.090	0.090	0.090	0.090

	2023e DPS (OMR)				
Target dividend yield	**0.009**	**0.009**	**0.010**	**0.010**	**0.011**
6.4%	0.093	0.097	0.101	0.105	0.109
6.9%	0.088	0.092	0.096	0.099	0.103
7.4%	0.084	0.087	**0.091**	0.094	0.097
7.9%	0.080	0.083	0.086	0.090	0.093
8.4%	0.077	0.080	0.083	0.086	0.089

Our overall TP for **SHRQ** changes in the 1%-2% range to +/- 0.25% change in terminal growth or cost of equity (CoE) assumptions. Further, our overall **TP** varies in the range of 1.5%-2.0% to +/-0.5% change in the target Dividend Yield.

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SHRQ

CoE \ Terminal growth	0.00%	0.25%	0.50%	0.75%	1.00%
8.0%	0.162	0.165	0.167	0.170	0.172
8.3%	0.160	0.162	0.164	0.166	0.169
8.5%	0.157	0.159	**0.161**	0.163	0.166
8.8%	0.154	0.156	0.158	0.160	0.163
9.0%	0.152	0.154	0.156	0.158	0.160

Target dividend yield \ 2023e DPS (OMR)	0.014	0.014	0.015	0.015	0.016
9.9%	0.163	0.165	0.168	0.170	0.173
10.4%	0.159	0.162	0.164	0.167	0.169
10.9%	0.156	0.159	**0.161**	0.163	0.166
11.4%	0.154	0.156	0.158	0.160	0.163
11.9%	0.151	0.153	0.155	0.158	0.160

Our overall TP for **MSPW** changes in the 1%-2% range to +/- 0.25% change in terminal growth or cost of equity (CoE) assumptions. Further, our overall **TP** varies in the range of 2.0%-2.5% to +/-0.5% change in the target Dividend Yield.

MSPW

CoE \ Terminal growth	0.00%	0.25%	0.50%	0.75%	1.00%
7.6%	0.342	0.347	0.353	0.358	0.365
7.8%	0.336	0.341	0.346	0.351	0.357
8.1%	0.331	0.335	**0.340**	0.344	0.350
8.3%	0.325	0.329	0.334	0.338	0.343
8.6%	0.320	0.324	0.328	0.332	0.337

Target dividend yield \ 2023e DPS (OMR)	0.027	0.027	0.028	0.028	0.029
8.3%	0.351	0.354	0.357	0.360	0.363
8.8%	0.342	0.345	0.348	0.351	0.354
9.3%	0.334	0.337	**0.340**	0.342	0.345
9.8%	0.327	0.330	0.332	0.335	0.337
10.3%	0.320	0.323	0.325	0.328	0.330

Peer Group Valuation

Name	Mkt Cap (OMR mn)	Last Px (LC)	Px Change 1M, %	Px Change 3M, %	Px Change YTD, %	EV/EBITDA' TTM, (x)	P/E'22 (x)	ROE'22, (%)	Div Yield' TTM, (%)	FCF Yield'TTM (%)
Omani Utilities (without cash sweep)										
SEMBCORP SALALAH POWER & WA	95.5	0.10	1	18	52	3.3	3.2	14.3%	9.5%	41.8%
PHOENIX POWER CO SAOC	98.0	0.07	2	16	56	5.1	3.1	9.3%	7.8%	56.3%
MUSANDAM POWER CO	19.7	0.28	0	-11	-10	9.4	8.2	23.2%	10.6%	28.0%
SHARQIYAH DESALINATION CO SA	12.7	0.13	4	0	11	13.3	12.7	5.8%	11.5%	27.2%
MUSCAT CITY DESALINATION CO	14.2	0.09	-8	-8	-7	8.4	6.2	11.6%	12.4%	37.3%
BARKA DESALINATION CO SAOC	10.1	0.13	0	-4	-3	10.5	6.7	10.0%	9.0%	86.1%
Omani Utilities (with cash sweep)										
AL BATINAH POWER	19.6	0.03	4	-6	0	4.2	1.6	11.9%	24.1%	114.5%
AL SUWADI POWER	20.7	0.03	4	-6	0	3.9	1.5	12.1%	0.0%	142.9%
DHOFAR GENERATING CO SAOC	12.9	0.06	-3	-8	0	10.6	12.8	2.7%	0.0%	78.1%
SMN POWER HOLDING SAOG	16.8	0.08	2	-9	83	2.3	1.2	17.0%	17.9%	128.7%
Regional Utilities										
QATAR ELECTRICITY & WATER CO	2,090.5	18.01	4	9	2	21.4	11.7	12.8%	5.3%	6.3%
ABU DHABI NATIONAL ENERGY CO	38,605.4	3.28	0	3	-4	20.7	21.4	24.5%	0.4%	4.6%
DUBAI ELECTRICITY & WATER AU	14,184.5	2.71	3	14	18	11.9	18.1	8.5%	4.6%	3.0%
ACWA POWER CO	14,382.7	191.80	15	23	26	65.0	98.9	9.9%	0.4%	0.6%
SAUDI ELECTRICITY CO	9,684.0	22.66	1	-5	-2	5.3	14.6	2.5%	3.1%	8.9%
Average						**12.9**	**14.5**	**11.9%**	**6.9%**	**50.8%**
Median						**9.5**	**7.9**	**11.6%**	**4.8%**	**34.3%**

Source: Bloomberg, U Capital Research, na – not available, nm – not meaningful

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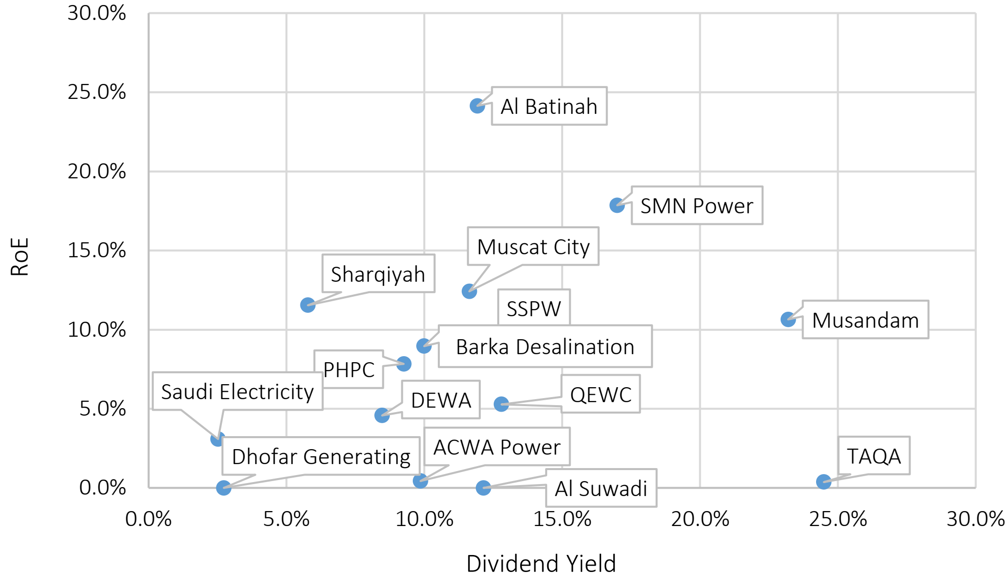
Fig. 1: GCC Utilities – RoE & Dividend Yield



Source: Bloomberg, U Capital Research; As of 23 July 2023

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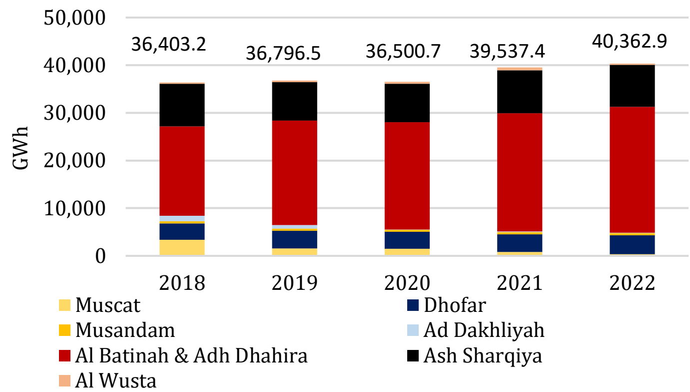
Utility Sector Update

Electricity and water generation heads further north…

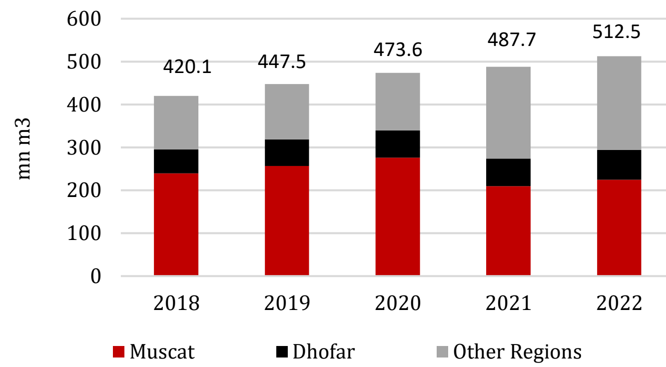
After remaining largely stagnant during 2018-2020 amid the onslaught of the COVID-19 pandemic, Oman's electricity generation increased further in 2022 from 2021 as the economic growth accelerated with the pandemic subsiding almost completely. The total electricity generation edged past 40 terawatt hours (TWh) in 2022, increasing at a slower pace of 2.1% YoY as compared to 8.3% YoY growth registered in 2021, which is understandable since power generation had slipped in 2020 creating a somewhat low base. In contrast, water generation maintained its strong going, rising 5.1% YoY in 2022 (2021: +3.0% YoY). We believe, in addition to consumer demand, a rise in industrial demand has boosted water production.

Fig. 2: Net electricity production rises further in 2022



Source: NCSI, APSR, U Capital Research

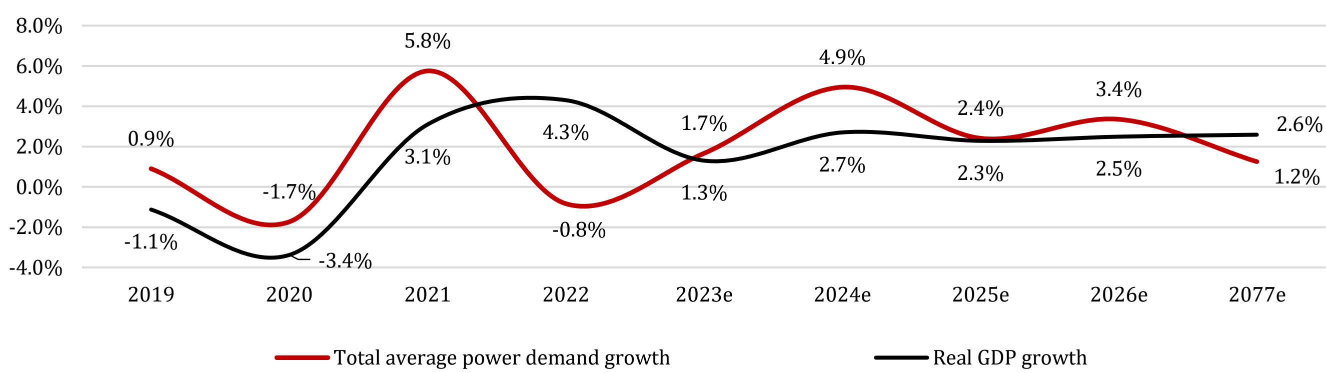
Fig. 3: Water production grows at an accelerated rate last year



Source: NCSI, APSR, U Capital Research

…but power demand is estimated to grow at a reduced pace than forecasted previously owing to structural and policy changes…

Fig. 4: Oman's power demand has a close correlation with the economic activity



Source: OPWP, IMF, U Capital Research; Note: 2022 power demand growth is based on OPWP's avg. power demand estimate under expected case scenario for different systems

The above figure depicts that Oman's average power demand has moved in close tandem with economic activity, and the trend is likely to continue going forward as well, considering OPWP's expected or normal case scenario estimates. Among the different power networks in Oman — the Main Interconnected System (MIS) is the biggest, and the overall demand will surely be driven by this system as it would continue to account for bulk (around 85%-90%) of the total power demand in the country. Among the remaining power systems, i.e., the Duqm Power System, the Dhofar Power System, and the Musandam Power System (MPS), Dhofar Power System is the largest as its share in the total power demand averages about 9%.

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While the overall power demand of Oman is estimated to keep expanding going forward tracking the economic growth, it is to be noted here that in its latest 7-year statement (2022-2028), OPWP has either maintained or lowered the average yearly growth demand estimates under different scenarios for three of the four power systems as compared to its previous statement (Fig. 5). The average power demand estimate for Duqm Power System, on the other hand, has been maintained and/or increased. This is because the region is likely to witness a sharp rise in power demand during the next two-three years arising from several committed and uncommitted large-scale industrial and infrastructure projects by SEZAD (The Special Economic Zone Authority at Duqm). Another demand driver for the region is the inclusion of new demand areas which are linked or expected to be linked to the Duqm region as part of the North-South Interconnect project.

Fig. 5: MIS' and Dhofar's average power demand growth has been reduced for a third year in a row by OPWP

MIS - Power	Expected case growth		Low case growth		High case growth	
OPWP Statements	Av. Demand	Peak demand	Av. Demand	Peak demand	Av. Demand	Peak demand
2022-2028	2.0%	3.0%	0.2%	1.0%	3.0%	5.0%
2021-2027	2.0%	4.0%	1.0%	2.0%	4.0%	6.0%
2020-2026	3.6%	4.0%	2.0%	2.0%	6.0%	7.0%
2019-2025	5.0%	5.0%	3.0%	3.0%	7.0%	8.0%

Ad Duqm - Power	Expected case growth		Low case growth		High case growth	
OPWP Statements	Av. Demand	Peak demand	Av. Demand	Peak demand	Av. Demand	Peak demand
2022-2028	23.0%	21.0%	15.0%	16.0%	28.0%	25.0%
2021-2027	23.0%	na	14.0%	na	28.0%	na
2020-2026	27.0%	na	23.0%	na	33.0%	na
2019-2025	23.0%	na	13.0%	na	27.0%	na

Dhofar - Power	Expected case growth		Low case growth		High case growth	
OPWP Statements	Av. Demand	Peak demand	Av. Demand	Peak demand	Av. Demand	Peak demand
2022-2028	3.0%	5.0%	1.0%	3.0%	4.0%	6.0%
2021-2027	3.0%	4.0%	2.0%	2.0%	5.0%	6.0%
2020-2026	5.0%	5.0%	3.0%	4.0%	7.0%	8.0%
2019-2025	7.0%	6.0%	5.0%	5.0%	10.0%	9.0%

Musandam - Power	Expected case growth		Low case growth		High case growth	
OPWP Statements	Av. Demand	Peak demand	Av. Demand	Peak demand	Av. Demand	Peak demand
2022-2028	5.0%	5.0%	3.0%	3.0%	6.0%	7.0%
2021-2027	5.3%	na	3.2%	na	7.4%	na
2020-2026	3.0%	na	2.0%	na	4.0%	na
2019-2025	6.4%	na	5.5%	na	6.9%	na

Source: OPWP, U Capital Research; na – not available

The downward revision in the average and/or peak electricity demand growth for the other power systems under the three different scenarios is due to some structural changes in the sector as well as some policy initiatives that are captured in the points below:

- **Cost Reflective Tariffs (CRT):** CRT was introduced by the authorities in 2017 to incentivize large power consumers to shift their power consumption from the peak time of a day to non-peak time by charging a higher rate for the peak time. Since then, the government has introduced more iterations of CRT like different tariffs for summer and winter seasons and/or flat tariffs with no seasonal or daily variation. Even the peak time rate in the initial version of CRT has come down with the commencement of Ibri II Solar IPP and with the start of more such projects in the future, peak high energy rates of afternoon are expected to fall further while night tariffs are estimated to increase, which will see a realignment of demand between peak and non-peak periods.

