

# GCC Agrinutrients/Oil & Gas Sector

April 20, 2022

Company	Rating							
SABIC Agrinutrients (SAFCO)	Hold	<div><div><div>➤ Oil market volatility driven by competing factors of demand and supply, but overall demand to be steady</div><div>➤ GCC region resilient amid Covid-19 and rode economic recovery wave in 2021</div><div>➤ GCC companies' proximity to commodity reserves is a cost advantage</div><div>➤ Demand, prices, and spreads of major agrinutrients like Urea and commodities like Aluminium to sustain till 2024 despite Russia Ukraine war</div></div><div><p>We add four more companies to our GCC Petrochemicals and Oil &amp; Gas Sector coverage, bringing the total to 13. Covered in this report are: <b>SABIC Agrinutrients (SAFCO)</b>, <b>Saudi Arabian Mining Co. (Ma'aden)</b>, <b>ADNOC Drilling (ADNOC DRI)</b>, and <b>Abu Dhabi National Energy Company PJSC (TAQA)</b>. Our valuations are based on a mix of DCF, EV/EBITDA, and P/E multiple. Since last week of February 2022, prices related to petrochemicals and agrinutrients/industrial metals as well as feedstock prices are being influenced by Russia Ukraine war as well as other factors such as disruption in supply of raw materials like phosphate from the region, as well as International Energy Agency's (IEA) decision to offload over 240mn barrels of oil over next six months to make up for shortfall from ban on Russian oil exports. These factors are causing near term volatility and are benefitting select segments such as fertilizer producers due to price hikes.</p><ul style="list-style-type: none"><li>• <b>Oil market volatility driven by competing factors of demand and supply.</b> The war between Russia and Ukraine (starting in the last week of February 2022) resulted in severe economic and financial sanctions being imposed by US and Europe on Russia, which put Russia's oil and gas supply at risk (~10mbpd or ~10% of global supply). Following the initial spike in oil prices past USD 130/barrel, prices have fallen back equally fast to below USD 100/barrel after IEA announced massive stockpile of 240 mn barrels of oil to be released over next six months, as well as lower economic activity in China (pursing zero-COVID policy). While feedstock prices (Naphtha, Saudi Propane) have seen price volatility, downstream products such as urea, phosphates have seen price rises due to shortfall from Russia/Ukraine region.</li><li>• <b>GCC region resilient amid Covid-19 and rode economic recovery wave in 2021.</b> The year 2021 witnessed GCC region's resilience to the pandemic, thanks to both rise in oil prices as well as shorter duration of economic restrictions compared to developed economies. As such, demand for oil and gas from major consumers like India, China, and now newer customer segments like the Europe (looking to reduce dependance on Russian supply) are likely to benefit the region. Local demand for energy is expected to continue based on economic growth.</li><li>• <b>GCC companies' proximity to commodity reserves is a cost advantage.</b> For GCC companies dependent on oil and gas and commodity markets directly or indirectly, proximity to source of reserves helps them to be low-cost producers on the cost curve and ensure profitability even in volatile external environment.</li></ul><p>We have assumed demand, prices, and spreads of major agrinutrients like Urea and commodities like Aluminium to sustain till 2024 despite Russia Ukraine war, as the initial spikes in oil prices have subsided and long-term impact looks limited. However, risks to our valuations arise from escalation of Russia Ukraine conflict (to the extent it increases oil market volatility), and another wave of COVID-19 infections (to the extent it reintroduces restrictions on economic activities).</p></div></div>						
Saudi Arabian Mining Co. (Ma'aden)	Hold							
ADNOC Drilling (ADNOC DRI)	Accumulate							
Abu Dhabi National Energy Company PJSC (TAQA)	Buy							
Ayisha Zia								
Acting Head of Research								
<a href="mailto:a.zia@u-capital.net">a.zia@u-capital.net</a>								
Tel: +968 24 94 90 36								
Name	Last Px (LCY)	Target Price (LCY)	Upside / (Downside) (%)	Current P/E (x)	P/E'22e, (x)	EV/EBITD A'22e, (x)	ROE'22e, %	Cash Div Yield'22e, (%)
SABIC AgriN.	181.0	169.9	-6.1	16.5	8.8	7.0	56.3	8.5
Ma'aden	136.2	130.6	-4.1	25.9	14.2	13.4	23.6	0.0
ADNOC Drilling	3.7	4.4	19.3	26.7	24.4	15.6	23.9	4.2
TAQA	1.4	1.9	35.2	25.8	26.5	11.2	7.9	3.6
Average				23.7	18.5	11.8	27.9	4.1

Source: Refinitiv, U Capital Research

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## Valuation

We have used a mix of DCF, EV/EBITDA, and P/E to arrive at our target price for each company. We find present value for each year over the forecast period (2022-2026e). This present value is then added to the present value of the terminal year valuation. For terminal value calculation, we use the Weighted Average Cost of Capital (WACC) and terminal growth rate for each entity.

	SABIC Agrinutrients	Ma'aden	ADNOC Drilling	TAQA
<b>EV/EBITDA '22e Median Multiple</b>	9.6	7.0	12.3	16.5
EBITDA '22e, LCY mn	11,877	13,652	4,076	19,502
<b>Target Price, LCY</b>	<b>250.5</b>	<b>37.9</b>	<b>2.9</b>	<b>2.2</b>
Weight	10%	10%	10%	10%
<b>P/E '22 Median Multiple</b>	10.7	8.8	29.3	20.0
Earnings per share '22e, LCY	20.5	9.6	0.6	0.1
<b>Target Price, LCY</b>	<b>218.8</b>	<b>84.5</b>	<b>4.5</b>	<b>1.0</b>
Weight	10%	10%	10%	10%
<b>DCF Methodology</b>				
<b>PV of Future Cashflows to the Firm (LCY mn)</b>				
2022e	8,211	15,801	909	11,430
2023e	8,326	11,911	994	10,915
2024e	5,811	10,348	1,476	10,516
2025e	4,207	8,720	3,610	10,185
2026e	3,700	8,652	3,562	10,185
Terminal Value	37,847	166,640	67,511	246,683
Total PV of Future Cashflows (Enterprise Value, LCY mn)	68,101	222,071	78,062	289,731
Weight	80%	80%	80%	80%
<b>Assumptions</b>				
Risk Free Rate	3.4%	3.4%	3.2%	3.2%
Risk Premium, (Equity Risk Premium)	9.4%	9.4%	5.5%	5.5%
Beta (2 year weekly), x	0.86	0.86	1.00	0.75
Cost of Equity (COE)	11.5%	11.5%	8.7%	7.3%
Growth Rate	1.5%	1.5%	1.5%	1.5%
Cost of Debt (COD)	2.8%	2.6%	3.5%	2.0%
WACC	11.4%	6.8%	6.9%	5.7%
Debt/Equity Ratio, %	1.0%	109.4%	55.1%	44.1%
Net Debt, LCY mn	(5,053)	39,952	3,987	74,834
Fair Value of Equity, LCY mn	73,153	182,119	74,075	214,897
Outstanding Shares, mn	476	1,231	16,000	112,434
<b>Target Price, LCY</b>	<b>153.7</b>	<b>148.0</b>	<b>4.6</b>	<b>1.9</b>
<b>Weighted Average Target Price, LCY</b>	<b>169.9</b>	<b>130.6</b>	<b>4.4</b>	<b>1.9</b>
Current Market Price, LCY	181.0	136.2	3.7	1.4
Upside/(Downside), %	-6.1%	-4.1%	19.3%	35.2%
<b>Recommendation</b>	<b>Hold</b>	<b>Hold</b>	<b>Accumulate</b>	<b>Buy</b>

Source: Company Financials, Refinitiv, U Capital Research, note: Different peer set used for the companies covered

## Risks to Valuation

Key downside risks to our valuations include

- A slower-than-expected economic growth due to renewed lockdowns triggered by new COVID-19 variants
- New capacity additions that would lead to surplus in key petrochemicals like polyethylene and fertilizers like Urea.

Key upside risks to our valuation include

- Stronger than expected demand for fertilizers and petrochemicals that will lead to higher-than-expected price
- Rising tension between Russia and Ukraine which has led crude oil & other petrochemical product price to increase

## Sensitivity Analysis

Our TP for SABIC Agri-Nutrients is sensitive to multiple products however, between them, the higher sensitivity is towards ammonia and urea prices. Our TP is also sensitive (though relatively lower) to valuation inputs such as Cost of Equity (CoE) (+/- 1%) and terminal growth rate (+/- 0.25%). Between them, the higher sensitivity is towards the terminal growth rate.

### SAFCO

		Cost of Equity					Urea price (USD/t, 2022e)						
Terminal Growth rate		10%	11%	12%	13%	14%	Ammonia price (USD/t, 2022e)		600	700	800	900	1000
	1.00%	189.3	176.7	166.5	158.0	150.9		900	155.9	162.3	168.8	175.2	181.6
	1.25%	192.0	178.8	168.2	159.4	152.0		950	156.5	162.9	169.3	175.7	182.1
	1.50%	194.8	181.0	169.9	160.7	153.1		1000	157.1	163.5	169.9	176.3	182.7
	1.75%	197.9	183.3	171.7	162.2	154.3		1050	157.6	164.0	170.4	176.8	183.2
	2.00%	201.1	185.7	173.6	163.7	155.5		1100	158.2	164.6	171.0	177.4	183.8

Our TP for Ma'aden is sensitive to multiple commodities which includes phosphate-based products, aluminium based commodities, and precious and base metals. However, between them, the higher sensitivity is towards aluminum and diammonium phosphate price. Our TP is also sensitive (though relatively lower) to valuation inputs such as Cost of Equity (CoE) (+/- 1%) and terminal growth rate (+/- 0.25%). Between them, the higher sensitivity is towards the terminal growth rate.

### Ma'aden

Cost of Equity							Diammonium Phosphate (SAR/mt)						
Terminal Growth rate	10%	11%	12%	13%	14%	Aluminium (SAR/mt)	2238	2338	2438	2538	2638		
	1.00%	146.2	132.3	120.8	111.0		102.6	10863	129.6	130.1	130.5	131.0	131.5
	1.25%	153.2	138.0	125.5	114.9		105.9	10963	129.6	130.1	130.6	131.1	131.6
	1.50%	161.1	144.4	130.6	119.2		109.5	11063	129.7	130.2	130.6	131.1	131.6
	1.75%	170.0	151.4	136.3	123.9		113.4	11163	129.7	130.2	130.7	131.2	131.7
	2.00%	180.0	159.2	142.6	129.0		117.7	11263	129.8	130.3	130.7	131.2	131.7

Our TP for ADNOC Drilling is sensitive to valuation inputs such as Cost of Equity (CoE) (+/- 1%) and terminal growth rate (+/- 0.25%). Between them, the higher sensitivity is towards Cost of Equity. Our TP is also sensitive (although relatively much lower) to number of rigs and rig rental day rate.

### ADNOC Drilling

	Cost of Equity						Rig Rental Day rate (AED)				
	7%	8%	9%	10%	11%		2370	2570	2770	2970	3170
Terminal Growth rate	1.00%	5.3	4.6	4.1	3.7	3.4	77	4.4	4.4	4.4	4.4
	1.25%	5.5	4.8	4.3	3.9	3.5	97	4.4	4.4	4.4	4.4
	1.50%	5.8	5.0	4.4	4.0	3.6	117	4.4	4.4	4.4	4.4
	1.75%	6.1	5.3	4.6	4.1	3.7	137	4.4	4.4	4.4	4.4
	2.00%	6.5	5.5	4.8	4.3	3.8	157	4.4	4.4	4.4	4.4

Our TP is sensitive to valuation inputs such as Cost of Equity (CoE) (+/- 1%) and terminal growth rate (+/- 0.25%). Between them, the higher sensitivity is towards the cost of equity. Our TP for TAQA is also sensitive (although relatively much lower) to gross operating power generation capacity and transmission revenue per user.

### TAQA

	Cost of Equity						Transmission Revenue per user				
	5%	6%	7%	8%	9%		9,582	11,582	13,582	15,582	17,582
Terminal Growth rate	1.00%	2.4	2.0	1.7	1.4	1.2	23.4	1.9	1.9	1.9	1.9
	1.25%	2.6	2.1	1.7	1.5	1.3	25.4	1.9	1.9	1.9	1.9
	1.50%	2.9	2.3	1.9	1.6	1.3	27.4	1.9	1.9	1.9	1.9
	1.75%	3.1	2.4	2.0	1.6	1.4	29.4	1.9	1.9	1.9	1.9
	2.00%	3.5	2.6	2.1	1.7	1.5	31.4	1.9	1.9	1.9	1.9

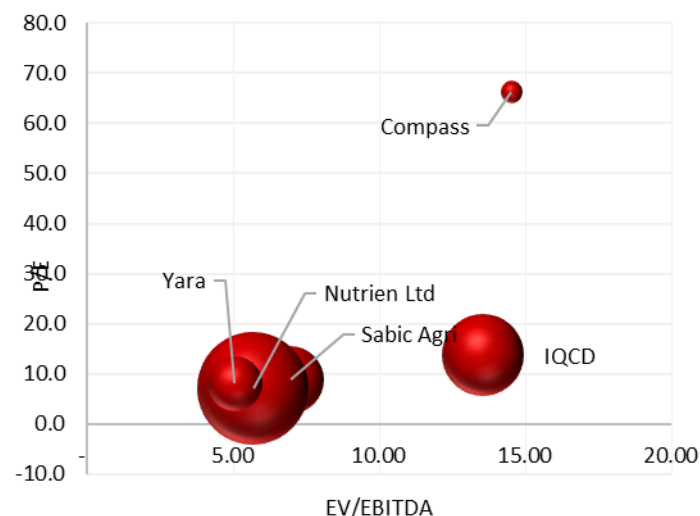
## Peer Group Valuation

### Peer Group - SABIC Agri-Nutrients

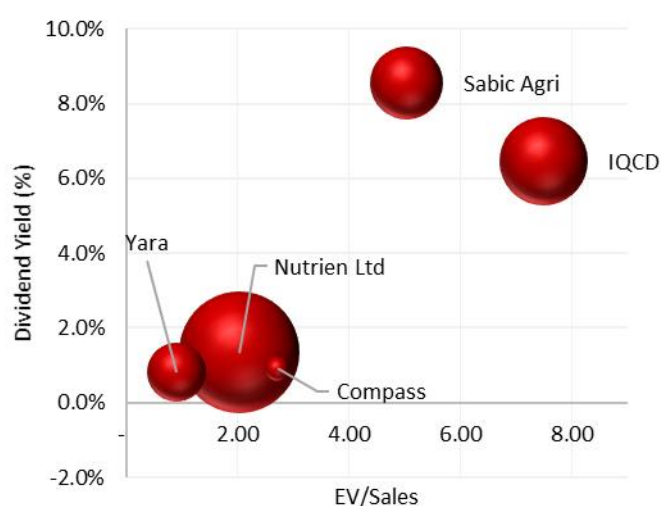
Name	Mkt Cap (USD bn)	Last Px (Local Currency)	Px Change 1M, %	Px Change 3M, %	Px Change YTD, %	Current EV/EBITDA (x)	EV/EBITDA '22e (x)	P/E '22e (x)	EV/Sales '22e (x)	Div Yield '22e
Sabic Agri	22.5	181.0	0.9%	-5.9%	2.5%	13.5	7.0	8.8	5.0	8.5%
Nutrien Ltd	62.0	142.1	13.6%	54.0%	49.5%	10.3	5.7	7.0	2.0	1.3%
Yara	14.6	489.4	12.1%	3.8%	10.0%	6.1	5.0	8.1	0.9	0.8%
IQCD	32.7	20.0	3.7%	18.9%	28.9%	16.7	13.6	13.3	6.6	2.0%
Compass	2.2	66.7	10.9%	24.0%	31.7%	13.9	14.5	66.3	2.7	0.9%
<b>Average</b>						<b>12.1</b>	<b>9.2</b>	<b>20.7</b>	<b>3.5</b>	<b>2.7%</b>
<b>Median</b>						<b>13.5</b>	<b>7.0</b>	<b>8.8</b>	<b>2.7</b>	<b>1.3%</b>

### Peer Group Valuation (2022E)

#### EV/EBITDA vs P/E



#### EV/Sales vs Dividend Yield (%)



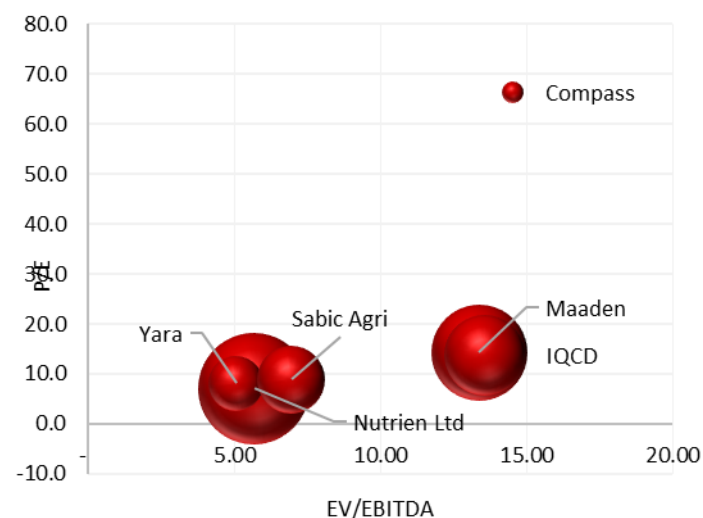
Source: Refinitiv; valuation as of 19<sup>th</sup> April 2022; Size of the bubble indicates market capitalization in USD bn

## Peer Group – Ma'aden

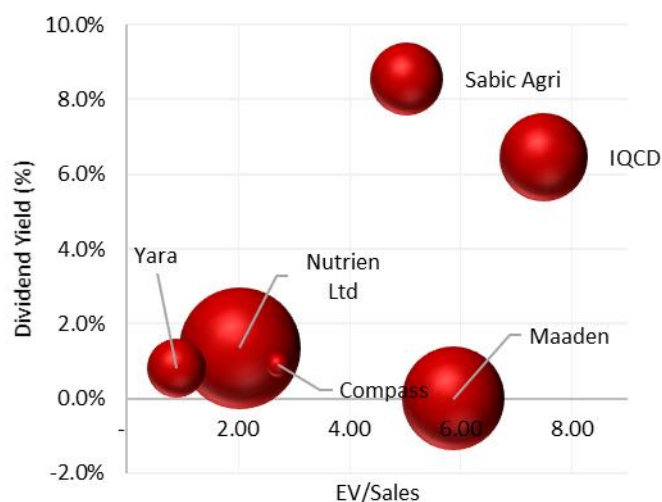
Name	Mkt Cap (USD bn)	Last Px (Local Currency)	Px Change 1M,	Px Change 3M,	Px Change YTD,	Current EV/EBITDA (x)	EV/EBITDA '22e (x)	P/E '22e (x)	EV/Sales '22e (x)	Div Yield '22e
Maaden	45.6	136.2	10.2%	47.7%	73.5%	18.4	13.4	14.2	5.9	0.0%
Nutrien Ltd	62.0	142.1	13.6%	54.0%	49.5%	10.3	5.7	7.0	2.0	1.3%
Yara	14.6	489.4	12.1%	3.8%	10.0%	6.1	5.0	8.1	0.9	0.8%
IQCD	32.7	20.0	3.7%	18.9%	28.9%	16.7	13.6	13.3	6.6	2.0%
Compass	2.2	66.7	10.9%	24.0%	31.7%	13.9	14.5	66.3	2.7	0.9%
Sabic Agri	22.5	181.0	0.9%	-5.9%	2.5%	16.5	7.0	8.8	5.0	8.5%
<b>Average</b>						<b>13.6</b>	<b>9.9</b>	<b>19.6</b>	<b>3.9</b>	<b>2.3%</b>
<b>Median</b>						<b>15.2</b>	<b>10.2</b>	<b>11.1</b>	<b>3.9</b>	<b>1.1%</b>

## Peer Group Valuation (2022E)

### EV/EBITDA vs P/E



### EV/Sales vs Dividend Yield (%)



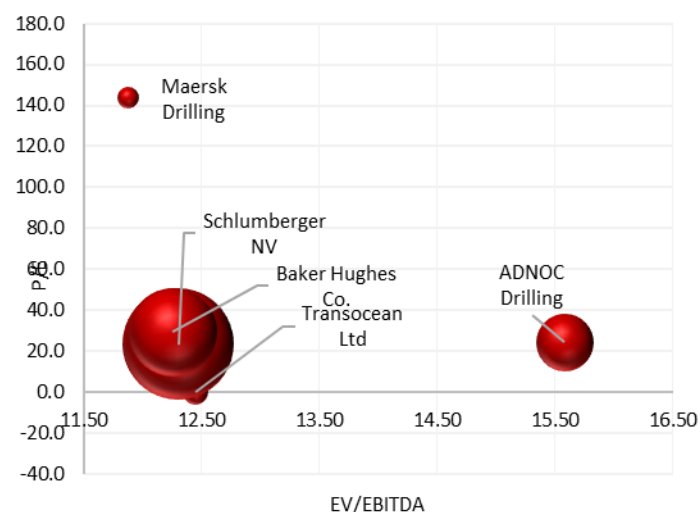
Source: Refinitiv; valuation as of 19<sup>th</sup> April 2022; Size of the bubble indicates market capitalization in USD bn

## Peer Group - ADNOC Drilling

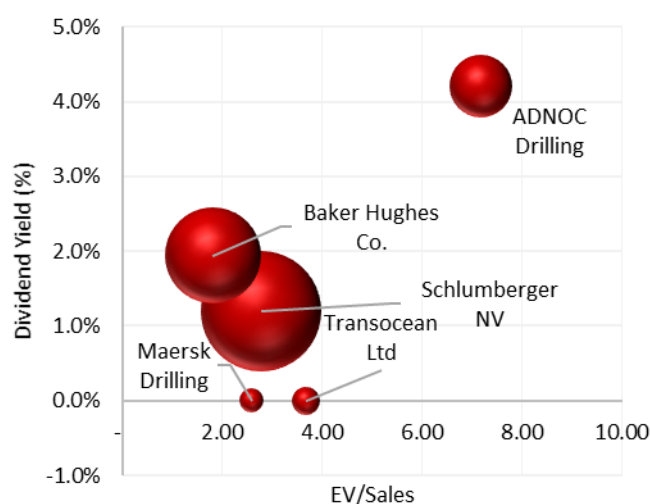
Name	Mkt Cap (USD bn)	Last Px (Local Currency)	Px Change 1M,	Px Change 3M,	Px Change YTD,	Current EV/EBITDA (x)	EV/EBITDA '22e (x)	P/E '22e (x)	EV/Sales '22e (x)	Div Yield '22e
ADNOC Drilling	16.0	3.7	-1.6%	10.7%	9.4%	16.7	15.6	24.4	7.2	4.2%
Transocean Ltd	3.1	4.6	7.2%	33.9%	60.7%	10.4	12.4	NaN	3.7	0.0%
Maersk Drilling	2.2	377.6	9.8%	43.4%	47.4%	8.6	11.9	143.5	2.6	0.0%
Schlumberger NV	61.1	43.7	10.0%	17.8%	46.6%	14.8	12.3	23.4	2.8	1.2%
Baker Hughes Co.	38.3	37.2	5.3%	41.3%	55.2%	15.3	12.3	29.3	1.8	1.9%
<b>Average</b>						<b>13.2</b>	<b>12.9</b>	<b>55.2</b>	<b>3.6</b>	<b>1.5%</b>
<b>Median</b>						<b>14.8</b>	<b>12.3</b>	<b>26.8</b>	<b>2.8</b>	<b>1.2%</b>

## Peer Group Valuation (2022E)

### EV/EBITDA vs P/E



### EV/Sales vs Dividend Yield (%)



Source: Refinitiv; valuation as of 19<sup>th</sup> April 2022; Size of the bubble indicates market capitalization in USD bn

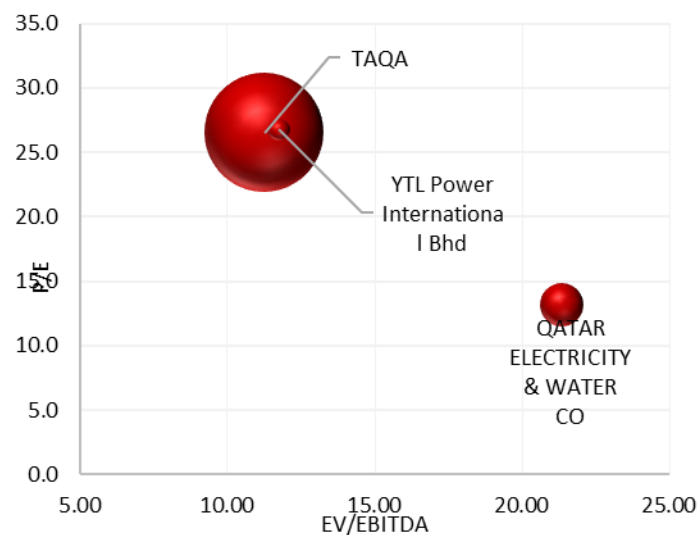


## Peer Group - TAQA

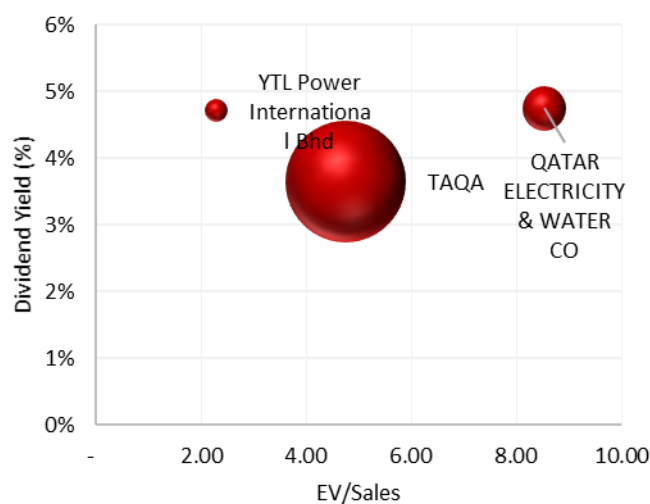
Name	Mkt Cap (USD bn)	Last Px (Local Currency)	Px Change 1M, %	Px Change 3M, %	Px Change YTD, %	Current EV/EBITDA (x)	EV/EBITDA '22e (x)	P/E '22e (x)	EV/Sales '22e (%)	Div Yield '22e (%)
TAQA	42.2	1.4	11.4%	7.9%	5.5%	11.4	11.2	26.5	4.8	3.6%
QATAR ELECTRICITY & WATER CO	5.4	18.0	-1.9%	5.0%	8.6%	20.7	21.3	13.2	8.5	4.7%
YTL Power International Bhd	1.4	0.7	13.4%	17.1%	17.1%	10.8	11.7	26.8	2.3	4.7%
<b>Average</b>						<b>14.3</b>	<b>14.8</b>	<b>22.2</b>	<b>5.2</b>	<b>4.4%</b>
<b>Median</b>						<b>11.4</b>	<b>11.7</b>	<b>26.5</b>	<b>4.8</b>	<b>4.7%</b>

## Peer Group Valuation (2022E)

### EV/EBITDA vs P/E



### EV/Sales vs Dividend Yield (%)



Source: Refinitiv; valuation as of 19<sup>th</sup> April 2022; Size of the bubble indicates market capitalization in USD bn

## Local Peer Group Analysis

### GCC Agrinutrients/Oil and Gas Sector – Listed Companies

The GCC region has several companies aligned with the oil and gas industry, ranging from drilling companies to agriproducts and energy companies. With a large and easy-to-extract reserves, the region has several companies in the petrochemicals value chain, right up to direct-to-farm Urea fertilizers. However, the bulk of the companies are still in main petrochemicals value chain.