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- **Energy Efficiency (EE) promotion:** Initiatives undertaken by the government to promote energy-efficient appliances, like issuing energy efficiency cards for air conditioners, and the gradual adoption of such appliances is estimated to bring the energy demand down in the future, according to OPWP.
- **Tariff reform:** Yet another factor that is believed to drag down the demand for power going forward is the steps undertaken by the concerned authorities in 2021 to eliminate subsidies by 2030 from the tariffs of residential and small commercial consumers.
- **Solar power adoption by the private sector:** While the deployment of rooftop solar and industrial solar plants is already underway, OPWP expects an acceleration in the same once the government sets clear guidelines for market evolution, transmission charges, and other technical parameters. This might also bring down the average and/or peak energy demand.

...though water demand is estimated to remain resilient

The average demand growth for water for the three main networks — the MIS, the Sharqiyah Water Network, and the Dhofar Water Network — has largely been revised up by OPWP on the back of growth in overall population and per capita water consumption, as well as expansion of the water supply network.

Fig. 6: Total MIS average water demand growth has been raised primarily due to the Muscat zone

MIS - Water	Muscat zone		Barka zone		Sohar zone	
OPWP Statements	Av. Demand	Peak demand	Av. Demand	Peak demand	Av. Demand	Peak demand
2022-2028	3.0%	3.0%	3.0%	3.0%	5.0%	5.0%
2021-2027	1.0%	1.0%	4.0%	4.0%	8.0%	8.0%
2020-2026	2.0%	2.0%	10.0%	10.0%	10.0%	10.0%
2019-2025	4.0%	4.0%	10.0%	10.0%	12.0%	12.0%

Total - Water	Total MIS		Sharqiyah		Dhofar	
OPWP Statements	Av. Demand	Peak demand	Av. Demand	Peak demand	Av. Demand	Peak demand
2022-2028	4.0%	4.0%	5.0%	4.0%	8.0%	9.0%
2021-2027	3.0%	3.0%	5.0%	5.0%	8.0%	8.0%
2020-2026	6.0%	6.0%	5.0%	6.0%	13.0%	13.0%
2019-2025	6.0%	7.0%	5.0%	5.0%	13.0%	14.0%

Source: OPWP, U Capital Research

OPWP adopts a multi-faceted approach to manage future power and water demand and supply

OPWP's 2022-2028 statement shows that there were 18 power and water utility companies operating in Oman (vs. 17 in 2021), with the start of Aseelah IWP of Al Aseelah Desalination Company in January 2022. Of them, 12 utility companies are listed — five thermal power generators (Dhofar Generating Co, Al Suwadi Power, Al Batinah Power, Phoenix Power, Musandam Power), four co-power & water generation companies (Sembcorp Salalah Power & Water, Barka Water & Power, SMN Power Holding, Sohar Power), and three water desalination companies (Muscat City Desalination, Barka Desalination, Sharqiyah Desalination). In addition to the 18 entities above, two IPPs — Rusail of SMN Power Holding whose original contract expired in 2022, and Manah of the United Power Company whose contract concluded in 2020 — are also operational but to provide ancillary services only till 2023-end and 2024, respectively.

However, out of the 18 utilities,

i) Sohar Power's PWPA expired in May 2022 and has not been renewed. While there are options of Spot Market and Bilateral Trading, Sohar Power said that at present these mechanisms do not provide a viable alternative to its expired PWPA.

ii) SMN Power Holding's Barka II IWPP's contract will expire in 2024, while its other project Rusail IPP's contract has been extended till the end of December 2023 though only to provide ancillary services, and that too only for a part of its total capacity (192 MW out of the total 694 MW capacity). Hence the company has initiated a process to decommission and sell its retired plant's equipment.

iii) Barka Water & Power has also got an extension for its two RO water plants till March 2024, while the contract of its power plant has not been extended after its expiration in February 2022. All three companies have shown interest in the Power-2024 and Water-2024 procurement initiatives of OPWP.

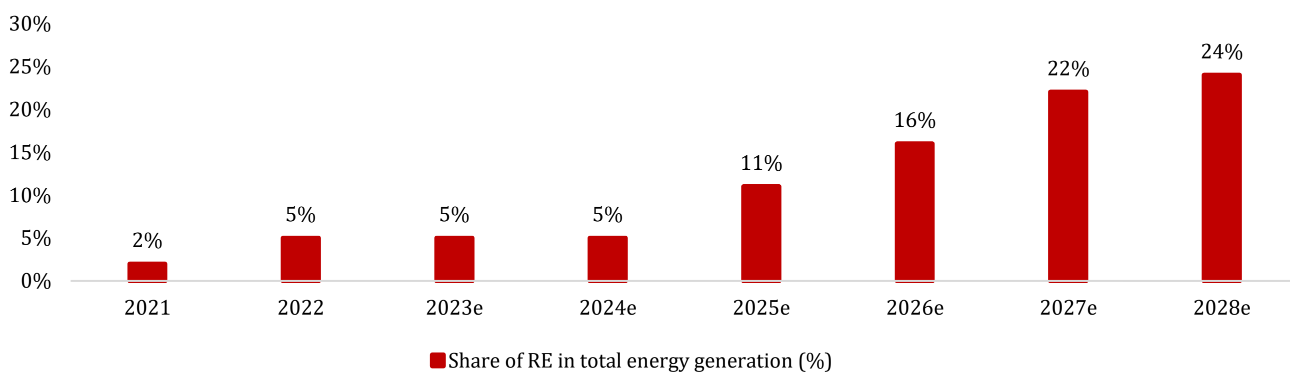
Over the next 5-6 years, some more power and/or water projects could stop operating with their contract coming to an end (Fig. 7) and if they do not secure an extension or find any other feasible options to operate.

Fig. 7: Details of the projects whose contracts are set to expire over the next 5-6 years

Project name	System	Project type	Capacity	Company	Contract expiry
Salalah IWPP	DPS	PWPA	445 MW/15 MIGD	Sembcorp Salalah	2027
Sohar II IPP	MIS	PPA	766 MW	Al Batinah Power	2028
Barka III IPP	MIS	PPA	766 MW	Al Suwadi Power	2028
Sur IPP	MIS	PPA	2,018 MW	Phoenix Power	2029

Source: OPWP, U Capital Research

Fig. 8: Renewable energy's share in the total power generation in Oman is estimated to grow rapidly



Source: OPWP, U Capital Research

However, OPWP has a resource development plan in place to ensure proper and timely replacement for the outgoing water and power capacities as listed in the points below:

- **The spot market for electricity:** The spot market for electricity trading is in operation in Oman since 01 January 2022. While OPWP is purchasing power daily from the market, it is still in a nascent stage and its reliability and adequacy will only be established over time. Nevertheless, sourcing from the spot market is an important aspect of OPWP's planning for future electricity supply.
- **Power 2024/2028:** This is the name given by OPWP to the procurement of long-term electricity capacities. Under these, OPWP will enter into multi-year contracts either with existing projects whose contracts have ended or with new projects. According to the management report of some listed utilities, OPWP has already launched the Power 2024 process in April 2023, while for Power 2028, it will assess the power supply situation at that time, taking into account the availability of reliable power supply from different sources. OPWP, though, believes Power 2028 will be necessary, given the contract expiry of Al Batinah and Al Suwadi Power.
- **Intra and inter-country power transmission networks:** Work on the North-South Interconnect project to connect different power systems of the country and facilitate the transfer of electricity from surplus areas to deficit areas is ongoing. The first phase of the project connecting MIS with the PDO (Petroleum Development Oman) power system and then extended to the Ad Duqm power system was targeted to be completed by June 2023. This is expected to boost the development of Duqm's Special Economic Zone (SEZ) and enhance the overall efficiency of different power systems of the country. The North-South Interconnect is aimed to later extended to Dhofar Power

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System by 2026. In the inter-country transmission, apart from the existing 220 kV link with the GCC Interconnection Authority (GCCIA) system via Abu Dhabi Interconnect, a 400 kV direct link with KSA is in planning which is expected to offer better generation planning and trading opportunities.

- **Renewable Energy development:** The development of Renewable Energy energy projects remains at the center stage as the government aims to release gas from power production to other industries and stimulate the growth of the non-hydrocarbon sector. Accordingly, the share of electricity generation from Renewable Energy projects in total electricity production is expected to expand from 2% in 2021 to 11% by 2025.

Fig. 8: Summary of the renewable energy projects under planning or development

Project name	System	Capacity	Scheduled COD
Manah I Solar IPP	MIS	500 MW	1Q 2025
Manah II Solar IPP	MIS	500 MW	2Q 2025
MIS solar IPP	MIS	500 MW	1Q 2026
Jalaan Bani bu Ali wind IPP	MIS	100 MW	1Q 2026
Duqm wind IPP	Duqm	200 MW	1Q 2026
Dhofar II Wind IPP	DPS	100 MW	2026
Ras Madrakah Wind IPP7	Duqm	200 MW	2027
MIS Solar IPP 2027	MIS	500 MW	2027
Waste-to-Energy (WTE)	—	140 MW	2Q 2028
Sadah Wind IPP	DPS	100 MW	2028

Source: OPWP, U Capital Research

In addition to the above, OPWP has some more avenues which aid or will aid the authority to manage the demand and supply of electricity in the future. For instance:

- **Surplus production of captive power capacities:** Among the non-firm sources of power supply which OPWP considers for its future electricity supply planning is an import of surplus power from the captive power plants of industries. An example is OPWP's agreement with Sohar Aluminium under which the latter supplies up to 180 MW of power to MIS during the summer season while the reverse happens in the winter season.
- **Demand Response:** This mechanism is still in the conceptualization phase and OPWP intends to work on this in the current year. Under this, OPWP intends to manage the power demand and system load between peak and off-peak periods by penalizing or incentivizing customers to shift their usage from peak to lean periods.

Like the power sector, the water sector is also witnessing the development of some new water desalination plants by OPWP, in coordination with OWWSC, so that citizens do not face any water supply shortages as some existing plants go offline due to the end of their contract period.

Fig. 9: Water projects whose contracts are set to expire over the next 4-5 years

Project name	System	Company	Capacity	Contract expiry
Barka IWPP	MIS	Barka Water & Power	45,000 m3/d (10 MIGD)	2024
Barka IWPP	MIS	Barka Water & Power	57,000 m3/d (12.5 MIGD)	2024
Barka II IWPP	MIS	SMN Barka Power	120,000 m3/d (26 MIGD)	2024
Salalah IWPP	Dhofar	Sembcorp Salalah	68,190 m3/d (15 MIGD)	2027

Source: OPWP, U Capital Research

Fig. 9: Most of the new water projects will come up in the MIS

Project name	System	Capacity	Scheduled COD
Barka V IWP	MIS	100,000 m3/d (22 MIGD)	3Q 2024
Ghubrah III IWP	MIS	300,000 m3/d (66 MIGD)	2Q 2024
Qurayyat IWP	MIS	200,000 m3/d (44 MIGD)	2024; 40 MIGD is operational
Dhofar Water IWP 2026	Dhofar	150,000 m3/d (33 MIGD)	2026
North Batinah IWP	MIS	150,000 m3/d (33 MIGD)	2029

Source: OPWP, U Capital Research

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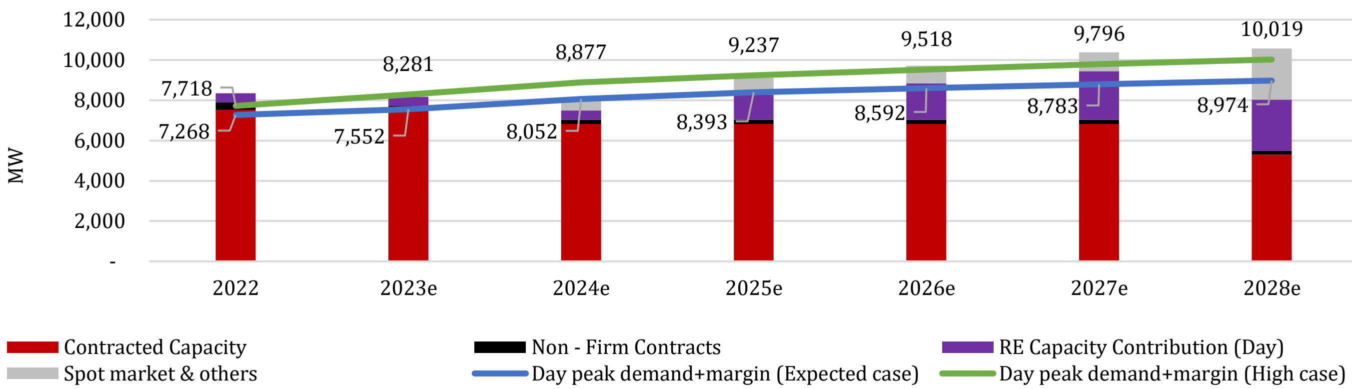
Conventional power plants seem to lose favor as OPWP focuses on Renewable Energy projects and non-firm resources to meet future power requirements

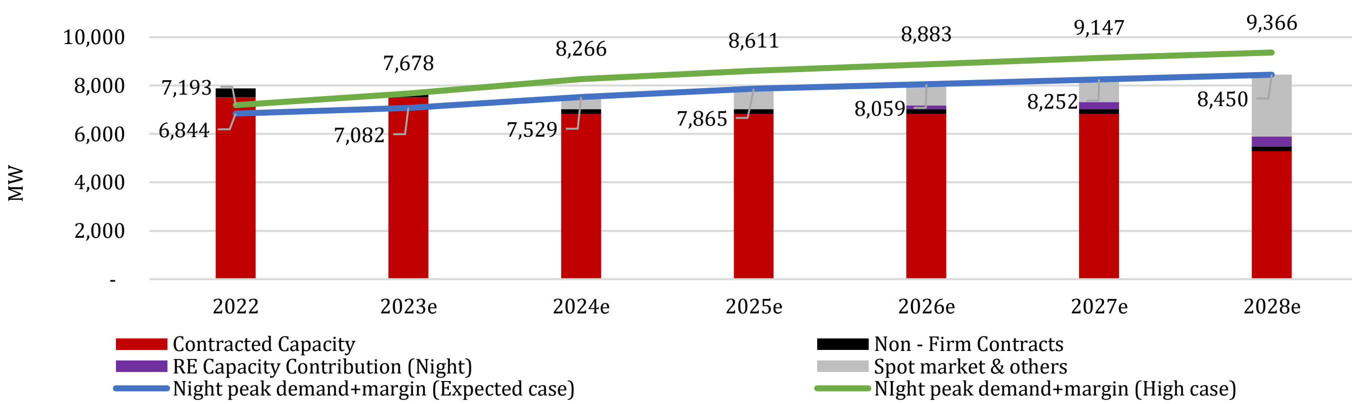
As per our observation, while the overall power and water sector in the country is advancing and the initiatives and steps being undertaken by the concerned authorities are expected to bring an overall improvement for both the consumers and producers in the long run, in the short-term, conventional power producers are likely to face headwinds. As highlighted earlier, the conventional power and/or water producers whose contracts with OPWP have expired or are about to expire are clueless about whether they will get sustainable business opportunities going forward, given more focus on growing the Renewable Energy share of the sector.