In terms of the listed companies, there are two fertilizer producing companies, **SABIC Agrinutrients** and **Maaden**. These companies are unique in the sense that products are mostly sold outside the region while also benefiting from proximity to resource base and consequent advantages which help the companies to remain competitive. There are no comparable companies in the region, with most of the peers coming outside the region including US companies.

Among the sectors allied to oil & gas industry, drilling rigs is an important component and **ADNOC Drilling** is one of the only local drilling companies and latest entrant on the capital markets, having listed in October 2021. Similar to the fertilizer companies, the company also competes with global peers for oil field services to ADNOC group, which is separate from the captive drilling business that it receives from the parent company.

In terms of infrastructure providers like Power and Water, **Abu Dhabi National Energy Company or TAQA** plays an important role in the economic growth of UAE. At the same time, TAQA is present in over 10 countries in African, and European continent through power and water infrastructure projects, competing with both government owned and privately owned companies for business expansion.

Considering the niche sectors these companies occupy, there are very few local or regional peers, and yet these companies have established high standards of product and service delivery, ready to face stiffer competition. In terms of performance of the companies' stocks, the ones like SABIC Agrinutrients and Maaden have clearly benefited from the global petchem and commodity upcycle in 2021, which continues into 2022. Further, the escalation of Russia-Ukraine war has driven prices of select products like fertilizers even higher than in 2021, which improves the prospects for these companies.

## Global and Sector Outlook

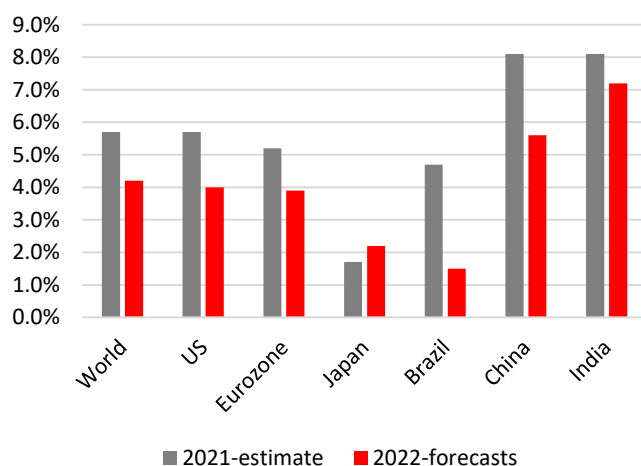
### Russia-Ukraine damped the chances of global recovery in 2022

The global economy is still recovering from the widespread effects of the pandemic. The year 2022 began with the expectation of a recovery in the global economy, with only inflation casting a shadow over the recovery. Easing of supply chain disruptions was expected to aid the recovery by mid-2022.

The pandemic led to major changes in behavior: Inventory management, change in working conditions and increased government spending on economic recovery. Global oil demand is long due from catching up to its pre pandemic levels. The IEA in its report (March 2021) forecasts that oil demand was nearly 9mb/d below the levels seen in 2019 and does not expect it to return to similar levels by 2023. The IEA expects the global oil consumption to be 104.1 mb/d by 2026.

However, the Russia-Ukraine crisis caused a major dent on the recovery of the economy. Looking ahead, the challenges in the global economy regarding slower economic recovery, higher inflation trends and ongoing Russia-Ukraine war will have a lasting impact on demand for oil.

### Annual GDP growth (%)



### UAE Annual Real GDP growth rates (%)

	2019	2020	2021	2022
Overall GDP	3.4	-6.1	2.1	4.2
Non-oil GDP	3.8	-6.2	3.8	3.9
Oil GDP	2.6	-6.0	-2.0	5.0

### KSA Annual Real GDP growth rates (%)

	2019	2020	2021	2022
Overall GDP	0.3	-4.1	3.2	7.7
Non-oil GDP	3.3	-3.4	6.1	3.4
Oil GDP	-3.6	-6.7	0.2	15.5

Source: OPEC MOMR March'22.

Source: CBUAE Quarterly economic review Q3 2021. CBUAE projections for 2021 and 2022.

Source: General Authority of Statistics

During the Q321, economic activity in the UAE continued its upward trajectory after recovering in 2Q21. UAE headline inflation turned positive in Q321 for the first time since Q418. It reached 2.5% for the year 2021. The UAE shifted from deflation to price growth in August 2021, outlining a recovery in the economy after the effects of the pandemic.

The International Monetary Fund (IMF) revised upward the economic growth outlook for the UAE in 2022 to 4.2% in 2022 up from its previous forecast of 3.5%. The latest IMF projection aligns with the forecast made by the Central Bank of the UAE for 2022. In 2023, the UAE is projected to grow 3.8%.

The hydrocarbon sector has been regaining strength in 2022 with the rise in global oil prices. This along with recovery and business activity has also allowed the non-hydrocarbon sector to recover in the UAE. With lenient restrictions on global travel, for 2022, the

Central Bank of UAE forecasts real GDP growth at 4.2%, non-oil GDP to 3.9% on the account of continuous increase in public spending, higher employment, and better business activities. Whereas IMF forecasts real GDP growth at 3.08%.

Post recovery in Q2 21, the non-oil sector continued its upward trend in 3Q21 led by improvement in local and global demand as it curbed the spread of the covid-19 virus.

The average UAE PMI (Purchasing managers index) increased to 54.8 in February 2022 from 54.1 for the previous month due to increased tourism, rising crude oil prices and government support. Amid recovery in market demand and increased travel, the private-sector output grew strongly, however, like other economies, inflation pressure persists which are caused by ongoing food crisis and rising crude oil prices.

### OPEC+ agreement & war led to increase in oil production and exports

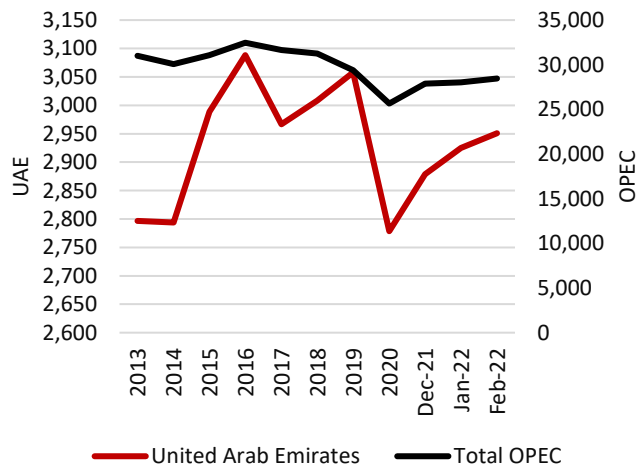
UAE's oil production increased by 9.3% on YoY basis and 4.3% on QoQ basis, leading to 2.72 mb/d for the year 2021. The increase in production came on the back of the agreement made with the OPEC+ in July 2021 to increase oil production by 400,000 bpd to boost oil supply and support the pent-up demand.

According to OPEC, total OPEC crude oil production averaged 28.47 mb/d for the month of February 2022 an increase of 0.44 mb/d on MoM basis driven by output increase in Saudi Arabia and UAE. UAE oil production reached 2.95 mb/d in February 2022, increasing 26 mb/d on m-o-m basis.

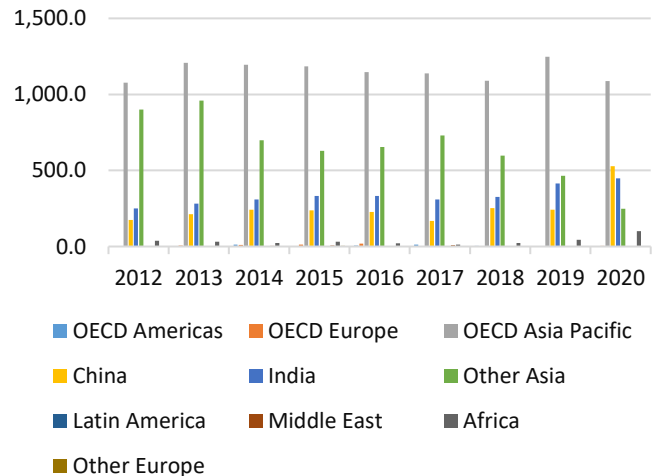
Amidst the Russia Ukraine war, the OPEC+ agreed to produce additional 400,000 mb/d of oil for the month of April 2022. Going forward, production of oil is expected to increase by the members of the OPEC to support the increase in crude oil prices and meet the pent-up demand for oil.

With the increase in crude oil production in 2021, the UAE crude oil exports, 45% of which is exported to the Asian markets, are projected by IMF to drop 1.6% for the year 2021 to 2.4 mb/d. Due to the Russia-Ukraine war, the crude oil exports hinge on the duration of the war and sanctions put on Russia but oil exports by the OPEC member countries is expected to rise in 2022.

**Daily crude oil production ('000 bpd)**



**UAE crude oil exports (thousand barrels/day)**

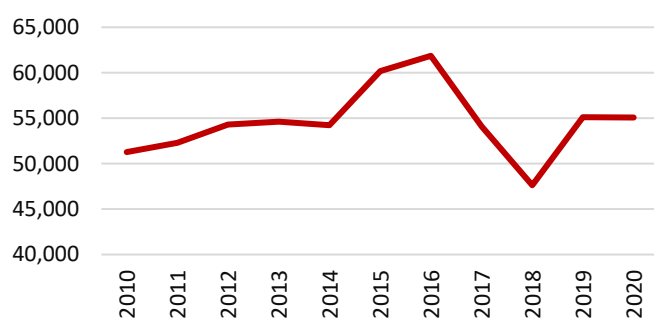


Source: OPEC, CBUAE Q3 Economic review

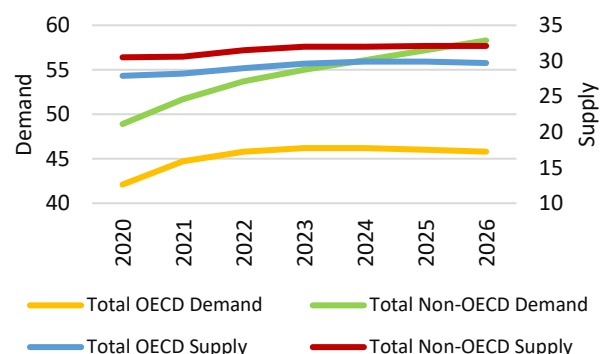
According to the BP Statistical Review of world energy 2021, the UAE holds 8th largest proven oil reserves globally. It produces approximately 3 mn barrels of petroleum and liquid per day and has oil reserves of approximately 100 bn barrels. It contributes 4% of the world's total oil production and 30% of the country's GDP is directly related to the oil and gas output.