Most of these companies are now earning only a fraction of the income that they were generating when their PPA/PWPA was in-force, and there is a fair chance they might shut down completely and liquidate. Accordingly, this has reduced the investable universe in the utility space for equity market players, and this can shrink further in the next 5-6 years unless the sector witnesses the listing of newer companies. Below are some charts showing expected power and water demand and probable sources of supply, as per OPWP's latest 7-year statement.

Fig. 10: Share of non-firm resources in MIS+Duqm power system will grow significantly



Source: OPWP, U Capital Research; Note: Power demand and supply estimates are for the day time



Source: OPWP, U Capital Research; Note: Power demand and supply estimates are for the night time

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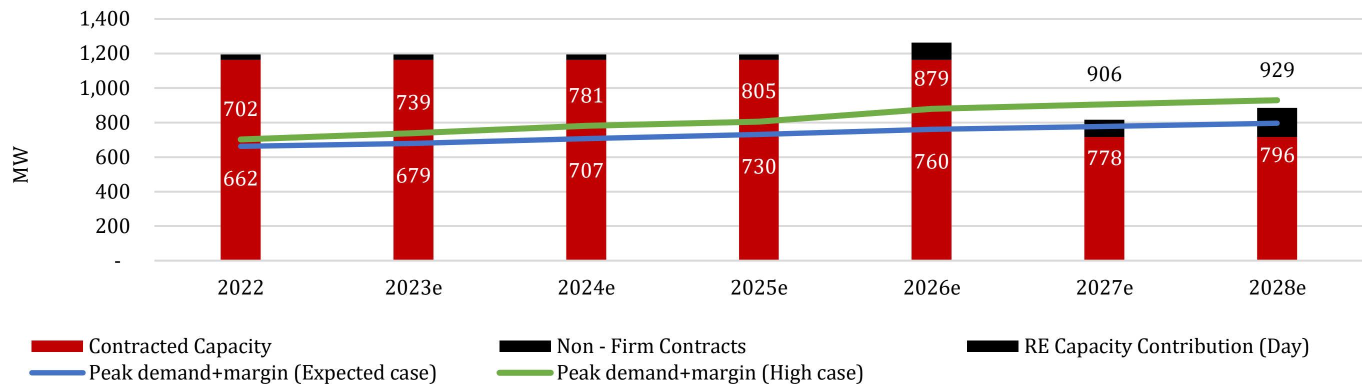
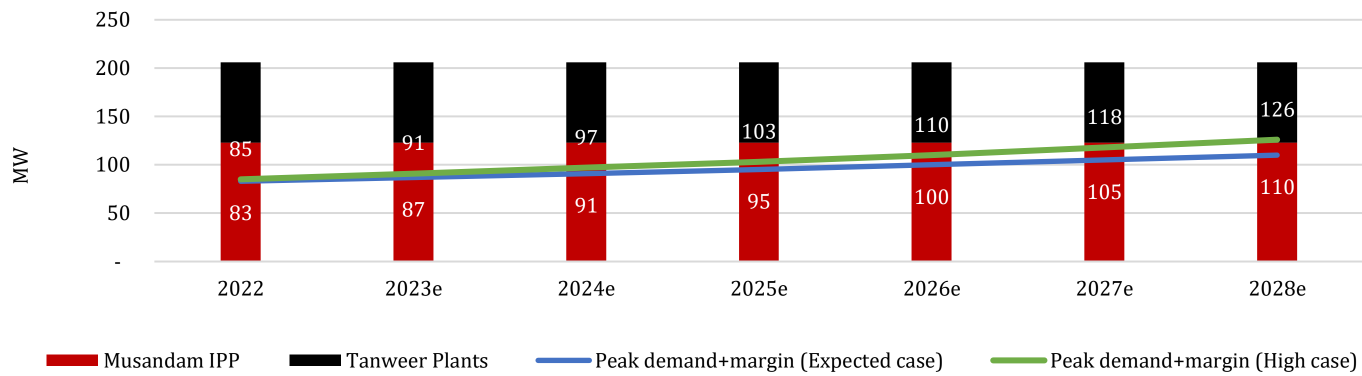
Fig. 11: Firm capacity in Dhofar Power System will decline in 2027 with the contract expiry of SSPW



Source: OPWP, U Capital Research

Fig. 12: Musandam IPP is expected to easily meet the entire Musandam governorate's power demand till FY 2028e



Source: OPWP, U Capital Research

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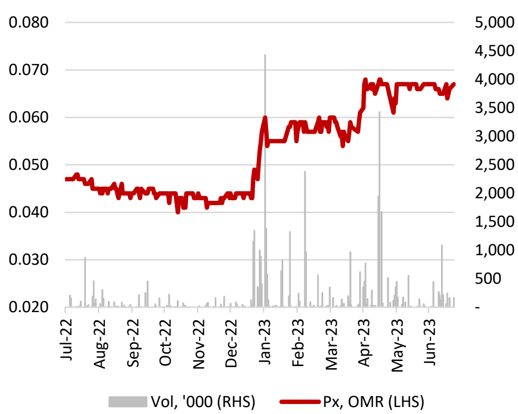
Phoenix Power Company

Target Price: OMR0.074/share
Upside/(downside): 10.5%

Recommendation	**Accumulate**
Bloomberg Ticker	PHPC OM
Current Market Price (OMR)	0.067
52wk High / Low (OMR)	0.070/0.040
12m Average Vol. (000)	183.2
Mkt. Cap. (USD/OMR Mn)	255/98
Shares Outstanding (mn)	1,462.6
Free Float (%)	100%
3m Avg Daily Turnover (OMR'000)	17.5
6m Avg Daily Turnover (OMR'000)	18.0
P/E'23e (x)	4.7
EV/EBITDA'23e (x)	5.2
Dividend Yield '23e (%)	8.1%
Price Performance:	
1 month (%)	1.5
3 month (%)	15.5
12 month (%)	36.7

Source: Bloomberg, valued as of 23 July 2023

Price-Volume Performance



Source: Bloomberg

- **PHPC's plant is the largest single-location plant in Oman, catering to the MIS, the largest power system of the Sultanate**
- **The regulated framework ensures a relatively stable revenue stream, steadily expanding margins and cash flows**
- **No cash sweep will enable PHPC to maintain consistent dividends at attractive yields over the remaining term of its contract**
- **PHPC stands a good chance for the renewal of its contract, in our opinion, given its large size and decreasing firm power supply in MIS**

We review our coverage on **PHPC** and raise the target price to OMR 0.074 (previously, OMR 0.051) per share, attributable to an increase in our dividend estimates based on the latest declared dividends. Also, we are optimistic about the chance for the renewal of PHPC's PPA upon its expiry on 31st Mar'29, given its significant share of MIS' power generation capacity which is set to rise further as more contracts expire. At the current market price, the target price indicates an upside of 10.5% and hence we maintain our **Accumulate** rating to the stock. Currently, the stock trades at a P/E of 4.7x based on our FY'23 estimates, offering a TTM dividend yield of c. 8%, slightly above the average dividend yield of peers.

Investment Summary

Steady top-line growth driven by an assured revenue stream:

i) The plant is estimated to maintain its excellent availability of over 99% on average going forward, aiding the company to generate around 40%-45% of its total revenue through the capacity charge.

ii) PHPC's energy charge has clocked 5% CAGR during FY17-22, partly driven by slight growth in utilization and we expect a similar growth trend over the remaining contract period. Accordingly, we estimate total revenue to grow at 3% CAGR during FY22-28e, the same as in the past 5 years.

iii) Improving profitability, negligible capex, and scheduled debt repayments (D/E: FY17-2.2x; FY22-1.0x; FY28e-0.1x) to boost cash flows.

iv) No threat to dividend payments is likely in the absence of cash sweep.

v) We are hopeful of an extension of PHPC's PPA after 31 Mar'29, given the plant's sizeable share (c. 27% of MIS' firm power capacity in FY'23e), and the advantage a thermal plant provides over RE in terms of reliability which is crucial for OPWP's to meet its LOLH requirements.

Year	FY20	FY21	FY22	FY23e	FY24e	FY25e
Revenues (OMR mn)	135.4	146.2	149.2	153.5	159.2	163.8
Net income (OMR mn)	16.4	16.9	20.4	21.1	24.6	28.8
Operating margin	26.0%	23.4%	24.6%	24.1%	24.5%	25.4%
Net profit margin	12.1%	11.5%	13.7%	13.7%	15.5%	17.6%
RoE	9.2%	8.8%	9.3%	8.7%	9.6%	10.4%
FCF (OMR/share)	0.032	0.034	0.038	0.033	0.036	0.036
DPS (OMR/share)	0.004	0.005	0.005	0.005	0.006	0.006
Dividend Yield	8.1%	9.2%	12.2%	8.1%	8.4%	8.7%
P/E (x)	4.6x	4.3x	3.1x	4.7x	4.0x	3.4x
EV/EBITDA (x)	6.9x	6.3x	5.1x	5.2x	4.4x	3.5x

Source: Company Reports **P/E, EV/EBITDA, and Dividend yield from FY23 onwards are calculated on current price*

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Investment rationale

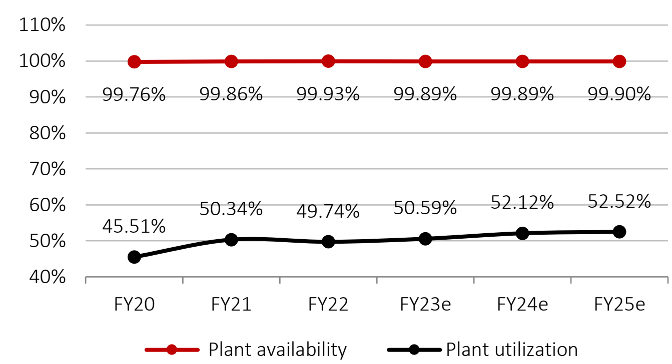
Top-line growth to be driven largely by increasing energy charge with fixed capacity charge lending stability

PHPC's variable energy has grown at about 5% average annual rate during FY 2017-22, partially driven by an increase in plant utilization which improved by slightly over 500 basis points (bps) since FY 2017 to reach 49.7% in FY 2022. PHPC caters to the MIS system and has the largest capacity among the existing players. PHPC's power plant is located towards the South-East of Muscat, in contrast to most of the other plants that are situated towards the north of the Omani capital.

Notably, it has relatively closer proximity to the Duqm region, which, according to OPWP's latest 7-year statement, is estimated to register strong double-digit growth in its average power demand under all three scenarios, i.e., Expected Case, Low Case, and High Case. This, in turn, will be led by the demand from the ongoing and new industrial and infrastructure projects in the Ad Duqm area, apart from the commercial and residential energy demand arising from the development plans of SEZAD. A likely connection of new demand centers like Mahout to Ad Duqm during the later part of 2022 is also expected to drive the Ad Duqm region's power demand, which largely is expected to be fulfilled through the MIS.

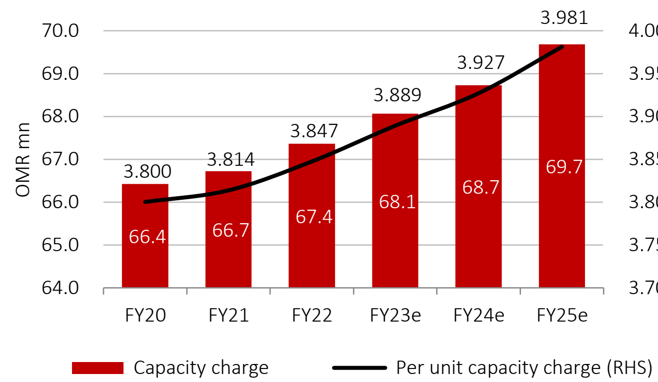
Although Omani utilities sell their output only to OPWP as per the latter's directives, we believe owing to its locational advantage highlighted above, PHPC could get a preference over other plants as OPWP fulfills Ad Duqm and MIS region's power demand. Accordingly, we believe PHPC's utilization will register similar growth over the next 5 years, increasing by another c. 500 bps to nearly 55% by FY 2028e, boosting the energy charge's share in the total revenue to around 60% by FY 2028e as compared to ~55% in FY 2022.

Fig. 13: Plant availability to remain stable at above 99%



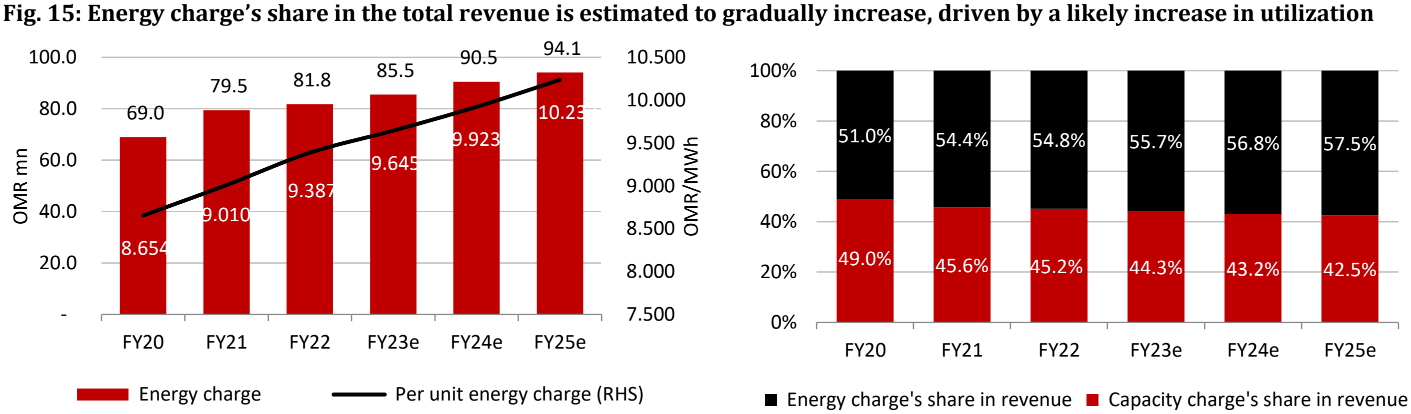
Source: Company Reports, U Capital Research

Fig. 14: Per unit capacity charges have been rising slightly



Source: Company Reports, U Capital Research

Fig. 15: Energy charge's share in the total revenue is estimated to gradually increase, driven by a likely increase in utilization



Source: Company Reports, U Capital Research

Source: Company Reports, U Capital Research

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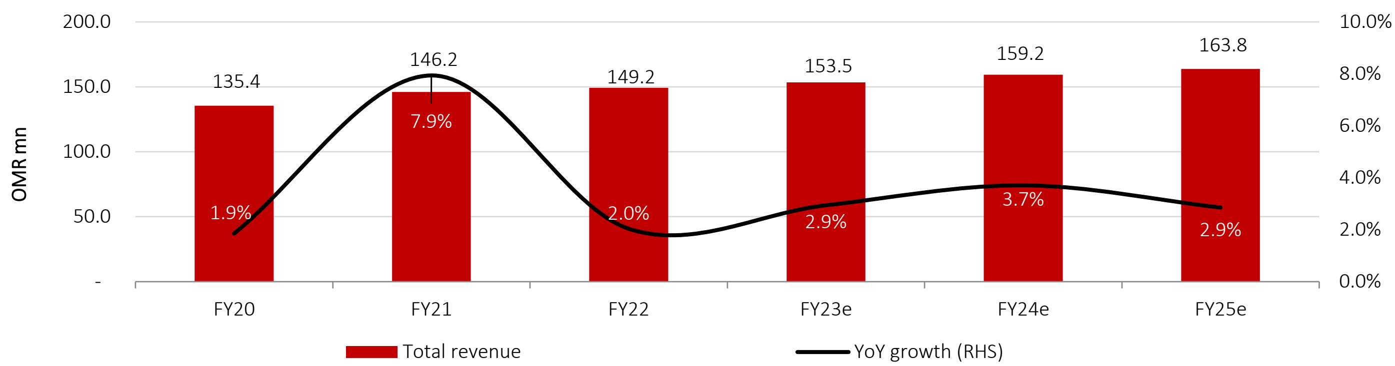
PHPC is required under the terms of its PPA to maintain its plant availability 100% of the time in summer and 85% in winter. We opine it will comfortably maintain a high level of its plant availability (99%-100% range) annually on average over its remaining contract period which expires on 31 March 2029, thereby continuing to earn an assured revenue stream in terms of capacity charges. Consequently, we estimate that the company's top line will replicate its past 5-year CAGR of 3% over the next five years as well.