The UAE held the 9th largest proved reserve of natural gas in the world with 209.7 trillion cubic feet at the end of 2020. Natural gas is one of the important strategic points for the growth of UAE economy. The UAE has undertaken several investments to develop its natural gas reserve to meet its domestic consumption and to increase exports. ADNOC drilling, announced in December 2021 a USD127 Bn capital expenditure plan for 2022-2026 to increase UAE's oil and natural gas reserves. The investment is expected to increase the kingdom's upstream production capacity, downstream portfolio and improve its clean energy business. (ADNOC drilling investments)

**UAE Natural gas market production (mn std cubic meter)**



**IEA global oil demand and supply (mb/d)**



**Source: IEA Oil 2021 report. Note: Excludes impact of Russia-Ukraine war**  
**Source: OPEC**

### IEA forecasts reduced global demand and supply

Implications of worldwide sanctions on Russia are expected to have a long-lasting effect on the global economy. As a result, the IEA have revised down its projections for world oil demand by 1.3 mb/d for Q2 2022-Q4 2022. Total demand is now forecasted at 99.7 mb/d in 2022, a 2.1 mb/d YoY increase. IEA estimate that the sanctions on Russia will lead to a drop in supply of oil by 3 mb/d which will lead to higher prices and major supply crisis in the energy markets, but losses could increase if the war prolongs, and the sanctions are tightened or continued to be imposed. The oil prices can only be controlled if the lack of supply from Russia is met immediately. Only Saudi Arabia and UAE have spare capacity to produce oil.

Increase in oil prices and lack of supply, if not sustained, will lead to higher inflation, and subdue economic growth. IEA has lowered its GDP and oil demand.

### Oil market volatility rose due to sanctions on Russia

US has outright banned imports of oil from Russia. Although Russia's exports to the USA are not significant, the greater implication will be on whether Europe will also ban or limit Russian imports of oil and gas, which are significant. Around 40% of Europe's gas imports and 25% of oil imports come from Russia. Apart from outright ban on Russian oil and gas, the sanctions imposed on Russia in terms of significant exclusion from the network of international financial institutions (exclusion from SWIFT messaging system, freezing Russian central bank's overseas assets) has led to higher risk for all countries to transact with Russia. Consequently, there is rising possibility of Russia being unable to sell oil and gas in global markets, or at least to the extent it could before the war. As Russia makes up for around 10% of global oil market and there is no other country who can fill up this gap at short notice, oil markets reacted sharply to such turmoil, with prices going past USD 130 per barrel briefly. After the initial panic reaction, oil prices then moderated to lower than USD 100 per barrel.

**Oil prices trend (USD/barrel)**



**Gas Prices trend (USD/mbtu)**



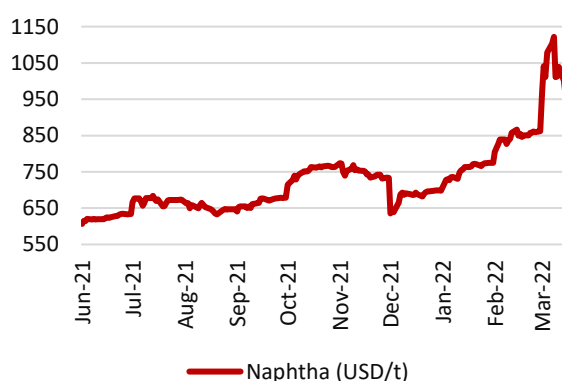
**Source: Refinitiv**

The oil prices in the year 2022 were already on the rise. Since, 23 February 2022, the Russian invasion, the oil prices increased by 27%. However, they have subsequently also fallen back to below USD 100 per barrel. Similarly, gas prices had briefly shot up to over USD 6/mbtu but have subsequently fallen below USD 5/mbtu. As such, both oil and gas markets are experiencing significant volatility, and it is challenging to estimate long term equilibrium prices.

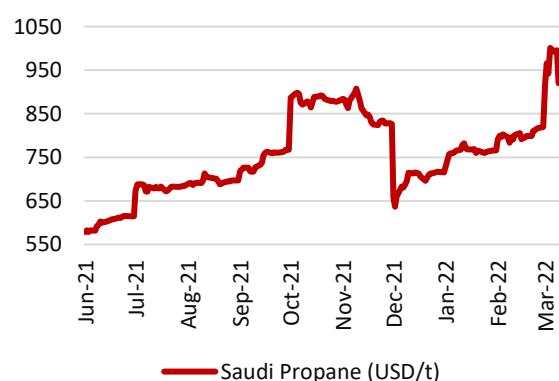
#### **Oil market volatility extends to the Petrochemicals market**

The petrochemicals market is influenced by oil market volatility as major feedstock like naphtha are derived from crude oil. As such, the oil market volatility recently has extended to petrochemicals market as well. In terms of feedstock prices, both Naphtha and Saudi Propane prices have spiked and then fell equally sharply, aligned with oil prices movement. The price movements show volatility, especially for Saudi propane, prices fell sharply in December 2021 only to climb back up in first quarter of 2022.

**Naphtha price trend (USD/ton)**



**Saudi propane price trend (USD/ton)**



— Naphtha (USD/t)

— Saudi Propane (USD/t)

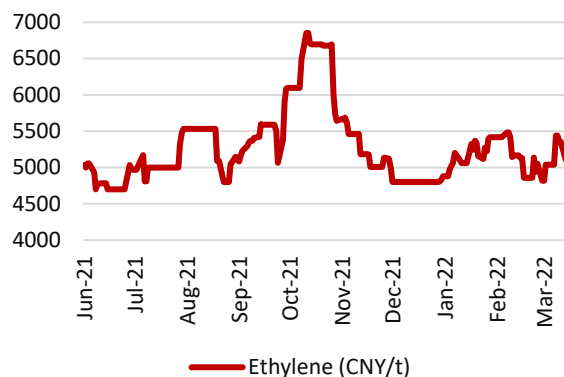
**Source: Refinitiv**

In terms of products down the value chain, Ethylene and Propylene prices have also shown a non-linear trend. For Ethylene, the Russia Ukraine war has not impacted price movements much since the end of February 2022, when the war actually broke out. However, in the case of Propylene, the price trends have followed the pattern of Naphtha and Saudi propane prices in terms of an initial spike in price after the start of the Russia Ukraine war, followed by a correction.

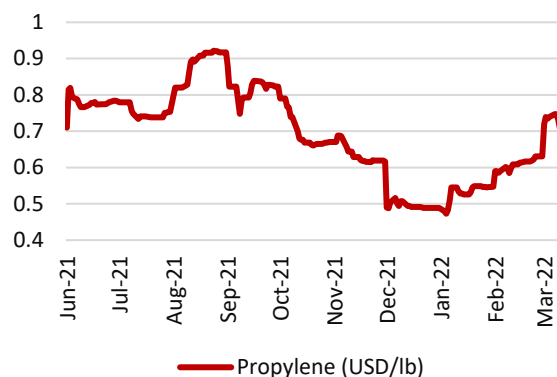
The price volatility has extended from petrochemicals to fertilizer prices as well. Even before the war, the prices of key fertilizers were rising rapidly, especially since 2021, the prices of ammonia went up by 220%, urea by 148%, di-ammonium phosphate by 90% and

potassium chloride by 198%. With Russia and Ukraine being top exporters of fertilizers like potash, prices are expected to go up even further as production and exports are impacted by the ongoing conflict.

**Ethylene price trend (CNY/ton)**



**Propylene price trend (USD/lb)**

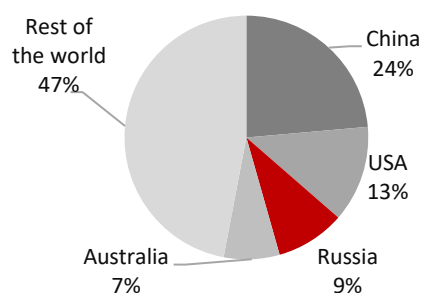


Source: Refinitiv

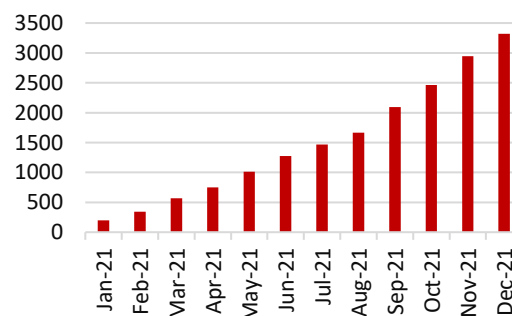
#### Fertilizer and commodities market to benefit from Russia Ukraine war and sanctions on Russia

Russia and Ukraine are among the regions with phosphate reserves and also had rising trend of fertilizer exports to rest of the world. Russia is also among the top mining nations in the world, supplying nearly 25% of Europe's oil demand and 40% of gas demand. Russia is also a major exporter of potassim fertilizers to the world. The war between Russia and Ukraine, followed by sanctions by US and Europe on Russia have created supply shortages and consequently led to rise in prices of fertilisers like Urea and commodities like Aluminium. As the war continues to drag on, the shortage situation would lead to elevated prices and benefit fertilizer producers.

#### Four biggest mining nations in the world (2019 % share)



#### Russia Fertilizer Potassium Exports (USD mn)



Source: World Mining Data Report 2021 by Austria Federal Ministry of Agriculture, Regions and Tourism

Source: Federal Customs Service, Russia

# SABIC Agri-Nutrients Co. (SABIC Agri-Nutrients)

**Target Price: SAR 169.9**

**Downside: 6.1%**

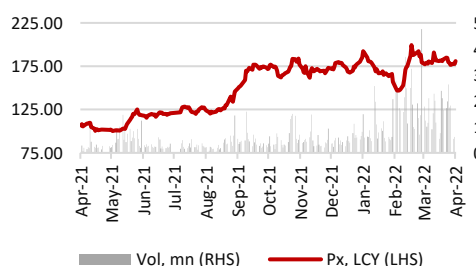
<b>Recommendation</b>	<b>Hold</b>
Bloomberg Ticker	SAFCO:AB
Current Market Price (SAR)	181.0
52wk High / Low (SAR)	199.4 / 100.2
12m Average Vol. (mn)	0.7
Mkt.Cap. (SAR bn)	86.2
Shares Outstanding (mn)	476.0
Free Float (%)	49.9%
3m Avg Daily Turnover (SAR mn)	264.8
6m Average Daily Turnover (SAR mn)	179.7
PE 2022e (x)	8.8x
EV/EBITDA 2022e (x)	7.0x
Dividend Yield '22e (%)	8.5%

## Price Performance:

1 month (%)	1.2%
3 months (%)	-5.2%
12 months (%)	67.6%

Source: Bloomberg, as of April 19, 2022

## Price -Volume Performance



Source: Refinitiv

- Diversified operations provide resilience to business
- Revival in demand is reflected across volume and price growth
- Rising fertilizer prices and volume growth to drive revenues
- Diversified global presence to provide cushion in case of regional geopolitical tensions

We initiate coverage on Sabic Agri-Nutrients Co. (SABIC Agri-Nutrients) with a Hold rating and a target price of SAR 169.9 per share, implying a downside of 6.1% to the last closing price (19<sup>th</sup> April 2022). Our target price implies a P/E'22e of 8.3x, and we believe that it is justified as the stock has rallied in the recent past, due to a strong revival in demand for fertilizers, record high fertilizer prices, support from parent company, resilient macroeconomic environment, and rising product prices.

## Investment Thesis

**Valuation & Risks:** Our valuation is based on a mix of discounted cash flows (80% weight), and multiples approach (10% weight each to PE and EV/EBITDA based multiples). Key downside risks include a decrease in fertilizer demand due to high prices and reduction in margins due to higher feedstock prices. Key upside risks include sustenance of high fertilizer prices and higher utilization levels to take advantage of higher prices.

## Diversified global presence

The company has presence across the continents of America and Europe along with footprints in Middle East, Africa, Southeast Asia, and Oceania. The company garners majority of revenue from international markets. Majority of revenue comes from Southeast Asia followed by South and North America. Domestic market accounts for 12% of the total revenue.

## Strong parentage and synergies with Aramco to augur well

Saudi Aramco owns 70% stake in SABIC. Most of the raw materials are procured from Aramco which enables the company to lower its feedstock costs enabling the company to increase its profitability in an environment when product price increases with minimal increase in feedstock price. The company expects a synergy target of USD 1.5-1.8 bn by FY25.

## Recent war environment to spur growth

The instability and the supply chain disruption caused by Russia-Ukraine war and the resulting sanctions on top producer and exporter of fertilizer (Belarus) places ME as attractive destination for fertilizer products.