Fig. 16: Total revenue to grow at ~4% CAGR during FY20-25e

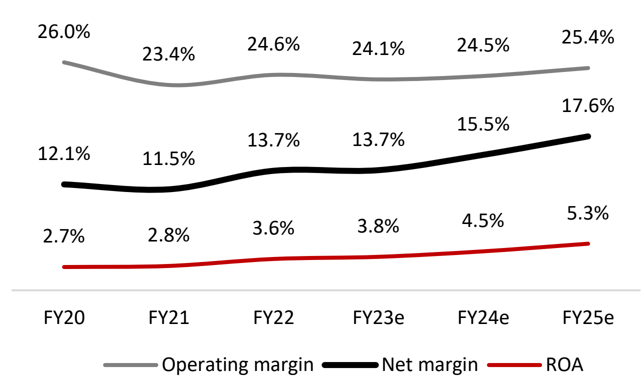


Source: Company Reports, U Capital Research

A growing revenue stream coupled with negligible incremental capex to enhance return on assets

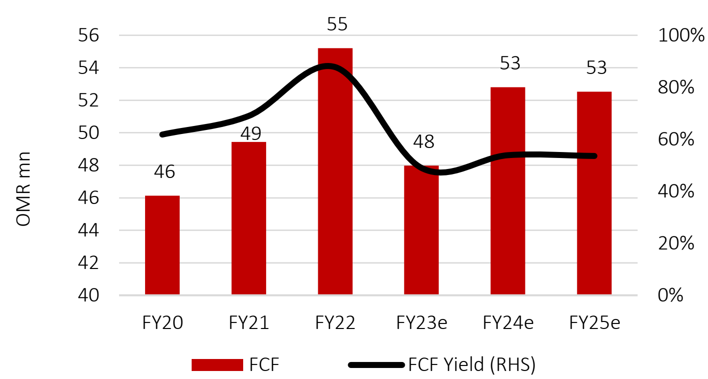
PHPC's plant capacity will remain constant during the term of its contract which implies capex will remain low, mostly limited to maintenance (between 0.0-0.5% of the total revenue). As the PPE forms the largest component of the balance sheet, and with the depreciation exceeding the incremental capex, the overall balance sheet size is estimated to shrink. Hence, with a forecasted steady rise in the revenue, and an expanding bottom line supported by decreasing finance costs, we estimate the return on assets (RoA) to remain in a rising trend, expanding by slightly over 400 bps by the end of FY 2028e from 3.6% in FY 2022.

Fig. 17: RoA to improve as balance sheet size shrinks



Source: Company Reports, U Capital Research

Fig. 18: Strong free cash flow generation



Source: Company Reports, U Capital Research

Accordingly, we also estimate cash flow generation to remain strong, averaging between OMR 50mn and OMR 60mn over the next 5 years.

A gradual rise in DPS to continue

PHPC has proposed a total of 5.25 baizas dividend per share (DPS) for the year ended December 2022 as compared to a cumulative 4.50 baizas DPS declared for FY 2021. With a forecasted growth in net income, we expect the company will

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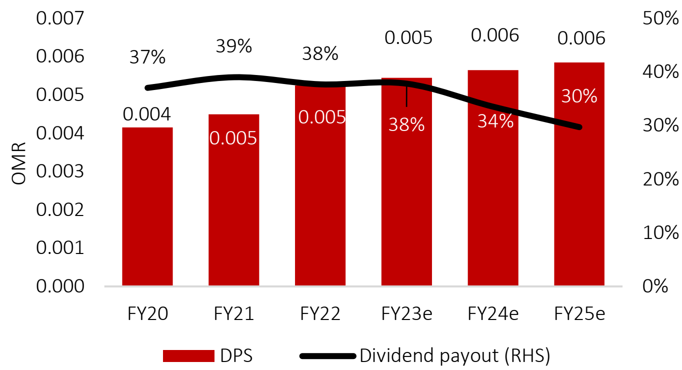
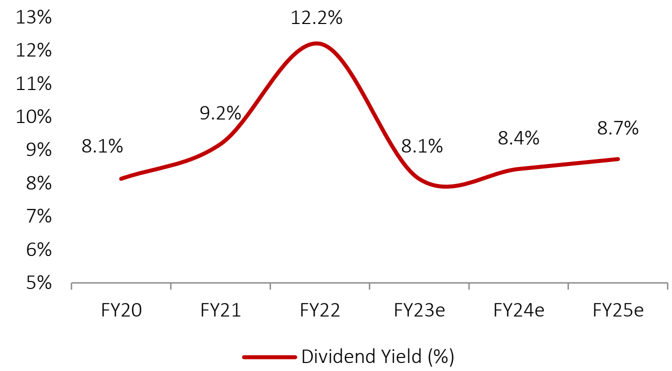
continue to lift its DPS. Given that PHPC is not subject to any cash sweep mechanism, dividend payments can continue uninterrupted in the future.

Fig. 19: Per share dividend rises gradually, thereby offering a good yield



Source: Company Reports, U Capital Research



Source: Company Reports, U Capital Research

Valuation

Our target price is based on blended valuation methodologies – (i) DDM and (ii) Relative Valuation (using Div. Yield).

Based on the latest proposed dividend payout and the company's financials, we have increased our DPS estimates by about 2.0% for FY 2023e and FY 2024e. On the other hand, we believe PHPC's PPA stands a good chance of renewal upon its expiry at the end of Mar'29. This is because PHPC's Sur IPP is one of the largest power plants in the MIS system, with ~27% of the system's total thermal power capacity in FY 2023e. As some contracts expire over the next 4-5 years, OPWP's latest 7-year statement shows that by FY 2028e only three thermal power plants will remain in operation where PHPC will account for 38% of the capacity. OPWP has a regulatory requirement to ensure 24 LOLH (Loss-of-Load Hours) on a short-term basis, i.e., the power outage does not exceed 24 hours in any year. OPWP also says in its statement that peak demand will shift towards night from 2025 onwards, and since some RE like solar power are more effective in the day, we opine MIS will require reliability of firm power supplies which a thermal power plant gives to meet its LOLH requirements, and hence we are hopeful this will favor PHPC's contract extension. Yet, on a conservative basis we have taken a lower terminal growth rate of 0.25% (previously, 0.50%). Overall, we increase our target price of the company to OMR 0.074 (previously, OMR 0.051), which at the current market price indicates an upside of 10.5%.

Thus, we maintain our **Accumulate** rating on the company. Currently, the stock trades at a P/E of 4.7x, based on our FY 2023 estimates.

Risks

Key downside risks:

i) below expected reliability or lower utilization due to reduced offtake from OPWP, causing a less-than-estimated growth rate of the top line

ii) below expected dividend payments.

Key upside risks:

i) Resumption of dividend payments post the expiry of PWPA, with the company securing an extension of its contract or any other profitable avenue to run the business.

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Valuation

	PHPC
Currency	OMR
DDM (50% weight)	
PV of Dividends (mn)	
Year 1	7.7
Year 2	7.3
Year 3	6.9
Year 4	6.5
Year 5	6.2
Year 6	5.8
Year 7	0.0
Terminal Value	104.8
PV of Terminal Value	64.6
Assumptions	
Risk Free Rate (%)	6.2%
Adjusted Beta	0.75
Risk Premium (%)	4.1%
Cost of Equity (Ke) (%)	9.3%
WACC (%)	8.9%
Equity value (mn)	104.9
Outstanding Shares (mn)	1,462.6
Target Price	***0.072***
Dividend yield based Relative Valuation (50% weight)	
Target dividend yield	7.1%
DPS 2023e	*0.005*
Target Price	***0.076***
Weighted Average Target Price	**0.074**
Current Market Price	*0.067*
Upside/(Downside), %	10.5%
Recommendation	**Accumulate**

Source: Company Financials, Bloomberg, U Capital Research

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Key financials

In OMR mn, except per share metrics and price	FY20	FY21	FY22	FY23e	FY24e	FY25e
Income Statement						
Revenue	135	146	21	154	159	164
Operating costs	(99)	(111)	(20)	(115)	(119)	(121)
Gross profit	**36**	**35**	**0**	**38**	**40**	**43**
General and administrative expenses	(1)	(1)	(0)	(1)	(1)	(1)
Selling expenses	-	-	-	-	-	-
Operating profit	**35**	**34**	**0**	**37**	**39**	**42**
Finance costs	(16)	(14)	(3)	(13)	(11)	(9)
Interest expense for lease liability	(0)	(0)	(0)	(0)	(0)	(0)
Income before tax	**19**	**19**	**(4)**	**24**	**28**	**32**
Income tax	(2)	(2)	(1)	(3)	(3)	(4)
Net income/(loss) attributable to shareholders of the company	**16**	**17**	**(4)**	**21**	**25**	**29**
Balance Sheet						
Cash and cash equivalents	6	10	12	17	19	22
Trade and other receivables	70	63	9	49	48	49
Inventories	9	9	11	8	9	8
Right of use assets	8	8	8	8	7	7
Property, plant and equipment	520	504	500	473	457	442
Total assets	**616**	**597**	**540**	**561**	**547**	**536**
Interest bearing loans and borrowings	278	249	249	186	153	121
Lease Liabilities	9	9	8	8	8	8
Trade accounts payable	63	55	4	49	50	51
Total liabilities	**436**	**394**	**334**	**311**	**280**	**249**
Share capital	146	146	146	146	146	146
Retained earnings/(accumulated losses)	57	66	62	89	103	120
Equity Attributable to Shareholders	**180**	**203**	**206**	**250**	**266**	**286**
Cash Flow Statement						
Net cash generated from operating activities	35	40	5	50	54	54
Net cash generated from investing activities	-	-	(2)	(6)	(0)	(0)
Net cash (used in) provided by financing activities	(36)	(36)	(3)	(54)	(52)	(50)
Cash and cash equivalents at the end of the period as per BS	**6**	**10**	**12**	**17**	**19**	**22**
Key Ratios						
Gross margin	26.8%	24.2%	1.5%	25.0%	25.4%	26.3%
EBITDA margin	37.9%	34.5%	19.6%	34.6%	34.6%	35.2%
Operating margin	26.0%	23.4%	0.1%	24.1%	24.5%	25.4%
Net margin	12.1%	11.5%	-20.7%	13.7%	15.5%	17.6%
ROA	2.7%	2.8%	-3.0%	3.8%	4.5%	5.3%
ROE	9.2%	8.8%	-8.3%	8.7%	9.6%	10.4%
Current Ratio (x)	0.8x	0.7x	0.6x	0.9x	0.9x	1.0x
Capex/Sales	0.0%	0.0%	0.0%	0.2%	0.2%	0.2%
Debt-Equity Ratio	1.6x	1.3x	1.2x	0.8x	0.6x	0.4x
EPS	0.011	0.012	(0.003)	0.014	0.017	0.020
BVPS	0.123	0.139	0.141	0.171	0.182	0.196
DPS	0.004	0.005	-	0.005	0.006	0.006
Dividend Payout Ratio	37.0%	39.0%	0.0%	37.8%	33.5%	29.7%
Dividend Yield (%)	8.1%	9.2%	0.0%	8.1%	8.4%	8.7%
P/E (x)	4.6x	4.3x	-4.1x	4.7x	4.0x	3.4x
P/BV (x)	0.4x	0.4x	0.3x	0.4x	0.4x	0.3x
EV/EBITDA (x)	6.9x	6.3x	19.5x	5.2x	4.4x	3.5x
Price as at period end*	0.051	0.049	0.048	0.067	0.067	0.067

Source: Company Reports *Current market price is used for forecast periods

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Sembcorp Salalah

Target Price: OMR 0.091/share
Upside/(downside): (9.3%)

Recommendation	**Hold**
Bloomberg Ticker	SSPW OM
Current Market Price (OMR)	0.100
52wk High / Low (OMR)	0.110/0.050
12m Average Vol. (000)	205.0
Mkt. Cap. (USD/OMR mn)	248/95
Shares Outstanding (mn)	954.6
Free Float (%)	100%
3m Avg Daily Turnover (OMR'000)	23.9
6m Avg Daily Turnover (OMR'000)	15.8
P/E'23e (x)	4.6
EV/EBITDA'23e (x)	3.5
Dividend Yield '23e (%)	9.9%
Price Performance:	
1 month (%)	1.0
3 month (%)	17.6
12 month (%)	44.9

Source: Bloomberg, valued as of 23 July 2023

Price-Volume Performance

Source: Bloomberg

- **SSPW is expected to remain a key asset for Dhofar governorate's energy and water requirements over the next 2-3 years**
- **Plant reliability for both the power and water generation is estimated to remain high (99-100% range)**
- **With minimal capex requirements and relatively stable margins, cash flows are estimated to rise gradually thereby aiding in sustained dividend payouts till the expiry of the contract**
- **The latest OPWP report does not give a clear picture of SSPW's business prospects post the PWPA expiry in early Apr'27, which can severely impact the company's dividend-paying ability**

We review our coverage on **SSPW** and increase the target price to OMR 0.091 (previously, OMR 0.084) per share on upward revision in our dividend estimates. However, owing to the short contract period remaining and little clarity on the company's business continuity after the expiry of its PWPA on 03 April 2027, we rate the company **Hold** (vs. Accumulate, previously). Also, we believe most of the near-term positives are priced in, post ~52% appreciation in the stock prices since the end of FY'22. Currently, the stock trades at a P/E of 4.6x, offering a healthy dividend yield of around 10.0%, based on our FY'23 estimates, above the peers' average dividend yield of between 7.0% and 7.5%.

Investment Summary

Healthy financials to support sustained dividend payouts till the expiry of the PWPA:

i) Reliability levels of the power and water plants are likely to remain solid in the 99-100% range on average over the remaining term of the contract, with the company undertaking regular maintenance and upgrades. Accordingly, we estimate capacity charge will continue to contribute bulk (65-70%) of the company's total revenue.

ii) With a majority of the expected revenue coming from the fixed nature capacity charge, and supported by some pre-fixed costs, margins are estimated to be relatively stable

iii) Capex is estimated to remain low and limited to maintenance. With a reducing debt servicing requirement, SSPW looks well placed to keep rewarding its shareholders with steady dividends till its contract period ends. However, we are not very optimistic about SSPW's ability to carry a profitable business thereafter, and hence we have assumed NIL dividends after FY'27e.

Year	FY20	FY21	FY22	FY23e	FY24e	FY25e
Revenues (OMR mn)	71.9	72.2	74.2	77.0	78.9	80.8
Net income (OMR mn)	18.3	18.3	19.6	20.6	23.0	25.3
Operating margin	47.0%	44.4%	42.4%	40.7%	41.1%	41.2%
Net profit margin	25.5%	25.3%	26.5%	26.7%	29.2%	31.4%
RoE	17.4%	15.5%	14.3%	13.4%	14.0%	14.2%
FCF (OMR/share)	0.038	0.041	0.042	0.041	0.042	0.041
DPS (OMR/share)	0.008	0.010	0.010	0.010	0.011	0.012
Dividend Yield	8.3%	14.1%	14.4%	9.9%	10.6%	11.6%
P/E (x)	5.2x	3.8x	3.2x	4.6x	4.1x	3.8x
EV/EBITDA (x)	5.0x	4.1x	3.3x	3.5x	2.9x	2.2x

Source: Company Reports — **P/E, EV/EBITDA, and Dividend yield from FY23 onwards are calculated on current price*

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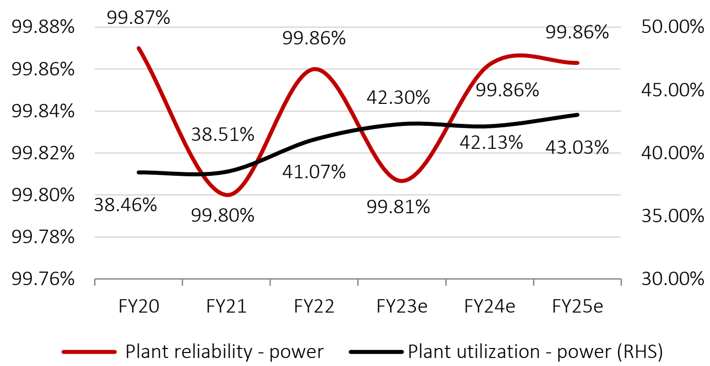
Investment rationale

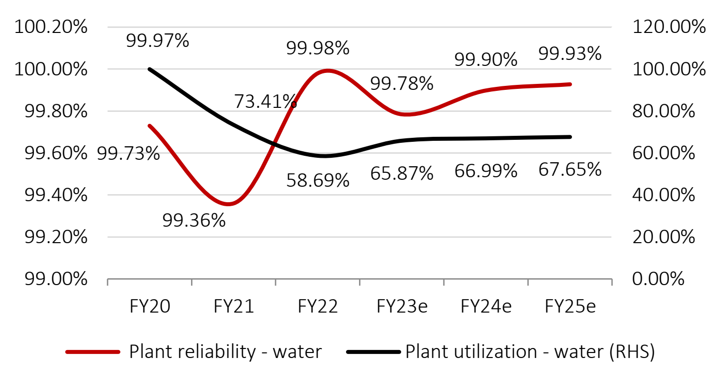
The top line to post steady growth with capacity charge lending strong support

SSPW has operated its Independent Water & Power Plant (IWPP) with consistently high reliability, averaging between 99% and 100% over the past 4-5 years. Reliability showcases the certainty with which a plant will be able to deliver the availability that it has declared for a particular year. This is critical for the company to earn its full capacity charge which is designed to recover its fixed O&M costs, debt service costs, and insurance expenses, among others. SSPW has dedicated parties that undertake regular and timely maintenance to ensure high plant availability. In FY 2022 also, these entities performed major maintenance of several critical components and initiated some improvements to the plants, which, we believe, will aid the company in maintaining the high reliability of its plants over the next few years.

Fig. 20: Both the power and water plant estimated to operate with over 99% reliability



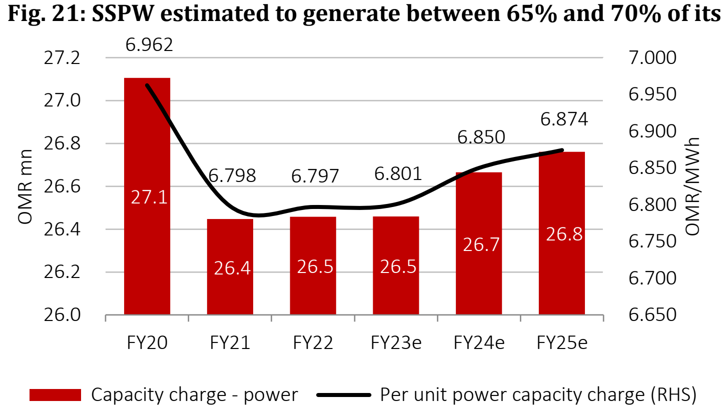
Source: Company Reports, U Capital Research



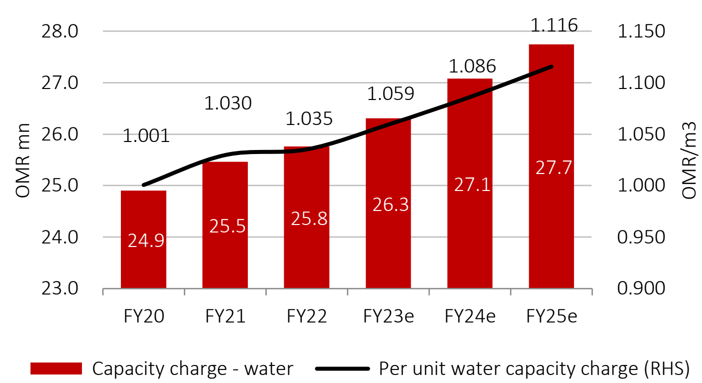
Source: Company Reports, U Capital Research

Accordingly, we estimate the capacity charge for the power and water desalination business combined will continue to provide the company with the bulk of its revenue as in the past, averaging in the 65%-70% range.

Fig. 21: SSPW estimated to generate between 65% and 70% of its total revenue through capacity charge



Source: Company Reports, U Capital Research



Source: Company Reports, U Capital Research

SSPW is one of the two gas-fired power plants of the Dhofar Power System and it is expected to remain a primary source of energy for the system till the end of its contract period in early 2027. Separately, in its latest statement, OPWP has revised up Dhofar Power System's average annual peak demand growth under the Expected Case scenario by one percentage point to 5% (vs. 4% in the previous 7-year statement) as some more areas are expected to be connected by 2026. Accordingly, we estimate the utilization of SSPW's power plant to continue rising gradually.

On the other hand, utilization of SSPW's water plant has decreased, reaching 58.7% in FY 2022 from 73.4% in FY 2021, mainly due to the commissioning of the Salalah III IWP plant in 2021. While we estimate the SSPW water plant's utilization to remain below the rate achieved before the start of Salalah III IWP, a slight improvement from the current levels is anticipated. This is because DISC, which oversees the Dhofar region's water supply, intends to extend its water network to

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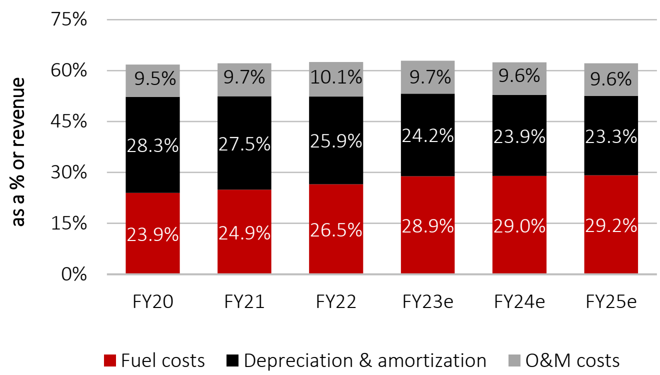
the Jabal areas of the governorate which currently is only partially connected with the Dhofar water network. DISC is also exploring the possibility of adding a couple more cities apart from the existing three cities of Salalah, Taqah, and Mirbat to its water distribution network.

Thus, backed by a largely stable capacity charge and gradually rising plant utilization, we forecast total revenue to clock ~3% CAGR during FY 2022-2026e (FY 2018-2022: +2% CAGR).

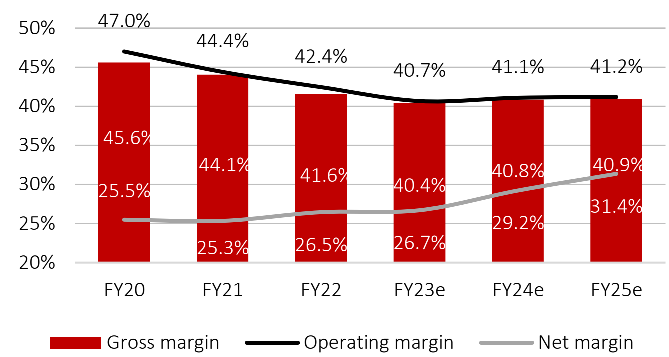
Net income to expand at a relatively faster pace with declining debt-servicing costs; strong liquidity to ensure consistent dividend payouts, though we assume no dividend payments post PWPA expiry

We estimate Sembcorp Salalah's operating margin to remain largely stable, aided by the fixed capacity charges, and pass-through operating costs, that are reimbursed through variable energy, water output, and fuel charges.

Fig. 22: Operating margins are estimated to stabilize in the 40-41% range going forward



Source: Company Reports, U Capital Research



Source: Company Reports, U Capital Research

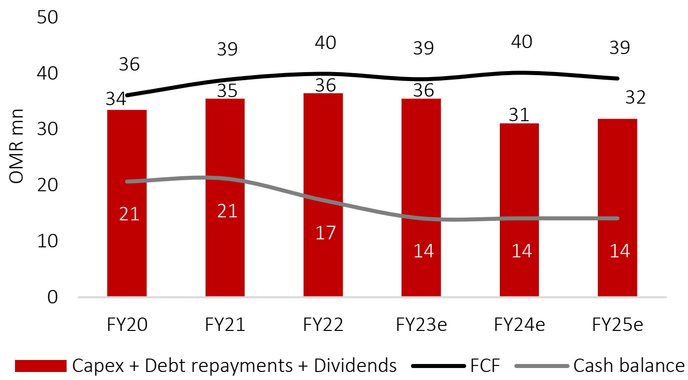
NPM, however, is estimated to expand by nearly 7 percentage points (pp) by FY 2026 from 26.5% in FY 2022, benefitting from reducing finance costs with the company gradually repaying its borrowings. Accordingly, SSPW's debt/equity (D/E) ratio is forecasted to fall to 0.1x by the end of FY 2025 as compared to 0.6x at the end of 1Q 2023.

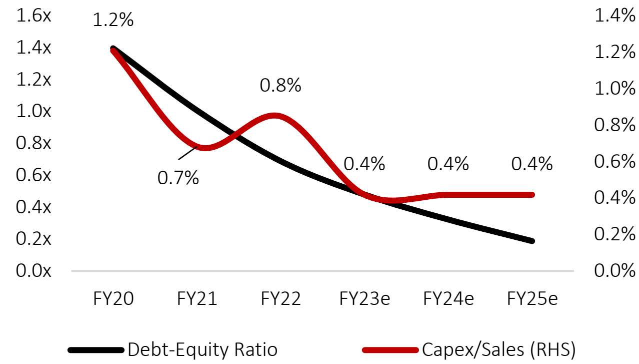
Capital expenditure is also expected to be limited to maintenance only, given that there is no question of any organic or inorganic business expansion. Accordingly, we estimate SSPW to continue generating steady free cash flows between OMR 35mn and OMR 40mn over the next 3-4 years. This ultimately indicates the company will keep on rewarding its shareholders with healthy dividend payouts. However, as per our analysis of some companies whose contracts with OPWP have expired recently, we found that each one of them is grappling with serious issues in running a profitable business.

OPWP's latest 7-year statement also shows that the authority is not considering any replacement for SSPW's Salalah IWPP after the conclusion of its term on 03 April 2027, particularly for the electricity plant, since it expects that the shortfall will be met with a new proposed 100 MW wind power plant, expected to commence operations in 2026, and the additional power supply available from the extension of the North-South interconnection to the Dhofar Power System.

Consequently, on a conservative basis, we have assumed dividend payments to stop once the PWPA expires on 03 April 2027, until we get any clarity on business continuity prospects.

Fig. 23: Free cash flows comfortably cover the business' operational and financing spending requirements

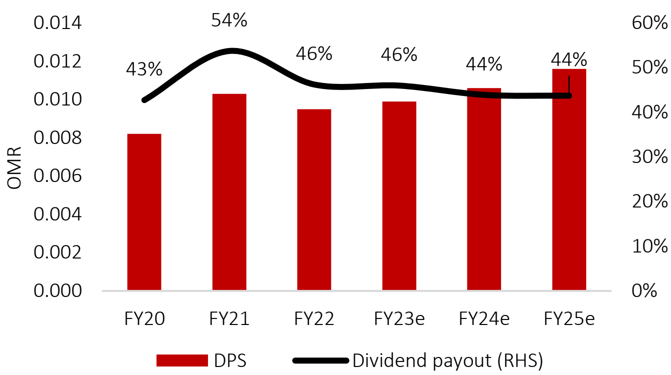


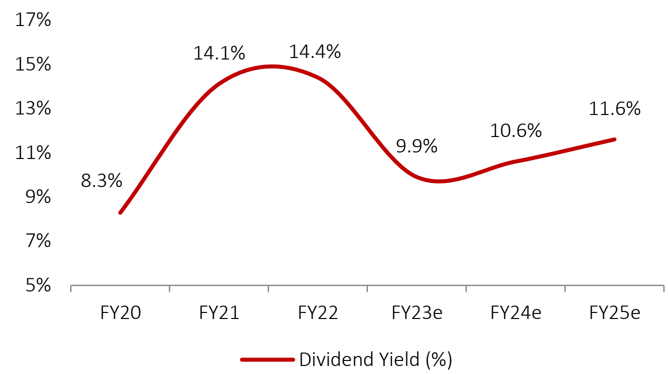


Source: Company Reports, U Capital Research

Source: Company Reports, U Capital Research

Fig. 24: SSPW estimated to comfortably maintain dividend payout near current levels, generating excellent yield





Source: Company Reports, U Capital Research

Source: Company Reports, U Capital Research

Valuation

Our target price is based on blended valuation methodologies – (i) DDM and (ii) Relative Valuation (using Div. Yield).

Based on the latest proposed dividend payout and the company's financials, we have increased our dividend estimates by around 4.0% for FY 2023e and increased it progressively over the remaining years of our forecast period. Accordingly, we increase our target price of the company to OMR 0.091 (previously, OMR 0.084), though it indicates a downside of 9.3%, after ~52% run-up in the stock price since the end of FY 2022.

Accordingly, we rate the company **Hold** (previously, Accumulate). Currently, the stock trades at a P/E of 4.6x, based on our FY 2023 estimates.

Risks

Key downside risks:

iii) below expected reliability, leading to under realization of the majority revenue provider capacity charge,

iv) below expected dividend payments.

Key upside risks:

ii) Resumption of dividend payments post the expiry of PWPA, with the company securing an extension of its contract or any other profitable avenue to run the operations.