## Key Indicators

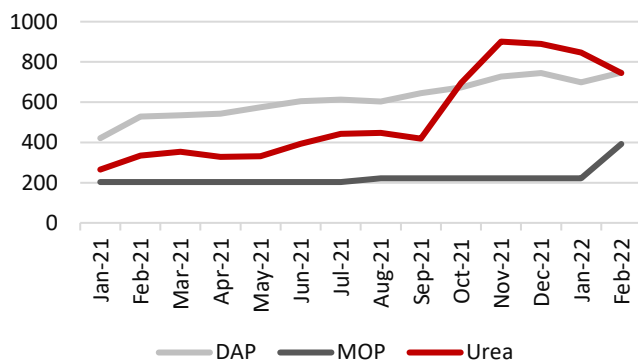
Year (in SAR mn)	FY19	FY20	FY21	FY22e	FY23e	FY24e
Sales	3,288	3,328	9,592	16,425	14,380	10,340
Gross profit	1,694	1,665	6,507	11,852	10,241	7,078
EBITDA	1,903	1,884	6,674	11,877	10,415	7,521
Operating profit	1,328	1,308	5,813	10,817	9,335	6,427
Net income	1,474	1,294	5,640	10,509	9,129	6,415
EPS	3.54	3.11	10.98	20.46	17.78	12.49
P/E (x)	22.4	29.2	17.5	8.8	10.2	14.5
EV/EBITDA (x)	16.7	17.2	12.3	7.0	7.9	11.0
Dividend yield	3.8%	2.2%	2.2%	8.5%	7.9%	6.0%



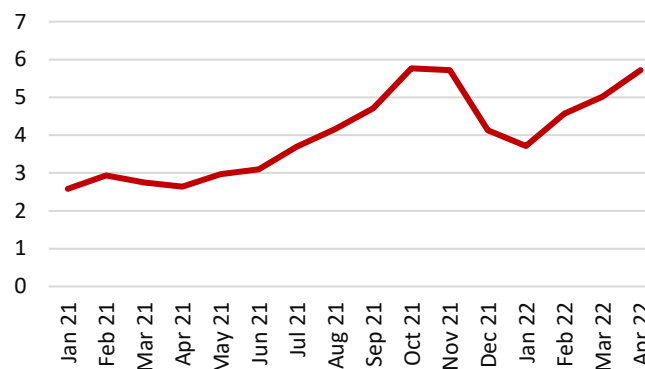
### Increasing Urea prices to help SABIC keep profitability high

Russia, China, and Canada are the largest exporters of fertilizers. Russia alone accounts for 13% of the world's total fertilizers production and is the biggest exporter of ammonia and urea. In December 2021, Russia announced to restrict the export of nitrogen and phosphate fertilizers for the next 6 months to ensure domestic supply and contain the price inflation. Similarly, China, which is the world's largest supplier of phosphate, suspended fertilizers exports till June 2022 for the purpose of maintaining domestic supply. As a result of this, the global supply decreased, increasing the prices of fertilizers as can be seen in the following data.

**Increase in prices of DAP, MOP, and Urea (USD/MT)**



**Natural Gas prices (USD/MMBtu)**



Source: Bloomberg

The natural gas price has been rising since the start of the last year. As Russia caters to about 40% of Europe's natural gas requirements, a 25% reduction in supply by the country in Q4 of 2021 created a shortage in the European market. The demand from Latin America and Asia remained the same leading to increase in the prices of natural gas and subsequently that of the fertilizers. The prices for other raw materials such as nitrogen, nitrate, phosphate, potash, and sulphates also increased leading to higher prices.

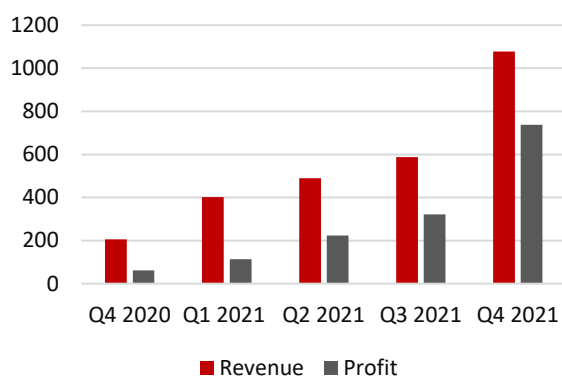
### Strong parent support from SABIC and strong synergies with Aramco

Saudi Basic Industries Corporation (SABIC) is among the largest petrochemical companies in the Middle East with a market capitalization of about USD 105 bn. It has 3 main operations: Petrochemicals, Agri Nutrients and Metals. Aramco, the world's largest oil producer (market capitalization USD 2.28 trillion) holds 70% stake in SABIC. The company provides feedstock and raw material to SABIC. This allows the company to lower its raw material cost and keep the profitability up. With the synergy, SABIC has achieved annual synergy of USD 373 mn in FY21 and has achieved a total of USD 468 mn savings since the acquisition in 2020. The company has set a synergy target of USD 1.5-1.8 bn till FY25.

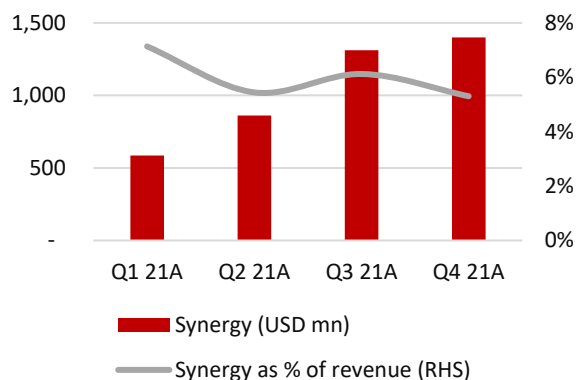
### Increasing revenue and profit of SABIC Agri Nutrients Company

With the increase in prices, the revenue of the SABIC Agri Nutrients also increased. By managing to keep the raw material and the input costs low (because of cheaper raw material from Aramco), the revenue and profit of SABIC Agri Nutrients Company kept on increasing while the profitability of its peers was decreasing for the duration. With the increasing fertilizer prices, the 2022 estimates of the revenue and profit for the company show a significant rise.

Quarterly data for SABIC Agri Nutrients, 2021 (USD mn)



SABIC' synergy in FY21 (values in USD mn)

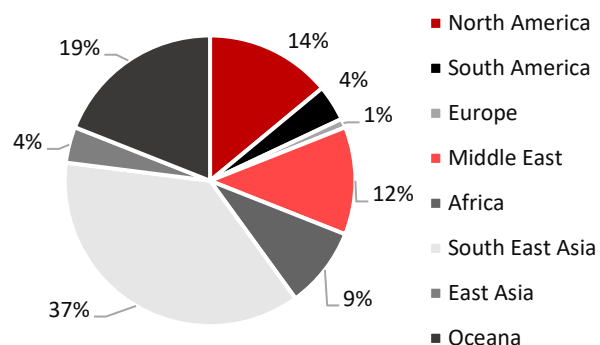


Source: Company Data

### Strong global presence

The parent company of SABIC Agri Nutrients, i.e., SABIC has a large number of subsidiaries and joint ventures in Saudi Arabia as well as outside of Middle East. It has innovation centers, manufacturing and compounding plants, distribution and storage facilities in the Americas, several European nations, Africa and in many countries in Asia with a presence in about 50 countries around the world.

Similarly, the Agri Nutrients business of the company has a presence in most of these countries with majority of the revenue coming from the international markets. The data below shows the market wise share of the total revenue of the company



Source: Company Data

### Russia-Belarus sanctions may increase the demand for the Middle Eastern fertilizers

With the recent Russia-Ukraine war, sanctions on Russia from the Western and European countries further worsened the fertilizer supply in the world. Belarus, who is the world's second largest potash fertilizers is facing sanctions, with EU banning all imports of potash from the country. Being one of the major producers and exporters of fertilizer products and raw materials, there is a good chance the world will look to Middle East for the supply of these products.

### Strong Dividend track record

For the year 2021, the company has paid out dividends twice. The first dividend (SAR 1.25) was paid in June 2021. The second dividend of SAR 3 will be paid in April 2022. This way, the dividend yield for the year 2021 will be around 3.36%. From the years 2017 to 2021, the company has paid out dividends in the yield range of 3.5-4%. The data for the same is as given below,

Year	Total Dividend (SAR)	Average Share Price (SAR)	Dividend Yield (%)
2021	4.25	126.58	3.36%
2020	2	76.41	2.62%
2019	3	80.80	3.72%
2018	3.5	70.02	5%
2017	1.75	65.06	2.69%

Source: Saudi Exchange

Note: the dividend yield is calculated as per the average share price for each year

## Relative valuation

We have given an equal weightage of 10% each to the P/E and EV/EBITDA multiples. At average median peer P/E multiple of 10.7x and EV/EBITDA multiple of 9.6x, we arrive at target price of SAR 218.8 and SAR 250.5 per share respectively.

## Discounted Cash Flow

	FY22e	FY23e	FY24e	FY25e	FY26e	Terminal Value
Pegged on April 19, 2022						
Time period index	0.70	1.70	2.70	3.70	4.70	4.70
<b>Free cash flow</b>						
PAT	9,742	8,463	5,947	4,805	4,831	
Interest (1-tax rate)	34	36	38	40	43	
Depreciation	1,060	1,079	1,095	1,104	1,110	
Changes in Working Capital	(1,633)	731	922	424	262	
Less: Capex	(345)	(302)	(217)	(93)	(93)	
Free cash flow to firm (FCFF)	8,858	10,008	7,785	6,280	6,153	62,948
Discounted FCFF	8,211	8,326	5,811	4,207	3,700	37,847

All figures in SAR mn unless otherwise stated

Enterprise Value	68,101
Less: Net debt (Includes lease liabilities)	(5,053)
Equity Value	73,153
Shares O/S	476
Equity Value per share	153.7
Current share price (SAR)	181.0
% upside/downside	-15.1%

### Assumptions

WACC	11.42%
Cost of debt / Lease Liabilities (A-T)	2.8%
Cost of Equity	11.5%
Terminal growth rate	1.5%

### Cost of equity calculation

Risk-Free Rate	3.43%
Beta	0.86
Equity Risk Premium	9.40%

### Weights

Debt	1.04%
Equity	98.96%

### About SABIC Agri-Nutrients

SABIC Agri-Nutrients Company was formerly known as Saudi Arabian Fertilizer Company (SAFCO). It is the first agrinutrient company in Saudi Arabia formed in the year 1965. It is one of the largest agrinutrients companies in the world specializing in fertilizers products. The company engages in the production, conversion, marketing, and trade of fertilizers in Saudi Arabia and internationally. The company offers three products: Urea, Ammonia, and other products

### Segments

The company manufactures following products:

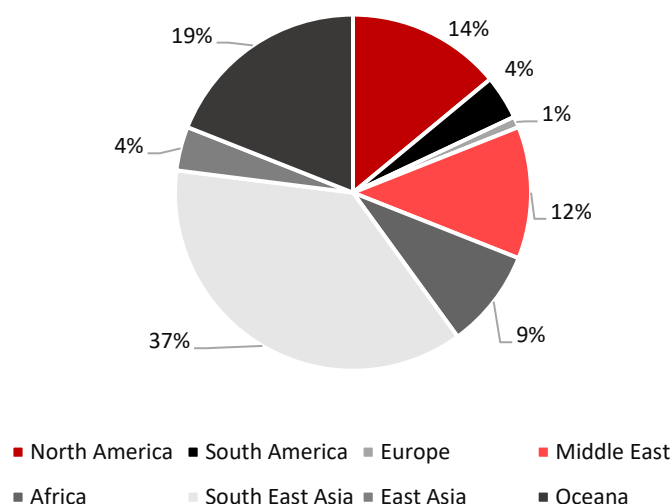
- 1) Urea – Granular urea, Prilled urea, Technical grade urea
- 2) Ammonia – Anhydrous ammonia
- 3) Other products – DAP, MAP, 2-Ethylhexanol, Dioctyl-phthalate and a variety of NPK fertilizers

The total production of the company in the year 2021 was 7,805 thousand MT.

### Geography

SABIC Agri-Nutrient Company has many subsidiaries with market presence in multiple continents. The following data shows the share company's revenue by locations for the year 2021,

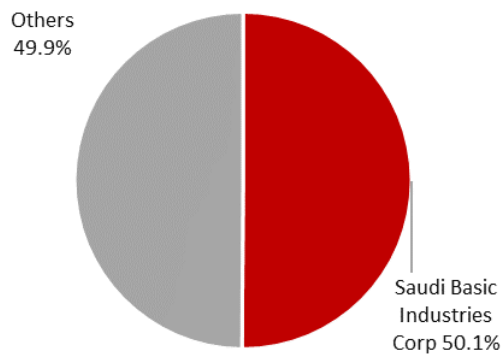
**SABIC Agri-Nutrient location-wise revenue share**



**Source: Company Data**

South-East Asia is the biggest market for the company making up about 37% of the total revenue. The other markets Oceania, North America and the Middle East are few of the company's biggest markets making up about 19%, 14% and 12% of the company's total revenue share. SABIC Agri Nutrients and its subsidiaries also sell their products in Africa, South America, East Asia, and Europe as is shown in the above data chart.

### SABIC Agri-Nutrients shareholding structure



Source: Bloomberg

### Recent M&A

Following data shows the recent mergers by SABIC Agri Nutrients Company,

Company	Brief about the acquisition
ETG Inputs Holdco Co.	At the beginning of the year 2022, SABIC Agri-Nutrients signed an agreement to acquire 49% shares in ETG at an enterprise value of SAR 1.2 bn (USD 320 mn).
SABIC Agri-Nutrients Investment Co.	Towards the end of 2019, SABIC Agri-Nutrients Company (then SAFCO) acquired the Investment co of SABIC at a value of SAR 4.59 bn (approximately USD 1.2 bn).

## Key financials

(SAR mn)

Income Statement	FY19	FY20	FY21e	FY22e	FY23e	FY24e
Sales	3,288	3,328	9,592	16,425	14,380	10,340
COGS	(1,594)	(1,662)	(3,085)	(4,574)	(4,139)	(3,262)
<b>Gross profit</b>	<b>1,694</b>	<b>1,665</b>	<b>6,507</b>	<b>11,852</b>	<b>10,241</b>	<b>7,078</b>
SG&A expenses	(366)	(357)	(694)	(1,035)	(906)	(651)
<b>Operating profit</b>	<b>1,328</b>	<b>1,308</b>	<b>5,813</b>	<b>10,817</b>	<b>9,335</b>	<b>6,427</b>
Share of results of inv in assoc. and JVs	127	48	243	241	250	260
Other income – net	27	13	(59)	41	36	26
Finance charges	(7)	(15)	(16)	22	38	75
<b>Income before tax</b>	<b>1,475</b>	<b>1,354</b>	<b>5,980</b>	<b>11,120</b>	<b>9,660</b>	<b>6,788</b>
Zakat and Income tax	(1)	(60)	(341)	(612)	(531)	(373)
<b>Net income for the period</b>	<b>1,474</b>	<b>1,294</b>	<b>5,640</b>	<b>10,509</b>	<b>9,129</b>	<b>6,415</b>
Balance Sheet						
Cash and bank balances	754	465	5,231	7,101	11,026	14,332
Prepayments and other current assets	200	120	256	493	431	310
Trade and other receivables	630	475	2,520	4,316	3,546	2,550
Inventories	434	403	709	940	850	670
Property, plant, and equipment	5,898	5,590	8,501	7,826	7,095	6,270
Investments in joint ventures	744	792	769	889	1,015	1,145
Right of use assets	124	128	177	155	128	95
<b>Total assets</b>	<b>9,663</b>	<b>9,995</b>	<b>19,789</b>	<b>23,659</b>	<b>25,951</b>	<b>27,066</b>
Trade and other payables	187	114	170	251	227	179
Long-term borrowings	0	0	0	0	0	0
Lease liabilities	106	103	157	160	163	165
Share capital	4,167	4,167	4,760	4,760	4,760	4,760
Statutory reserve	1,250	1,250	1,428	1,428	1,428	1,428
Retained earnings	2,221	2,310	4,884	7,270	8,886	9,701
<b>Total stockholders' equity</b>	<b>7,996</b>	<b>8,161</b>	<b>17,027</b>	<b>20,300</b>	<b>22,708</b>	<b>24,121</b>
<b>Total liabilities &amp; stockholders' equity</b>	<b>9,663</b>	<b>9,995</b>	<b>19,789</b>	<b>23,659</b>	<b>25,951</b>	<b>27,066</b>
Cash Flow Statement						
Cash from operating activities	1,778	2,094	5,108	9,899	11,010	8,506
Cash from investing activities	(410)	(1,297)	317	(676)	(242)	(71)
Cash from financing activities	(1,307)	(1,085)	(1,372)	(7,353)	(6,843)	(5,129)
Net changes in cash	61	(288)	4,053	1,870	3,925	3,306
Cash at the end of the period	754	465	5,231	7,101	11,026	14,332
Key Ratios						
Current ratio	2.6	3.2	4.2	6.4	6.4	8.7
Inventory turnover ratio	3.5	4.0	5.6	5.5	4.6	4.3
Debtors' turnover ratio	5.4	6.0	6.4	4.8	3.7	3.4
Creditors turnover ratio	56.8	31.9	73.9	103.8	89.2	63.1
Gross profit margin	51.5%	50.0%	67.8%	72.2%	71.2%	68.5%
Operating margin	40.4%	39.3%	60.6%	65.9%	64.9%	62.2%
Net profit margin	44.8%	38.9%	58.8%	64.0%	63.5%	62.0%
EBITDA margin	57.9%	56.6%	69.6%	72.3%	72.4%	72.7%
Average return on equity	18.5%	16.0%	44.8%	56.3%	42.5%	27.4%
Average return on assets	15.4%	13.2%	37.9%	48.4%	36.8%	24.2%
Debt/Equity (x)	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x
Interest coverage ratio (x)	49.7x	46.6x	136.0x	298.3x	243.6x	158.7x
P/E	22.4x	29.2x	17.5x	8.8x	10.2x	14.5x
EV/EBITDA	16.7x	17.2x	12.3x	7.0x	7.9x	11.0x
EV/Sales	9.7x	9.7x	8.5x	5.0x	5.7x	8.0x
EPS (SR)	3.54	3.11	10.98	20.46	17.78	12.49
Dividend payout ratio	84.8%	64.4%	38.7%	70.00%	75.00%	80.00%
Dividend yield (%)	3.8%	2.2%	2.2%	8.5%	7.9%	6.0%
Net debt (cash)	(634)	(342)	(5,053)	(6,920)	(10,841)	(14,144)
Net debt/ EBITDA	-0.33	-0.18	-0.76	-0.58	-1.04	-1.88
ROCE	15.1%	14.3%	42.0%	54.2%	40.9%	25.9%

Source: Company Financials, U Capital Research

# Saudi Arabian Mining Co (Ma'aden)

**Target Price: SAR 130.6**

**Downside: 4.1%**

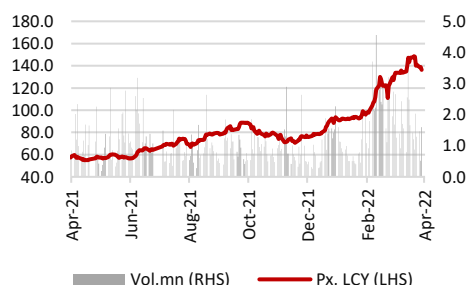
Recommendation	Hold
Bloomberg Ticker	MAADEN AB
Current Market Price (SAR)	136.2
52wk High / Low (SAR)	148.6 / 55
12m Average Vol. (mn)	1.2
Mkt.Cap. (SAR bn)	167.6
Shares Outstanding (mn)	1230.6
Free Float (%)	32.8%
3m Avg Daily Turnover (SAR mn)	199.8
6m Average Daily Turnover (SAR mn)	136.2
PE 2022e (x)	14.2x
EV/EBITDA 2022e (x)	13.4x
Dividend Yield '22e (%)	0.0%

## Price Performance:

1 month (%)	5.1%
3 months (%)	45.4%
12 months (%)	135.2%

Source: Refinitiv, as of 19<sup>th</sup> April 2022

## Price -Volume Performance



Source: Refinitiv

- Well diversified and integrated line of business helps maximize profit and lower cost
- The only large metal and mining company trading on Tadawul
- Higher product prices and increasing demand to drive revenue growth
- Increasing raw material costs may impact margins

We initiate coverage on Saudi Arabian Mining Co. (Ma'aden) with a Hold rating and a target price of SAR 130.6 per share, implying a downside of 4.1% to the last closing price (19<sup>th</sup> April 2022). Our target price implies a P/E'22e of 13.7x. The stock has rallied in the recent past, underpinned by the revival of the overall macroeconomic environment, rise in metals and fertilizer prices induced first by the economic recovery and then Russia-Ukraine war and rising fertilizer demand.

## Investment Thesis

**Valuation & Risks:** Our valuation is based on a mix of discounted cash flows (80% weight), and multiples approach (10% weight each to both PE and EV/EBITDA based multiples). Key downside risks include a decrease in the prices of metals and normalization of fertilizer prices and demand destruction due to record high fertilizer prices. Key upside risks include a sustained high fertilizer price (contribution to revenue?), increase in metals prices (mention the % of revenue) and higher than expected demand to fill the gap formed by lack of Russian fertilizers.

## Diversified and well-integrated line of business augurs well for the company

Maaden's business is divided among Agrinutrients (phosphates), industrial metals (aluminum) and precious metals (gold). Not only does a diversified revenue stream can help the company remain resilient during periods of economic volatility, having access to resources (mines) helps the company capture value across the production chain, thus ensuring lower production costs and thereby higher margins. Furthermore, the company is benefiting from the current geopolitical tensions due to higher demand for products in both segments.

## Supply constraints have resulted in both price and volume growth

Even before the Russia-Ukraine war, prices of Agri-nutrients like phosphate fertilizers were on the rise due to supply constraints from Russia and China. The war has further exacerbated the situation with prices touching record highs, thereby helping Maaden secure higher realizations per ton of phosphate fertilizers. While feedstock prices have partially offset the benefits and caused some pressure on margins, we expect the market to remain favorable for producers like Maaden.

## Key Indicators

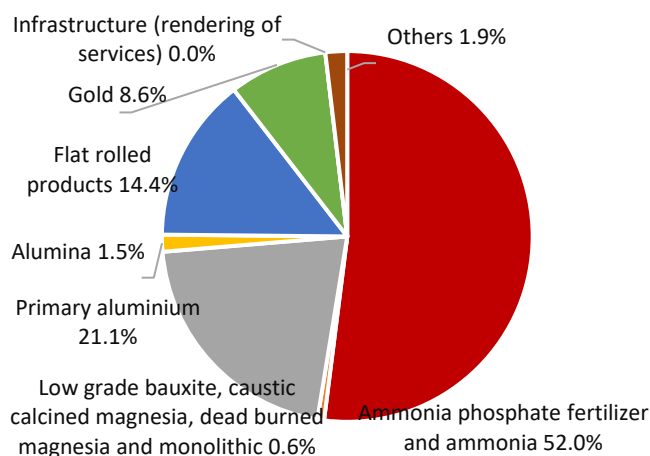
Year (In SAR mn)	FY19	FY20	FY21	FY22e	FY23e	FY24e
Sales	17,736	18,580	26,769	31,147	23,923	20,813
Gross profit	2,672	2,567	9,155	14,749	11,112	9,594
EBITDA	5,557	5,632	12,031	13,652	10,489	9,222
Operating profit	886	811	7,414	12,724	9,546	8,324
Net income	(1,528)	(847)	6,481	11,763	8,707	7,558
EPS	(1.30)	(0.69)	5.27	9.56	7.08	6.14
P/E (x)	NA	NA	14.9	14.2	19.3	22.2
EV/EBITDA (x)	18.8	17.4	11.9	13.4	17.4	19.8
Dividend yield	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%



### Ma'aden has diversified revenue sources across businesses which provide resilience to business cycles

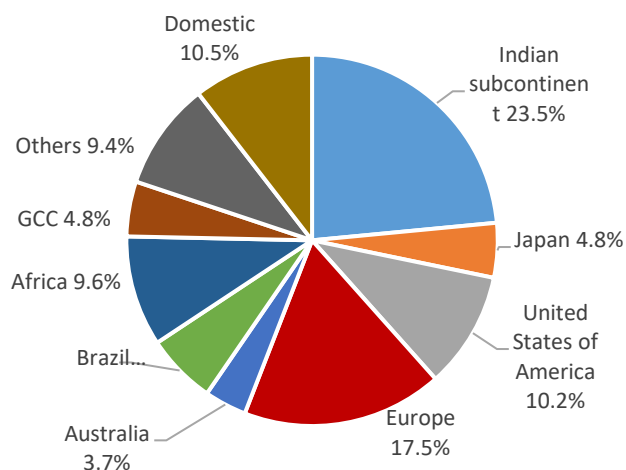
Ma'aden has diversified its revenue stream from various businesses. It is structured as a holding company having several subsidiaries and joint ventures focusing on mining, metals, and fertilizers. Its main operations are in the Kingdom of Saudi Arabia. The company's subsidiaries and joint ventures are located outside the origin country. Ma'aden generated 89.5% of its total revenue from its international operations and 10.5% of its total revenue from its domestic operations. Ammonia Phosphate fertilizer and ammonia are the key revenue drivers contributing 52% of the total revenue and around 53% of profit in FY21. Aluminum contributed around 21% of total revenue and around 37% of profit in FY21. This diversification of revenue minimizes the group's over-reliance on a single stream of revenue and reduces risk. This would also help the company to be delinked from economic cycles (ups and downs).