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Valuation

	SSPW
Currency	OMR
DDM (50% weight)	
PV of Dividends (mn)	
Year 1	9.1
Year 2	9.0
Year 3	9.1
Year 4	9.1
Year 5	9.0
Terminal Value	0.0
PV of Terminal Value	0.0
Assumptions	
Risk Free Rate (%)	6.2%
Adjusted Beta	0.51
Risk Premium (%)	4.1%
Cost of Equity (Ke) (%)	8.3%
WACC (%)	8.2%
Equity value (mn)	45.4
Outstanding Shares (mn)	954.6
Target Price	***0.048***
Dividend yield based Relative Valuation (50% weight)	
Target dividend yield	7.4%
DPS 2023e	*0.010*
Target Price	***0.134***
Weighted Average Target Price	**0.091**
Current Market Price	*0.100*
Upside/(Downside), %	-9.3%
Recommendation	**Hold**

Source: Company Financials, Bloomberg, U Capital Research

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Key financials

In OMR mn, except per share metrics and price	FY20	FY21	FY22	FY23e	FY24e	FY25e
Income Statement						
Revenue from contracts with customers	72	72	74	77	79	81
Cost of sales	(39)	(40)	(43)	(46)	(47)	(48)
Gross profit	**33**	**32**	**31**	**31**	**32**	**33**
Administrative and general expenses	(1)	(1)	(1)	(1)	(1)	(1)
Other income/(expenses)	2	1	1	1	1	1
Operating profit	**34**	**32**	**31**	**31**	**32**	**33**
Finance costs	(13)	(11)	(9)	(7)	(6)	(4)
Finance income	0	0	0	0	0	0
Income before tax	**21**	**22**	**23**	**24**	**27**	**30**
Income tax	(3)	(3)	(3)	(4)	(4)	(4)
Net income/(loss) attributable to shareholders of the company	**18**	**18**	**20**	**21**	**23**	**25**
Balance Sheet						
Cash and cash equivalents	1	1	7	7	12	17
Trade and other receivables	25	20	8	18	17	18
Inventories	6	5	6	6	6	6
Right of use assets	1	1	1	1	1	1
Property, plant and equipment	270	259	249	238	227	216
Total assets	**322**	**307**	**288**	**286**	**278**	**272**
Interest bearing loans and borrowings	152	127	101	75	55	34
Accrued expenses	2	2	2	3	3	3
Trade accounts & other payables	19	15	4	15	15	15
Total liabilities	**213**	**180**	**141**	**127**	**107**	**87**
Share capital	95	95	95	95	95	95
Retained earnings/(accumulated losses)	15	25	37	46	57	69
Equity Attributable to Shareholders	**109**	**127**	**148**	**159**	**172**	**186**
Cash Flow Statement						
Net cash generated from operating activities	30	32	35	38	42	40
Net cash generated from investing activities	(1)	(1)	3	3	(0)	(0)
Net cash (used in) provided by financing activities	(33)	(31)	(32)	(41)	(36)	(35)
Cash and cash equivalents at the end of the period as per BS	**1**	**1**	**7**	**7**	**12**	**17**
Key Ratios						
Gross margin	45.6%	44.1%	41.6%	40.4%	40.8%	40.9%
EBITDA margin	62.5%	59.9%	57.6%	55.1%	55.2%	55.0%
Operating margin	47.0%	44.4%	42.4%	40.7%	41.1%	41.2%
Net margin	25.5%	25.3%	26.5%	26.7%	29.2%	31.4%
ROA	5.6%	5.8%	6.6%	7.2%	8.2%	9.2%
ROE	17.4%	15.5%	14.3%	13.4%	14.0%	14.2%
Current Ratio (x)	1.0x	0.9x	1.0x	1.0x	1.2x	1.6x
Capex/Sales	1.2%	0.7%	0.8%	0.4%	0.4%	0.4%
Debt-Equity Ratio	1.4x	1.0x	0.7x	0.5x	0.3x	0.2x
EPS	0.019	0.019	0.021	0.022	0.024	0.027
BVPS	0.114	0.133	0.155	0.166	0.180	0.195
DPS	0.008	0.010	0.010	0.010	0.011	0.012
Dividend Payout Ratio	42.7%	53.7%	46.2%	46.0%	43.9%	43.7%
Dividend Yield (%)	8.3%	14.1%	14.4%	9.9%	10.6%	11.6%
P/E (x)	5.2x	3.8x	3.2x	4.6x	4.1x	3.8x
P/BV (x)	0.9x	0.5x	0.4x	0.6x	0.6x	0.5x
EV/EBITDA (x)	5.0x	4.1x	3.3x	3.5x	2.9x	2.2x
Price as at period end*	0.099	0.073	0.066	0.100	0.100	0.100

Source: Company Reports *Current market price is used for forecast periods

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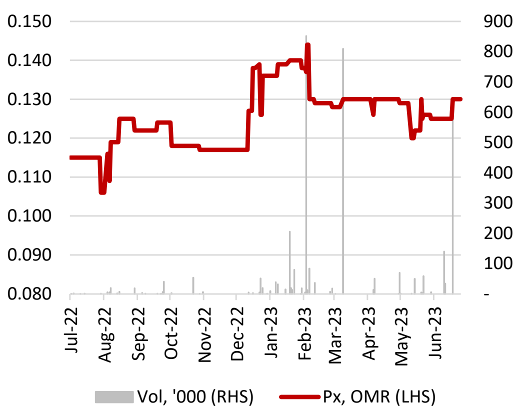
Sharqiyah Desalination

Target Price: OMR0.161/share
Upside/(Downside): 24.1%

Recommendation	**Buy**
Bloomberg Ticker	SHRQ OM
Current Market Price (OMR)	0.130
52wk High / Low (OMR)	0.140/0.110
12m Average Vol. (000)	14.4
Mkt. Cap. (USD/OMR mn)	33/13
Shares Outstanding (mn)	97.80
Free Float (%)	64%
3m Avg Daily Turnover (OMR'000)	2.3
6m Avg Daily Turnover (OMR'000)	3.6
P/E'23e (x)	14.7
EV/EBITDA'23e (x)	12.9
Dividend Yield '23e (%)	11.2%
Price Performance:	
1 month (%)	4.0
3 month (%)	-
12 month (%)	13.0

Source: Bloomberg, valued as of 23 July 2023

Price-Volume Performance



Source: Bloomberg

- **SHRQ, along with another plant, serves the water requirements of the Sharqiyah region, which is not connected to the larger MIS zone**
- **SHRQ has the bigger capacity (29 MIGD) among the two plants and is likely to remain a key asset for the region for several more years**
- **A lengthy contract period remaining provides a good business visibility, though receding finance income on amortizing receivables continues to weigh on top line and profitability**
- **We expect the company to comfortably maintain its DPS backed by healthy liquidity, translating into a more than 100% payout**

We review our coverage on **SHRQ** and raise our target price to OMR 0.161 (previously: OMR 0.145) as we raise our dividend estimates considering the company's dividend history. At the prevailing market price, the target price implies an upside of 24.1% and hence we maintain our **Buy** rating on the stock. Currently, the stock trades at a P/E of 14.7x, based on our FY'23 estimates, offering a dividend yield of around 11%, considering our FY'23 dividend expectations.

Investment Summary

Good long-term revenue visibility as a considerably long contract period remains:

i) SHRQ is set to remain an important water resource for the Sharqiyah region where the average and peak demand are estimated by OPWP to clock 4% and 5% CAGR between 2022 and 2028.

ii) SHRQ's plant utilization fell slightly in FY'22 which we contend was due to the commencement of Aseelah IWP's operations. Nevertheless, we expect utilization to improve gradually with a growth in demand.

iii) Availability improved largely, reaching 98% by FY'22 from 96.7% in FY'18, and is expected to rise further, backed by a strict maintenance schedule. However, decreasing finance income is likely to offset core revenue growth.

iv) Operation of a 17 MW solar plant is likely to commence from 3Q23 which we expect will help to enhance efficiency and profitability to some extent.

v) Cash flow generation is estimated to remain consistent and stable partially driven by lease receipts, scheduled debt repayments, and low capex

vi) Dividend payout is estimated to remain high, averaging more than 100% over the next five years.

Year	FY20	FY21	FY22	FY23e	FY24e	FY25e
Revenues (OMR mn)	13.5	13.8	13.5	13.1	13.1	12.8
Net income (OMR mn)	1.3	1.0	0.9	0.9	0.9	0.8
Operating margin	33.4%	28.0%	26.3%	27.0%	25.6%	24.6%
Net profit margin	10.0%	6.9%	6.7%	6.6%	6.6%	6.6%
RoE	10.2%	7.2%	5.8%	5.2%	5.3%	5.4%
FCF (OMR/share)	0.040	0.032	0.035	0.025	0.028	0.026
DPS (OMR/share)	0.014	0.015	0.015	0.015	0.015	0.015
Dividend Yield	8.5%	13.4%	12.8%	11.2%	11.2%	11.2%
P/E (x)	11.8x	11.5x	12.7x	14.7x	14.7x	15.2x
EV/EBITDA (x)	12.9x	13.0x	13.3x	12.9x	12.4x	11.9x

Source: Company Reports **P/E, EV/EBITDA, and Dividend yield from FY23 onwards are calculated on current price*

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Investment rationale

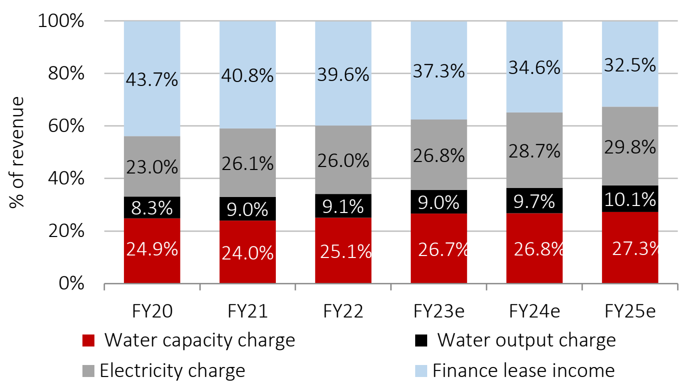
Core revenue growth to be offset by falling income from receivables' amortization

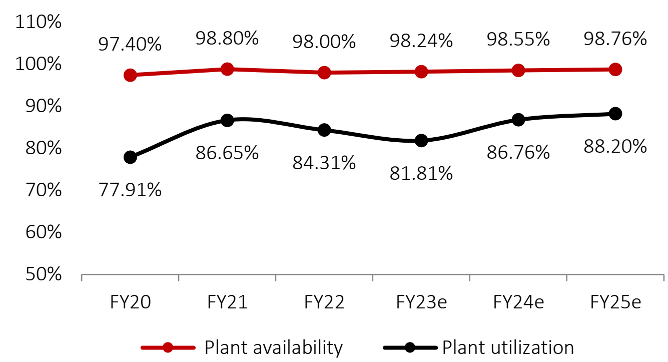
The Sharqiyah region will continue to be served exclusively by SHRQ's Sur IWP and Al Asilah Desalination Company's Aseelah IWP as it is not connected with other water systems like MIS, which is a much larger system. The Sharqiyah region also has some water wells, though OWWSC intends to use them only in case of emergency or when the demand exceeds the available supply. SHRQ's water desalination plant has a bigger capacity of ~132k m^3/day (29 MIGD) as compared to Aseelah IWP's 80k m^3/day (18 MIGD) capacity, and OPWP's latest 7-year statement shows that collectively, supply from both these plants will mostly equate the region's water demand over the next 4-5 years till 2028.

We expect SHRQ's plant utilization, which has largely maintained an improving trend except in FY'22 when it fell slightly due to the start of Aseelah IWP's operations, to eventually resume its growth trend, thereby generating higher variable revenue. The availability-based capacity charge is also estimated to remain steady over our forecast period, as, backed by a stringent maintenance schedule, we are hopeful SHRQ will continue to operate the plant with high availability in the range of 95%-100% level going forward.

Accordingly, we estimate SHRQ's overall revenue from water desalination to clock 3% CAGR during FY 2022-2027e, slightly higher than the 2% CAGR registered during the previous five years (FY 2017-2022).

Fig. 25: Finance lease income's share in total income is gradually falling





Source: Company Reports, U Capital Research

Source: Company Reports, U Capital Research

The water desalination revenue's share in the total revenue will also continue to rise, likely reaching ~72% by FY 2027e as compared to nearly 60% in FY 2022. This is because the other component of SHRQ's total revenue, i.e., interest income on finance lease, will continue to contract at an accelerated pace as the outstanding finance lease receivables shrink by about OMR 8.5-8.6mn per annum.

As of the end of March 2023, the finance lease receivable balance stood at ~OMR 59mn as compared to ~OMR 62mn at FY 2022-end, and ~OMR 65mn at FY 2021-end. As per our estimate, the finance lease income would decrease at around 8% compound annual rate between FY 2022 and FY 2027e, which will more than offset core revenue growth.

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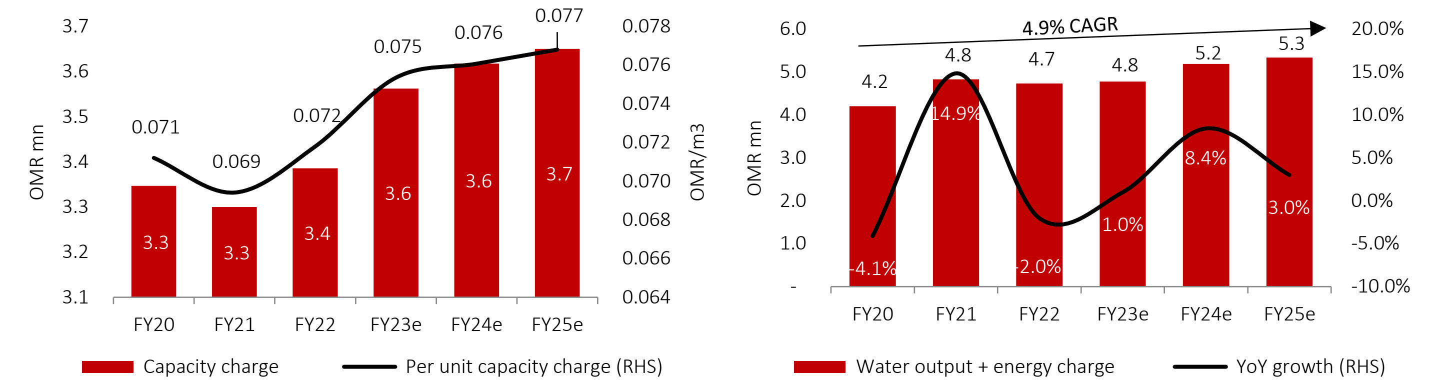
Fig. 26: SHRQ's variable revenue is expected to be driven by a recovery in plant utilization, clocking ~5% 5-year CAGR till FY25e

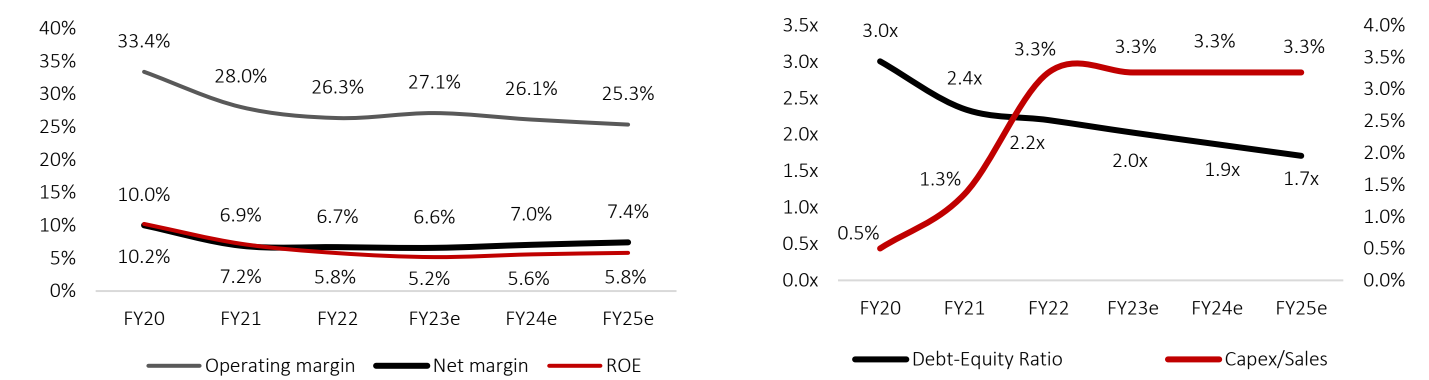


Source: Company Reports, U Capital Research **Source: Company Reports, U Capital Research**

A receding top line is estimated to weigh on the operating income, though the bottom line will benefit from lower interest payments

SHRQ's profitability has been under pressure owing to the declining top line and given our expectations of revenue remaining in a downtrend, we estimate operating profit margin (OPM) to weaken further, contracting by nearly 250 bps by FY 2027e from 26.3% at the end of FY 2022. However, with the company's finance costs declining at ~6% compound annual rate during FY 2022-2027e owing to the scheduled debt repayments, it is expected to counter the weakness in the operating income, supporting the bottom line to clock an overall 2% CAGR, reaching slightly over OMR 1.0mn by FY 20207e as compared to OMR 903k at the end of FY 2022.