**Revenue by product FY21**



Source: Company Data

**Revenue by geography FY21**

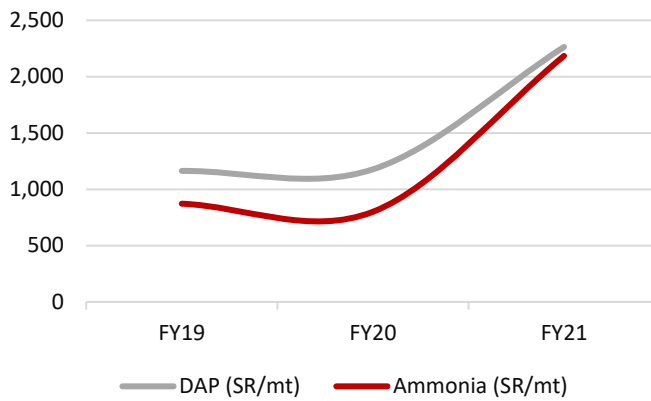


Source: Company Data

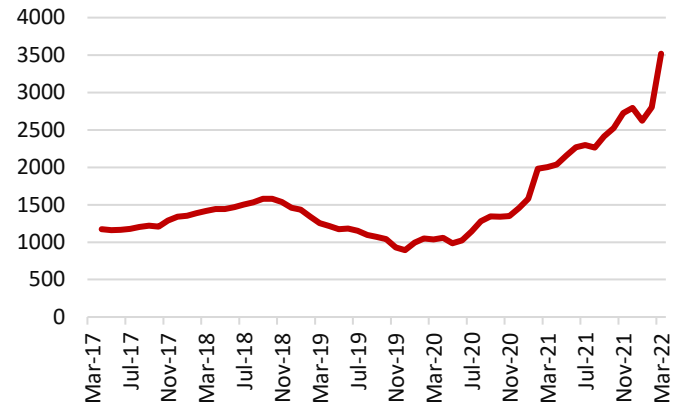
### Prices for agrinutrients have risen strongly in 2021 due to supply constraints

Ma'aden is the largest Metal and mining company in Saudi Arabia and continues to benefit from both price and volume growth. Prices continued to rise after bouncing back from the pandemic slowdown. The second half of 2021 however witnessed a supply shortage of fertilizers that continues to grow in magnitude. In December 2021, Russia announced to restrict the export of phosphate fertilizers for 6 months to ensure domestic supply and contain the price inflation. Similarly, China, who is the world's largest supplier of phosphate, suspended fertilizers exports till June 2022 for the purpose of maintaining domestic supply. As a result of this, the global supply decreased, increasing the prices of fertilizers. Sanctions on Russia's, the world's top aluminum producer outside China, could block 1.8m tons of aluminum from Europe and the U.S. (3% of global supply). Supply disruptions could widen the expected deficit pushing Aluminium prices higher, to USD 3,200-3,500/t. The prospect for agriproducts looks strong in 2022 as the Russia-Ukraine war would disrupt supply of phosphate from Ukraine region, and consequent price rise would benefit producers like Ma'aden. There is a good chance the world will look to Middle East for the supply of these products. With the increasing commodities prices, the 2022 estimates of the revenue and profit for the company show a significant rise.

**Di-ammonium phosphate and Ammonia price (SR/MT)**



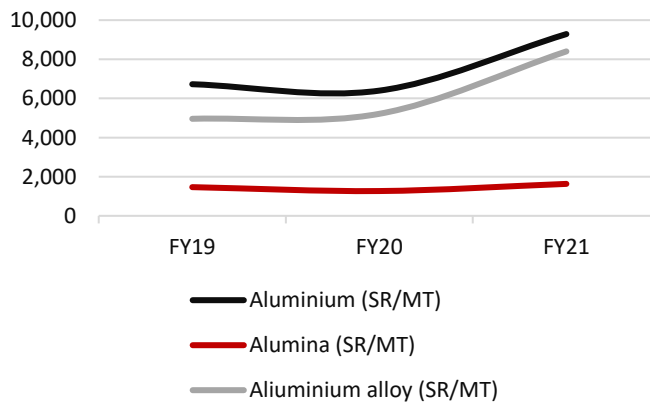
**Phosphate price (SR/MT)**



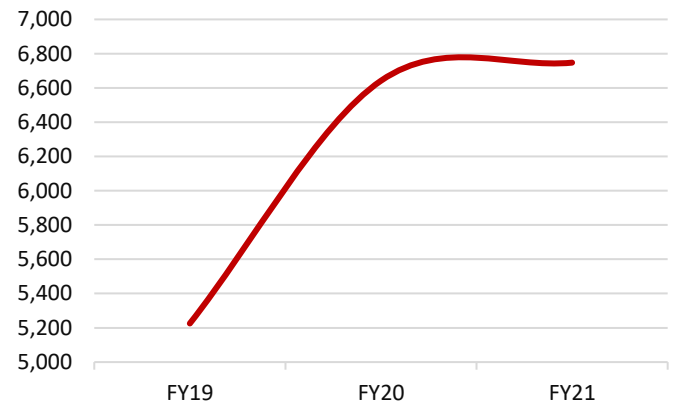
### Revival in demand

The demand continued to remain strong after bouncing back from the pandemic slowdown. The rise of commodity prices encouraged farmers to cultivate more crops and pushed the demand for fertilizers in first half of 2021 (vs 2020). Demand for gold recovered throughout the year in FY21 in line with economic growth and sentiments. The rising worries about high inflation and the perspective of the central bank staying behind the curve helped gold reach USD 1900 once again in early 2021. Industrial metals, saw one of their best years in 2021 as they posted their biggest annual price gains since 2009 due to increase in demand and tight supply. Aluminium saw the highest gains of 42%. Revival in demand is reflecting in both volume and price growth also across segments, especially in Agri nutrients and industrial metals.

**Aluminium, Alumina and Aluminium alloy price (SR/MT)**



**Gold price (SR/OZ)**



Source: Bloomberg

Source: Bloomberg

### **The only listed large metals and mining company on Tadawul**

Ma'aden is the only large metals and mining company listed on Tadawul, and by virtue of 'there is no alternative' factor, the stock will attract interest of both local institutional and foreign institutional investors, looking to tap into the growth of Saudi Arabia as part of Vision 2030. Saudi economic growth being driven by capital investments into infrastructure, construction, factory production and end products, will ensure demand for key products like Aluminium will remain for a longer term. This is beneficial for Ma'aden.

### **Rising feedstock prices may hurt margins**

The major reason for the supply shortage was the increasingly high costs of raw materials that are used to manufacture fertilizers. Natural gas is the key input (feedstock) in producing final metals. Key risk is from rising feedstock costs, which can impact margins. Globally the price of natural gas began increasing in July 2021 reaching a peak its peak of USD6.54 (USD/MBTU) in Feb 2022. Russia has cut gas shipments to Europe through Ukraine by 60% in Jan-22. Given that Russia sources Europe with 40% of its natural gas imports, with about a third of its exports flowing through Ukrainian pipelines, sanctions against Russia in response to an invasion could worsen Europe's energy crunch. Natural gas reserves are running low. With gas, an essential input to many logistics and supply chains, disruptions to essential supply will have widespread economic consequences. Natural gas prices surged more than 65% YoY after the Russian military launched an invasion of Ukraine.

## Relative valuation

We have given an equal weightage of 10% each to the P/E and EV/EBITDA multiples. The peer set includes the companies globally. At median peer P/E multiple of 8.8x and EV/EBITDA multiple of 7.0x, we arrive at target price of SAR 84.5 and SAR 37.9 per share respectively.

## Discounted Cash Flow

	FY22	FY23	FY24	FY25	FY26	Terminal Value
Pegged on April 19, 2022						
Time period index	0.70	1.70	2.70	3.70	4.70	4.70
<b>Free cash flow</b>						
PAT	9,488	7,023	6,096	5,917	5,758	
Interest (1-tax rate)	1,062	965	882	773	668	
Depreciation	5,071	5,057	5,103	5,144	5,185	
Changes in Working Capital	2,014	1,108	898	(113)	748	
Less: Capex	(1,091)	(838)	(625)	(606)	(585)	
Free cash flow to firm (FCFF)	16,544	13,315	12,354	11,114	11,774	226,778
Discounted FCFF	15,801	11,911	10,348	8,720	8,652	166,640

*All figures in SAR mn unless otherwise stated*

Enterprise Value	222,071	<b>Assumptions</b>	
Less: Total debt (Includes lease liabilities) as on Dec,2021	48,088	WACC	6.8%
Add: Cash & cash equivalents as on Dec,2021	8,136	Cost of debt / Lease Liabilities	2.6%
Equity Value	182,119	Cost of Equity	11.5%
Shares O/S	1,231	Terminal growth rate	1.5%
Equity Value per share	148.0	<b>Cost of equity calculation</b>	
Current share price (SAR)	136.2	Risk-Free Rate	3.4%
% upside/downside	8.7%	Beta	0.86
		Equity Risk Premium	9.4%
		<b>Weights</b>	
		Debt	52.2%
		Equity	47.8%

## About Ma'aden

Located in Riyadh, Saudi Arabian Mining Company (Ma'aden) is the largest multi-commodity mining and metals company in the Middle East. It was formed in 1997 by the Saudi Government. The company was formed with the intention to develop Saudi Arabia's mining sector. It has various arms dealing in mining of various products.

In 2008, the company was listed on the Saudi Stock Exchange (Tadawul) with half of the shareholding offered to the public.

## Segments

The company has 5 business units namely, Exploration, Gold and base mining, Phosphate, Industrial Minerals and Aluminium.

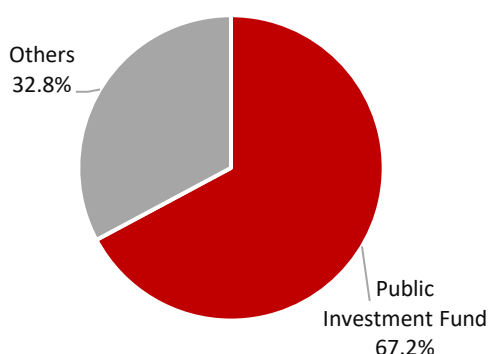
- **Exploration** – This segment of the company focuses on maintaining the resources for the other segments of the company. It works on exploring, discovering, and evaluating new mineral resources.
- **Gold and Base Metals** – The Ma'aden Gold and Base metal company works on mining of gold, copper, silver, and zinc. The company operates 6 gold mines.
- **Phosphate** – The phosphate business of the company has several subsidiaries and joint ventures. These include mining, fertilizers, and marketing & distribution companies.
- **Industrial Minerals** – This arm of Ma'aden focuses on industrial minerals such as Magnesite, Low-Grade Bauxite and Kaolin, Caustic Soda, and Dichloride Ethylene.
- **Aluminum** – Here the company has several wholly-owned subsidiaries specializing in Bauxite, aluminum and rolling works.

Other than these, Ma'aden has a wholly owned infrastructure company that undertakes the infrastructure constructions need of the businesses of the company.

## Geography

Ma'aden's operations are mainly located in the Kingdom of Saudi Arabia. The company has many subsidiaries and joint venture companies that are located outside of the origin country. It has presence in Mauritius, South Africa, Zambia, Zimbabwe, Malawi, Mozambique, and Seychelles through either direct or indirect subsidiaries.

## Ma'aden shareholding structure



## Recent M&A

Company	Brief about the acquisition
Meridian Group	In 2019, Ma'aden acquired 85% stake in Mauritius based fertilizer distribution group, Meridian at a cost of USD 140 mn.

## Key financials

(SAR mn)	FY19	FY20	FY21	FY22e	FY23e	FY24e
<b>Income Statement</b>						
Sales	17,736	18,580	26,769	31,147	23,923	20,813
COGS	(15,064)	(16,013)	(17,614)	(16,398)	(12,811)	(11,219)
<b>Gross profit</b>	<b>2,672</b>	<b>2,567</b>	<b>9,155</b>	<b>14,749</b>	<b>11,112</b>	<b>9,594</b>
Selling, marketing and logistic expenses	(641)	(510)	(586)	(682)	(524)	(416)
General and administrative expenses	(930)	(1,033)	(1,005)	(1,170)	(898)	(728)
Exploration and technical services expenses	(180)	(213)	(149)	(174)	(144)	(125)
<b>Operating profit</b>	<b>886</b>	<b>811</b>	<b>7,414</b>	<b>12,724</b>	<b>9,546</b>	<b>8,324</b>
Income from time deposits	205	72	49	32	25	19
Finance cost	(2,401)	(1,662)	(1,207)	(1,135)	(1,031)	(942)
Share in income from JVs	112	197	728	649	682	716
<b>Income before zakat &amp; tax</b>	<b>(1,111)</b>	<b>(695)</b>	<b>6,925</b>	<b>12,270</b>	<b>9,222</b>	<b>8,117</b>
Zakat and Income tax	(417)	(152)	(443)	(507)	(515)	(559)
<b>Net income for the period</b>	<b>(1,528)</b>	<b>(847)</b>	<b>6,481</b>	<b>11,763</b>	<b>8,707</b>	<b>7,558</b>
<b>Balance Sheet</b>						
Mine properties	10,045	10,672	11,688	11,860	11,849	11,617
Property, plant, and equipment	64,496	61,884	58,940	55,062	51,140	47,198
Intangible assets and goodwill	356	318	287	246	204	162
Investment in joint ventures	1,117	1,027	1,209	2,290	2,123	2,062
Advances and prepayments	252	304	294	393	301	262
Time deposits	3,187	1,466	971	756	588	457
Cash and cash equivalents	3,605	4,246	8,136	20,649	30,977	41,017
<b>Total assets</b>	<b>97,658</b>	<b>96,737</b>	<b>103,338</b>	<b>113,214</b>	<b>116,599</b>	<b>120,800</b>
Share capital	12,306	12,306	12,306	12,306	12,306	12,306
Statutory reserve:	11,793	11,793	12,316	13,265	13,967	14,577
Retained earnings and reserve	6,668	6,327	11,140	19,679	25,999	31,486
Borrowings	49,845	48,302	46,844	42,649	38,687	35,621
Lease	1,267	1,337	1,244	1,032	901	803
<b>Total equity</b>	<b>38,393</b>	<b>37,300</b>	<b>43,969</b>	<b>55,732</b>	<b>64,438</b>	<b>71,996</b>
<b>Total liabilities &amp; equity</b>	<b>97,658</b>	<b>96,737</b>	<b>103,338</b>	<b>113,214</b>	<b>116,599</b>	<b>120,800</b>
<b>Cash Flow Statement</b>						
Cash from operating activities	3,105	3,849	9,416	18,357	14,378	13,066
Cash from investing activities	(2,557)	(1,449)	(3,769)	(1,436)	42	138
Cash from financing activities	(2,360)	(1,798)	(1,800)	(4,407)	(4,092)	(3,164)
Net changes in cash	(1,812)	603	3,847	12,513	10,327	10,041
Cash at the end of the period	3,508	4,111	7,958	20,471	30,799	40,840
<b>Key Ratios</b>						
Current ratio	1.8	1.5	1.7	2.3	3.1	4.0
Inventory turnover ratio	3.0	2.7	2.8	2.5	2.2	2.3
Debtors' turnover ratio	6.5	6.2	6.5	5.6	4.5	4.9
Trade payables ratio	4.0	3.6	4.3	3.4	3.3	3.2
Gross profit margin	15.1%	13.8%	34.2%	47.4%	46.4%	46.1%
Operating margin	5.0%	4.4%	27.7%	40.8%	39.9%	40.0%
Net profit margin	-8.6%	-4.6%	24.2%	37.8%	36.4%	36.3%
EBITDA margin	31.3%	30.3%	44.9%	43.8%	43.8%	44.3%
Average return on equity	-4.1%	-2.2%	16.0%	23.6%	14.5%	11.1%
Average return on assets	-1.6%	-0.9%	6.5%	10.9%	7.6%	6.4%
Debt/Equity (x)	1.33x	1.33x	1.09x	0.78x	0.61x	0.51x
Interest coverage ratio (x)	0.4x	0.5x	6.1x	11.2x	9.3x	8.8x
P/E	NA	NA	14.9x	14.2x	19.3x	22.2x
EV/EBITDA	18.8x	17.4x	11.9x	13.4x	17.4x	19.8x
EV/Sales	5.9x	5.3x	5.4x	5.9x	7.6x	8.8x
EPS (SR)	(1.30)	(0.69)	5.27	9.56	7.08	6.14
Dividend yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Net debt (SR 'mn)	47,507	45,393	39,952	23,031	8,612	(4,593)
Net debt/ EBITDA	8.55	8.06	3.32	1.69	0.82	(0.50)
ROCE	1.0%	0.9%	8.2%	13.0%	9.2%	7.7%