Fig. 27: Weakness in the operating income is negating the benefit of declining finance costs on the net margin



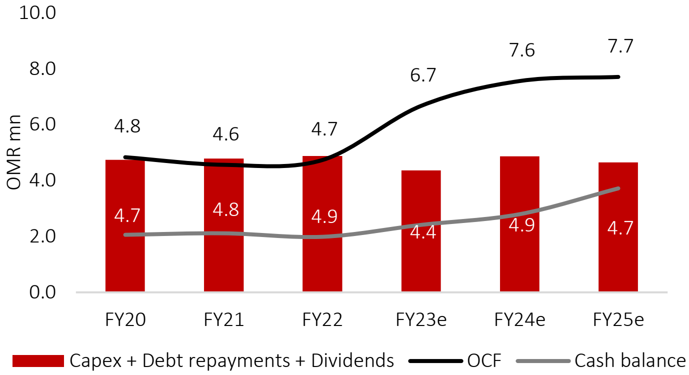
Source: Company Reports, U Capital Research **Source: Company Reports, U Capital Research**

Stable cash flows amid low capex requirements to aid SHRQ in maintaining high dividend payouts

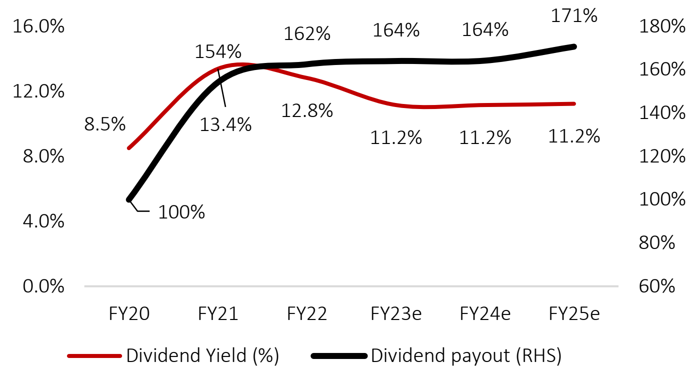
Despite pressure on the operating profit, SHRQ's free cash flows (FCF) have remained healthy over the past 4-5 years, driven by strong cash inflows as receipt against recoverable finance lease, and low capex needs as is the case with most other utilities in Oman operating under contract with OPWP. Accordingly, we expect FCF will remain relatively stable over our forecast period, averaging between OMR 2.5mn and OMR 3.0mn, which will aid the company in comfortably sustaining its high dividend payouts.

Having said that, we would like to highlight that we have increased our dividend payout estimates. SHRQ has paid 15 baizas per share dividend for FY 2022 and FY 2021, culminating into a payout ratio of 162.5% and 154.1%, respectively, while dividend payout ratio for FY 2020 stood at 100.0%. While previously we had forecasted dividend payouts to average around 100% over our forecast period, considering the company's healthy liquidity position and historical dividend trend, we hope the company to maintain its absolute DPS for FY 2023 minimum at FY 2022 level. Accordingly, we now forecast FY 2023e dividend payout ratio at slightly over 160% as compared to 100% estimated previously.

Fig. 28: Liquidity position is estimated to strengthen, aiding continued dividend payout,



Source: Company Reports, U Capital Research



Source: Company Reports, U Capital Research

Valuation

Our target price is based on blended valuation methodologies – (i) DDM and (ii) Relative Valuation (using Div. Yield).

Based on the upward revision of our dividend estimates, we increase our target price of the company to OMR 0.161 (previously, OMR 0.145). At the current market price, our target price indicates an upside of 24.1%.

Accordingly, we maintain our **Buy** rating on the stock. Currently, the stock trades at a P/E of 14.7x, based on our FY 2023 estimates.

Risks

Key downside risks:

i) below estimated availability due to any unexpected breakdowns and/or utilization owing to lower-than-expected power demand, which can adversely impact revenues and cash flows,

ii) below expected dividend payments.

Key upside risks:

i) The company continues to dole out dividend payments at a more than 100% rate as in the past.

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Valuation

	SHRQ
Currency	OMR
DDM (50% weight)	
PV of Dividends (mn)	
Year 1	1.4
Year 2	1.3
Year 3	1.2
Year 4	1.1
Year 5	1.0
Terminal Value	18.2
PV of Terminal Value	12.6
Assumptions	
Risk Free Rate (%)	6.2%
Adjusted Beta	0.56
Risk Premium (%)	4.1%
Cost of Equity (Ke) (%)	8.5%
WACC (%)	6.6%
Equity value (mn)	18.5
Outstanding Shares (mn)	97.8
Target Price	***0.189***
Dividend yield based Relative Valuation (50% weight)	
Target dividend yield	10.9%
DPS 2023e	*0.015*
Target Price	***0.133***
Weighted Average Target Price	**0.161**
Current Market Price	*0.130*
Upside/(Downside), %	24.1%
Recommendation	**Buy**

Source: Company Financials, Bloomberg, U Capital Research

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Key financials

In OMR mn, except per share metrics and price	FY20	FY21	FY22e	FY23e	FY24e	FY25e
Income Statement						
Revenue	13	14	14	13	13	13
Cost of revenue	(8)	(9)	(9)	(9)	(9)	(9)
Gross profit	**5**	**5**	**4**	**4**	**4**	**4**
General and administrative expenses	(1)	(1)	(1)	(1)	(1)	(1)
Selling expenses	-	-	-	-	-	-
Operating profit	**4**	**4**	**4**	**4**	**3**	**3**
Finance costs	(3)	(3)	(3)	(3)	(2)	(2)
Interest expense for lease liability	(0)	(0)	(0)	(0)	(0)	(0)
Income before tax	**2**	**1**	**1**	**1**	**1**	**1**
Income tax	(0)	(0)	(0)	(0)	(0)	(0)
Net income/(loss) attributable to shareholders of the company	**1**	**1**	**1**	**1**	**1**	**1**
Balance Sheet						
Cash and cash equivalents	2	2	2	2	3	4
Trade and other receivables	1	2	2	2	2	2
Finance lease receivable	65	62	59	55	51	47
Right of use assets	0	0	0	0	0	0
Property, plant and equipment	0	0	1	1	1	1
Total assets	**69**	**67**	**63**	**60**	**57**	**53**
Interest bearing loans and borrowings	46	43	40	37	34	32
Lease Liabilities	0	0	0	0	0	0
Trade accounts payable	2	2	2	2	2	2
Total liabilities	**57**	**52**	**46**	**44**	**41**	**38**
Share capital	10	10	10	10	10	10
Retained earnings/(accumulated losses)	6	6	5	4	4	3
Equity Attributable to Shareholders	**12**	**14**	**17**	**16**	**16**	**15**
Cash Flow Statement						
Net cash generated from operating activities	5	5	5	7	8	8
Net cash generated from investing activities	(0)	(0)	(0)	(1)	(1)	(0)
Net cash (used in) provided by financing activities	(5)	(4)	(5)	(6)	(7)	(6)
Cash and cash equivalents at the end of the period as per BS	**2**	**2**	**2**	**2**	**3**	**4**
Key Ratios						
Gross margin	39.5%	33.7%	31.6%	32.3%	31.1%	30.3%
EBITDA margin	34.3%	29.1%	27.6%	28.5%	27.5%	26.9%
Operating margin	33.4%	28.0%	26.3%	27.0%	25.6%	24.6%
Net margin	10.0%	6.9%	6.7%	6.6%	6.6%	6.6%
ROA	1.9%	1.4%	1.4%	1.4%	1.5%	1.5%
ROE	10.2%	7.2%	5.8%	5.2%	5.3%	5.4%
Current Ratio (x)	1.2x	1.3x	1.3x	1.5x	1.6x	1.8x
Capex/Sales	0.5%	0.5%	1.3%	3.3%	3.3%	3.3%
Debt-Equity Ratio	3.8x	3.0x	2.4x	2.3x	2.2x	2.1x
EPS	0.014	0.010	0.009	0.009	0.009	0.009
BVPS	0.124	0.146	0.173	0.169	0.163	0.157
DPS	0.014	0.015	0.015	0.015	0.015	0.015
Dividend Payout Ratio	100.0%	154.1%	162.5%	164.0%	164.2%	170.6%
Dividend Yield (%)	8.5%	13.4%	12.8%	11.2%	11.2%	11.2%
P/E (x)	11.8x	11.5x	12.7x	14.7x	14.7x	15.2x
P/BV (x)	1.3x	0.8x	0.7x	0.8x	0.8x	0.8x
EV/EBITDA (x)	12.9x	13.0x	13.3x	12.9x	12.4x	11.9x
Price as at period end*	0.162	0.112	0.117	0.130	0.130	0.130

Source: Company Reports *Current market price is used for forecast periods

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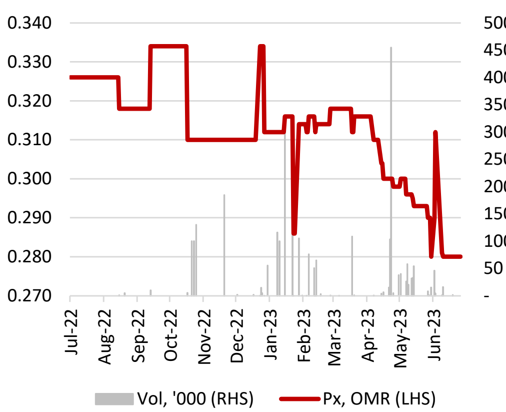
Musandam Power

Target Price: OMR 0.340/share
Upside: 21.3%

Recommendation	Buy
Bloomberg Ticker	MSPW OM
Current Market Price (OMR)	0.280
52wk High / Low (OMR)	0.330/0.280
12m Average Vol. (000)	10.6
Mkt. Cap. (USD/OMR mn)	51/20
Shares Outstanding (mn)	70.39
Free Float (%)	100%
3m Avg Daily Turnover (OMR'000)	4.9
6m Avg Daily Turnover (OMR'000)	5.2
P/E'23e (x)	8.3
EV/EBITDA'23e (x)	8.9
Dividend Yield '23e (%)	9.9%
Price Performance:	
1 month (%)	-
3 month (%)	(11.4)
12 month (%)	(14.1)

Source: Bloomberg, valued as of 23 July 2023

Price-Volume Performance



Source: Bloomberg

- **MSPW is the only permanent power supply source for the isolated grid of Musandam Governorate and is set to remain so at least over the next 5-6 years, according to OPWP.**
- **MSPW PPA expires early in 2032 which gives it long-term business visibility.**
- **Reliability has exceeded 99% over the past 6 years, which is commendable. Utilization is estimated to keep rising with growing demand, given MSPW is the primary power source for Musandam**
- **The dividend payout forecast has been lowered, based on the interim cash dividend announced for 2023**

We review our coverage on **MSPW** and lower the target price to OMR 0.340 per share (previously, OMR 0.393 per share), as we reduce our dividend payout estimates taking into account the latest dividend announcement. The target price implies a 21.3% upside from the current price, and thus we maintain our **Buy** rating. At the prevailing market price, the stock trades at a P/E of 8.3x, based on our FY'23 estimates, offering a dividend yield of 10.6% considering the TTM dividend, above the 9.0% average TTM dividend yield of relevant peers.

Investment Summary

Long-term business visibility and an attractive dividend yield

i) MSPW has maintained excellent plant reliability exceeding 99% since the commencement of its operations in 2017 and we expect a similar trend going forward. This will lend stability to the top line as the availability-based capacity charge will continue to account for a majority of the total revenue, averaging slightly over 55% during FY'23e-27e, though its share each year will gradually ebb with an increase in variable revenue.

ii) MSPW will continue to serve Musandam region as its main power source over the next 5-6 years and no other power plant is expected to come up in the region over this period. Accordingly, we estimate plant utilization to improve by c. 6 pp over the next 5 years, the same as in the previous 5 years.

iii) MSPW's strategic location provides it with a good chance of securing a contract extension, in our opinion.

iv) Healthy margins and best return to shareholders among the Omani utilities under our coverage.

v) High dividend payout offering attractive yield averaging around 9% over the past 2-3 years.

Year	FY20	FY21	FY22	FY23e	FY24e	FY25e
Revenues (OMR mn)	17.7	18.2	18.5	18.6	19.0	19.3
Net income (OMR mn)	2.3	3.1	2.6	2.4	2.4	2.5
Operating margin	33.5%	36.7%	33.3%	32.2%	31.7%	31.4%
Net profit margin	13.2%	17.0%	14.3%	12.7%	12.9%	13.1%
RoE	23.9%	29.3%	23.2%	19.9%	19.8%	19.6%
FCF (OMR/share)	0.151	0.096	0.078	0.106	0.106	0.094
DPS (OMR/share)	0.028	0.028	0.030	0.028	0.028	0.028
Dividend Yield	9.0%	9.2%	9.6%	9.9%	9.9%	10.0%
P/E (x)	9.2x	6.8x	8.2x	8.3x	8.1x	7.8x
EV/EBITDA (x)	10.7x	9.4x	9.4x	8.9x	8.5x	8.2x

Source: Company Reports **P/E, EV/EBITDA, and Dividend yield from FY23 onwards are calculated on current price*

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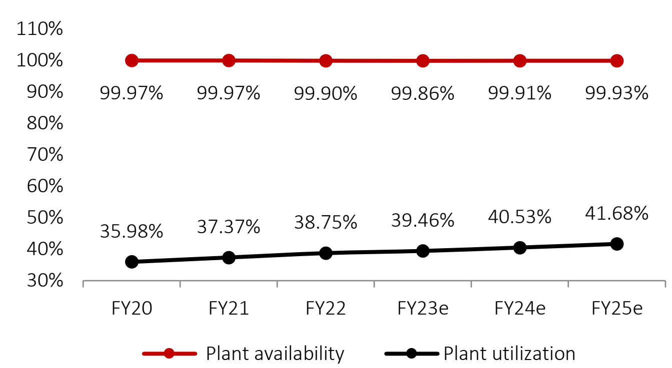
Investment rationale

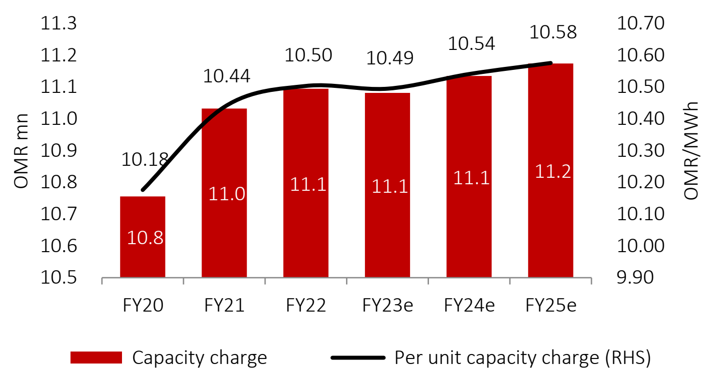
Capacity charge to continue generating the bulk of revenue as reliability is expected to remain solid; utilization estimated to improve gradually with the region's power demand as MSPW will continue to fulfill the region's electricity needs single-handedly…

MSPW has maintained its plant availability at consistently high levels since it commenced its operations, averaging between 99% and 100%, likely aided by an advanced engine technology that witnesses relatively less capacity degradation over time, and completion of all scheduled maintenance activities under the long-term service agreement (LTSA) as per the standard processes instructed by the manufacturers of the plant. With the LTSA's term being concurrent with that of the PPA, we believe the company would comfortably maintain its average plant availability above 99% over our forecast period. This will aid it in continuing to generate a stable capacity charge accounting for between 55% and 60% of the company's total revenue going forward.

Meanwhile, the combined share of energy and other (fuel) charges in the total revenue is estimated to rise with the increase in electricity generation. As explained earlier, Musandam governorate has an isolated grid as it is separated from the rest of Oman by the UAE, and hence the region is dependent entirely on MSPW's plant to meet its power requirements. Although Tanweer has some diesel generators with a combined capacity of 83 MW, they are meant to be used only as a backup. OPWP forecasts Musandam power system's average energy demand to grow in the range of 3-6% per annum by 2028, which will lift the plant's power generation.

Fig. 29: MSPW is witnessing consistent improvement in its utilization…

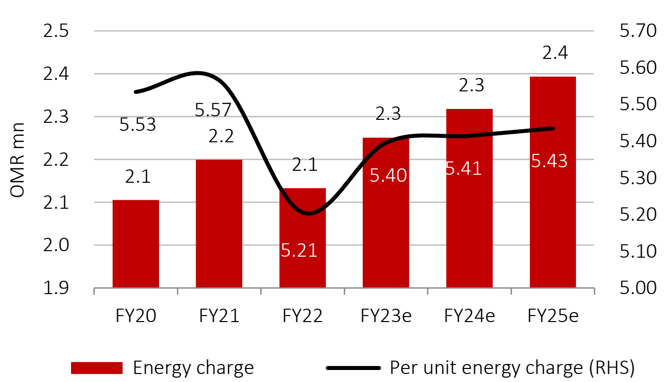


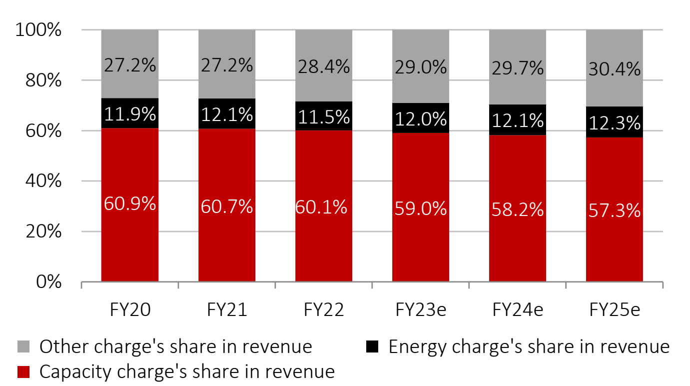


Source: Company Reports, U Capital Research **Source: Company Reports, U Capital Research**

After declining in FY 2020 to 36.0% from 37.3% in FY 2019 with the spread of the coronavirus pandemic, MSPW's plant utilization has gradually edged up to reach 38.8% in FY 2022. Given the OPWP's power demand estimate for the governorate, we believe utilization will maintain a rising trend to reach slightly over 44% by FY 2027e. Accordingly, we estimate variable revenue to clock 4% CAGR during FY 2022-2027e, thereby driving the overall top line at 2% CAGR during the same period.

Fig. 30: …which bodes well for overall revenue growth and accordingly variable revenue's share in total revenue is increasing





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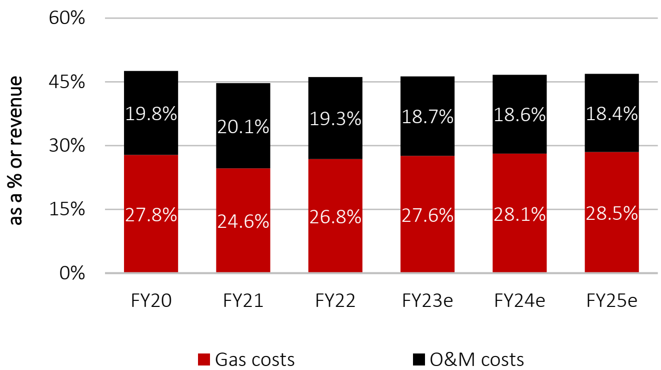
Source: Company Reports, U Capital Research

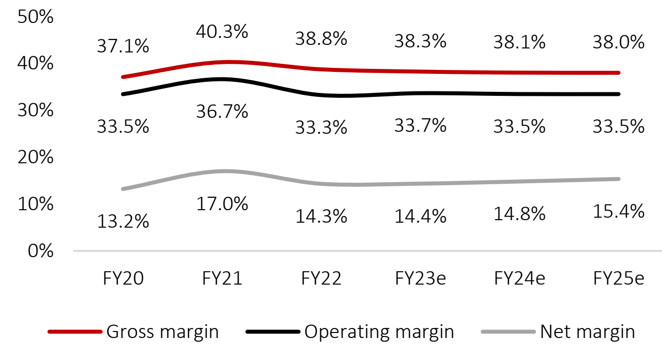
Source: Company Reports, U Capital Research

Assured revenue stream and pre-fixed costs to support margins

With the company generating a major part of its revenue based on plant availability, which is payable irrespective of the actual operation of the plant, and pre-set operations & maintenance costs owing to the long-term agreements, we expect the margin to remain relatively stable. Also, while the company is facing issues in the availability of gas and has to consume more expensive diesel fuel, its margin remains protected as the natural gas sales agreement (NGSA) allows the company to pass on the incremental costs arising due to the consumption of diesel to OPWP.

Fig. 31: An assured revenue stream and largely pre-set costs to help bring stability to margins





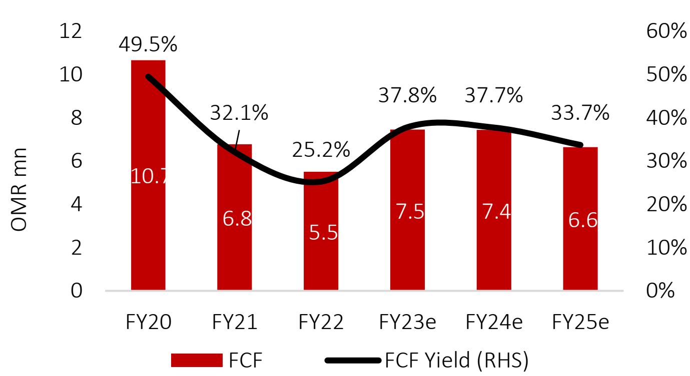
Source: Company Reports, U Capital Research

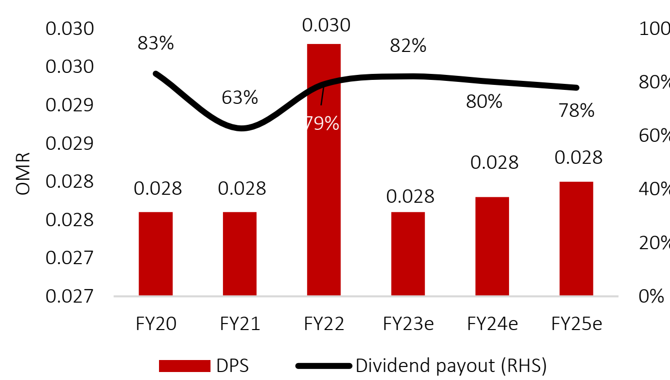
Source: Company Reports, U Capital Research

No cash sweep mechanism ensures sustained dividend payouts

MSPW business also has traits similar to other utilities in Oman, like long-term and assured revenue visibility, relatively steady margins, very low capex as the capacity once set at the inception is generally not modified or increased during the term of the agreement, and solid cash flows. Accordingly, MSPW has been generating solid free cash flows and in turn, offering generous dividends to their shareholders. During the past three years, the average dividend payout stood at a healthy 75%, and going forward we expect the company will comfortably maintain a 60-70% dividend payout. MSPW is also not exposed to cash sweep and hence it can sustain dividends during the remaining term of its PPA. However, for FY 2023e, the company has announced 13.8 baizas interim dividend per share (DPS), below the 16 baizas interim DPS of FY 2022. Hence, we estimate a lower dividend payout of 72.0% for FY 2023e as compared to 79.2% for FY 2022.

Fig. 32: MSPW has announced a lower interim dividend for FY 2023e owing to which we estimate the total dividend for the current year will be lower than last year





Source: Company Reports, U Capital Research

Source: Company Reports, U Capital Research

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Valuation

Our target price is based on blended valuation methodologies – (i) DDM and (ii) Relative Valuation (using Div. Yield).

As highlighted above, we reduce our dividend payout estimates for FY 2023 and onwards, post the announcement of the interim dividend for FY 2023, and thus we decrease our target price of the company to OMR 0.340 (previously, OMR 0.393), indicating an upside of 21.3%.

Accordingly, we rate maintain our **Buy** rating on the company. Currently, the stock trades at a P/E of 8.3x, offering an attractive dividend yield of ~9.9%, based on our FY 2023 estimates and the current market price.

Risks

Key downside risks:

i) below expected reliability, leading to under realization of the majority revenue provider capacity charge,
ii) below expected dividend payments.

Key upside risks:

iii) The company raising its dividend payouts at a more than estimated pace.

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Valuation

	MSPW
Currency	OMR
DDM (50% weight)	
PV of Dividends (mn)	
Year 1	1.9
Year 2	1.7
Year 3	1.6
Year 4	1.5
Year 5	1.4
Terminal Value	26.6
PV of Terminal Value	18.8
Assumptions	
Risk Free Rate (%)	6.2%
Adjusted Beta	0.46
Risk Premium (%)	4.1%
Cost of Equity (Ke) (%)	8.1%
WACC (%)	5.4%
Equity value (mn)	27.0
Outstanding Shares (mn)	70.4
Target Price	***0.384***
Dividend yield based Relative Valuation (50% weight)	
Target dividend yield	9.3%
DPS 2023e	*0.028*
Target Price	***0.295***
Weighted Average Target Price	**0.340**
Current Market Price	*0.280*
Upside/(Downside), %	21.3%
Recommendation	**Buy**

Source: Company Financials, Bloomberg, U Capital Research

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Key financials

In OMR mn, except per share metrics and price	FY20	FY21	FY22	FY23e	FY24e	FY25e
Income Statement						
Revenue	18	18	18	19	19	19
Operating costs	(11)	(11)	(11)	(12)	(12)	(12)
Gross profit	**7**	**7**	**7**	**7**	**7**	**7**
General and administrative expenses	(1)	(1)	(1)	(1)	(1)	(1)
Operating profit	**6**	**7**	**6**	**6**	**6**	**6**
Finance costs	(3)	(3)	(3)	(3)	(3)	(3)
Income before tax	**3**	**4**	**3**	**3**	**3**	**3**
Income tax	(0)	(1)	(0)	(0)	(0)	(0)
Net income/(loss) attributable to shareholders of the company	**2**	**3**	**3**	**2**	**2**	**3**
Balance Sheet						
Cash and cash equivalents	0	2	2	3	5	6
Trade and other receivables	13	19	24	22	21	23
Inventories	3	3	3	3	4	4
Right of use assets	0	0	0	0	0	0
Property, plant and equipment	72	70	68	66	64	62
Total assets	**88**	**94**	**97**	**94**	**94**	**94**
Interest bearing loans and borrowings	63	59	56	54	53	52
Provision for asset retirement obligation	0	0	0	0	0	0
Trade accounts payable	11	14	19	18	18	20
Total liabilities	**78**	**83**	**85**	**82**	**81**	**81**
Share capital	7	7	7	7	7	7
Retained earnings/(accumulated losses)	2	3	3	3	4	4
Equity Attributable to Shareholders	**10**	**11**	**12**	**12**	**13**	**13**
Cash Flow Statement						
Net cash generated from operating activities	3	8	6	8	8	7
Net cash generated from investing activities	(0)	(0)	(0)	(0)	(0)	(0)
Net cash (used in) provided by financing activities	(12)	(6)	(7)	(6)	(6)	(6)
Cash and cash equivalents at the end of the period as per BS	**0**	**2**	**2**	**3**	**5**	**6**
Key Ratios						
Gross margin	37.1%	40.3%	38.8%	37.1%	36.6%	36.2%
EBITDA margin	44.8%	47.6%	44.1%	43.0%	42.3%	41.8%
Operating margin	33.5%	36.7%	33.3%	32.2%	31.7%	31.4%
Net margin	13.2%	17.0%	14.3%	12.7%	12.9%	13.1%
ROA	2.5%	3.4%	2.8%	2.5%	2.6%	2.7%
ROE	23.9%	29.3%	23.2%	19.9%	19.8%	19.6%
Current Ratio (x)	1.0x	1.0x	1.0x	1.0x	1.1x	1.1x
Capex/Sales	0.2%	0.6%	0.2%	0.0%	0.1%	0.1%
Debt-Equity Ratio	6.3x	5.6x	5.2x	4.9x	4.6x	4.3x
EPS	0.033	0.044	0.038	0.034	0.035	0.036
BVPS	0.142	0.158	0.166	0.172	0.179	0.187
DPS	0.028	0.028	0.030	0.028	0.028	0.028
Dividend Payout Ratio	83.2%	62.8%	79.2%	82.2%	80.2%	77.9%
Dividend Yield (%)	9.0%	9.2%	9.6%	9.9%	9.9%	10.0%
P/E (x)	9.2x	6.8x	8.2x	8.3x	8.1x	7.8x
P/BV (x)	2.2x	1.9x	1.9x	1.6x	1.6x	1.5x
EV/EBITDA (x)	10.7x	9.4x	9.4x	8.9x	8.5x	8.2x
Price as at period end*	0.306	0.300	0.310	0.280	0.280	0.280

Source: Company Reports

*Current market price is used for forecast periods

P.O.BOX 1137, PC 111 – CPO, Sultanate of Oman I CR No. 1279406 I Tel: +9682494 9000 I Fax: +968 2494 9099 I Email: info@u-capital.net I Web: www.u-capital.net

Disclaimer

Recommendation

BUY	Greater than 20%
ACCUMULATE	Between +10% and +20%
HOLD	Between +10% and -10%
REDUCE	Between -10% and -20%
SELL	Lower than -20%

Ubhar Capital SAOC (UCapital)

Website: www.u-capital.net
PO Box 1137
PC 111, Sultanate of Oman
Tel: +968 2494 9000
Fax: +968 2494 9099
Email: research@u-capital.net