Source: Company Financials, U Capital Research

## ADNOC Drilling (ADNOC Drilling)

**Target Price: AED 4.4**

**Upside: 19.3%**

Recommendation	Accumulate
Bloomberg Ticker	ADNOCDR:Abu Dhabi
Current Market Price (AED)	3.7
52wk High / Low (AED)	3.8 / 2.9
12m Average Vol. (mn)	13.1
Mkt.Cap. (AED bn)	59.5
Shares Outstanding (mn)	16,000
Free Float (%)	11.0%
3m Avg Daily Turnover (AED mn)	9.2
6m Avg Daily Turnover (AED mn)	31.3
PE 2022e (x)	24.4x
EV/EBITDA 2022e (x)	15.6x
Dividend Yield '22e (%)	4.2%

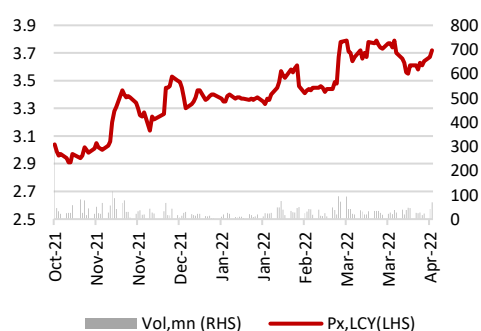
### Price Performance:

1 month (%)	-1.6%
3 months (%)	10.1%
12 months (%)	22.4%

Source: Refinitiv, as of 19th April 2022

Note: Company got listed in October 2021

Price -Volume Performance



Source: Refinitiv

- High revenue visibility in the drilling segment
- High oil and gas prices benefiting operations
- Synergies from ADNOC to continue for several years in the form of long -term contracts and exclusivity
- Oil Field Services Segment to drive sustained revenue growth

We initiate coverage on ADNOC Drilling (ADNOCDR:Abu Dhabi) with a Accumulate rating and a target price of AED 4.4 per share, implying a upside of 19.3% to the last closing price (19<sup>th</sup> April 2022). Our target price implies a P/E'22e of 29.1x. Post IPO, the stock has performed well owing to its robust business model, strong support from parent company, rise in oil and gas prices and revenue visibility.

### Investment Thesis

**Valuation & Risks:** Our valuation is based on a mix of discounted cash flows (80% weight), and multiples approach (10% weight each to both PE and EV/EBITDA based multiples). Key downside risks include low prices of oil and gas for long periods, withdrawal of support from parent company, unplanned shutdowns. Key upside risks include higher oil and gas prices for longer periods with low volatility and increased demand for Oil Field Services segment, especially from customers other than its parent company.

### Diversified operations provide resilience to business

The company primarily operates into two businesses – Drilling and Oil Field Services (OFS). There is less than perfect correlation between these segments which helps in diversification. The Drilling segment provides stability and has high revenue visibility due to long term contracts with ADNOC, the parent company of ADNOC Drilling. The OFS segment provides high growth, clocking 48% growth in FY21 and is expected to grow by 20% per year till FY26.

### Increasing demand for Middle Eastern oil and gas to boost revenues

After the Western and European sanctions on Russia post its invasion on Ukraine, the world is turning to Middle East for the supply of oil and gas. The demand for the Saudi and Emirates oil in February 2022 increased substantially. Keeping with the plan of OPEC to gradually increase oil production, UAE also it will increase the production of oil in the country. With the economic recovery in 2021, China and India, one of the biggest oil importers from UAE saw a huge Y-o-Y demand rise. Even Europe who imports more than 25% oil from Russia is facing pressure to join the Russian oil boycott. With this rising demand, the Middle Eastern countries could face huge demand surge in the coming years.

### Key Indicators

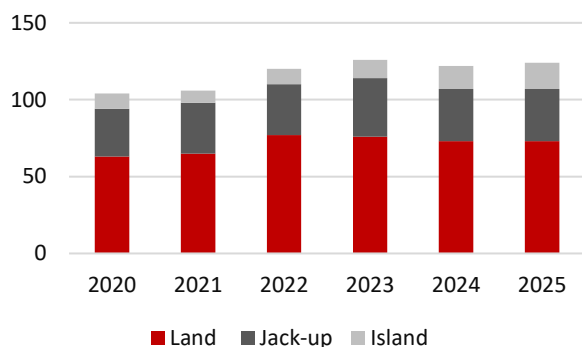
Year (In USD mn)	FY19	FY20	FY21	FY22e	FY23e	FY24e
Sales	2,062	2,098	2,269	2,410	2,757	2,908
Gross profit	797	806	884	925	1,051	1,080
EBITDA	985	949	1,016	1,111	1,279	1,355
Operating profit	603	591	611	671	781	798
Net income	583	569	604	666	772	780
EPS	0.54	0.13	0.14	0.15	0.18	0.18
P/E (x)	-	-	24.4	24.4	21.0	20.8
EV/EBITDA (x)	-	-	17.0	15.6	13.5	12.8
Dividend yield	-	-	7.2%	4.2%	4.4%	4.6%

### Strong parentage support from ADNOC group

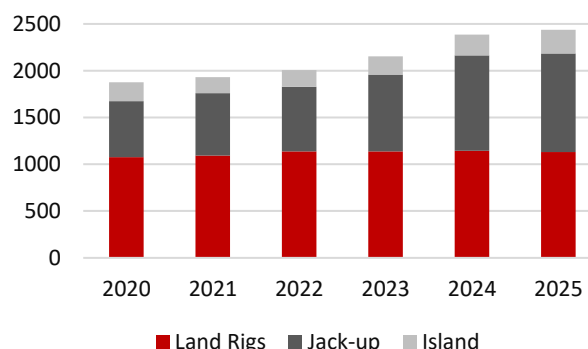
ADNOC Drilling is majorly owned by the ADNOC group which has a production capacity of around 4 mn barrels of oil and 10.5 cubic feet of natural gas per day. The group is amongst the top oil producing companies in the Middle East. It has a wide range of businesses such as petroleum, drilling, sour gas, offshore-onshore, distribution, gas processing, trading, industrial gases, LNG, hydrogen, refining, logistics and services, etc. Through synergies, ADNOC enjoys the services of its businesses in terms of expertise and cost efficiency. The group has set a target to achieve an output capacity of 5 mn barrels per day through increased exploration and unconventional reserves development by 2030. In 2020, it approved a budget of USD 122 bn for the future growth and projects.

ADNOC Drilling currently has 99 rigs and over 8,000 employees. The company mainly provides drilling services to ADNOC group and other mining industries. By being the major provider of services to ADNOC group, the company has better visibility of the future requirements from the parent company. Through this, the company can also have a fair idea of its future revenue inflows as well the CAPEX that will be required. The data below shows the expected future rigs and wells required as well as the future drilling revenue

**Expected number of rigs and wells to be drilled in future**



**Expected Drilling Revenue (USD mn)**



Recently, the Abu Dhabi National Oil Company (ADNOC) awarded a USD 1.94 bn worth wireless logging and perforation services agreement to some companies including ADNOC drilling. This investment is a part of the 5 mn barrels per day aim and to drill thousands of new wells in the country. Also, in November 2021, the group had announced an investment of USD 6 bn to enable drilling growth in UAE and it expects to bring 60% of the total value into the country's economy.

Additionally, as part of the agreement, a minimum 90% day rate has to be paid by ADNOC to ADNOC Drilling in case the rigs are idle. This provides the company with great returns as with most of the companies, the day rates are not paid in case if the equipment is idle for the day.

### Increasing demand of Middle Eastern oil and gas to boost the company's future revenues

After the Western and European sanctions on Russia post its invasion on Ukraine, the world is turning to Middle East for the supply of oil and gas. The demand for the Saudi and Emirates oil in February 2022 increased substantially. Keeping with the plan of OPEC to gradually increase oil production, UAE also it will increase the production of oil in the country. With the economic recovery in 2021, China and India, one of the biggest oil importers from UAE saw a huge Y-o-Y demand rise. Even Europe who imports more than 25% oil from Russia is facing pressure to join the Russian oil boycott. With this rising demand, the Middle Eastern countries could face huge demand surge in the coming years.

### Strategic Partnership with Baker Hughes gave ADNOC Drilling competitive capabilities

In 2018, world's second largest oil services company Baker Hughes acquired a 5% stake in ADNOC Drilling. This is a long-term strategic partnership between the two companies and through this ADNOC acquires specialized equipment and technologies from Baker Hugh.



Both the companies have set up an advisory board in order to oversee the implementation and ongoing operations. With this partnership, ADNOC has been able to participate and win several contracts for oilfield services.

Recently, the artificial intelligence unit of ADNOC, AIQ partnered with Baker Hughes to develop, deploy, and commercialize advanced analytics solutions AI products for the oil and gas industry. This will help in building efficient and sustainable growth to the drilling operations of the company.

#### **Dividend payment history and future plans**

For the year 2018, ADNOC Drilling paid out dividend of USD 1.572 bn to its shareholders and for the years 2019 and 2020, the company had paid a dividend of USD 51 mn and USD 700 mn respectively. After the recent IPO, the company has plans to grow its dividend payout for the coming years. For the second half of the year 2021, ADNOC Drilling expects to pay an amount of USD 325 mn (to be paid in April 2022) which will bring the total dividend for the year to USD 685 mn. As per the dividend policy, the company is planning to increase the dividend rate by 5% every year over the next five years (i.e., 2022-2026).

#### **Increasing rig requirement in future**

With ADNOC's expansion plans, the company can have a good understanding of the number of rigs required in the future. With the visible future demand, the company can benefit in terms of the CAPEX investment planning. The following data shows ADNOC group's rig requirements.

## Relative valuation

We have given an equal weightage of 10% each to the P/E and EV/EBITDA multiples. The peer set includes the companies globally. At average median peer P/E multiple of 29.3x and EV/EBITDA multiple of 12.3x, we arrive at target price of AED 4.5 and AED 2.9 per share respectively.

## Discounted Cash Flow

	FY22	FY23	FY24	FY25	FY26	Terminal Value
Pegged on April 19, 2022						
Time period index	0.70	1.70	2.70	3.70	4.70	4.70
<b>Free cash flow</b>						
PAT	666	772	780	820	886	
Interest (1-tax rate)	18	23	34	34	34	
Depreciation	440	498	557	585	594	
Changes in Working Capital	3	3	(3)	0	3	
Less: Capex	(868)	(992)	(887)	(183)	(192)	
Free cash flow to firm (FCFF)	260	303	481	1,257	1,326	25,128
Discounted FCFF	248	271	402	984	970	18,395

*All figures in USD mn unless otherwise stated*

Enterprise Value	21,270	<b>Assumptions</b>	
Less: Total debt (Includes lease liabilities) as on Dec,2021	1,086	WACC	6.9%
Equity Value	20,184	Cost of debt / Lease Liabilities	3.5%
Shares O/S	16,000	Cost of Equity	8.7%
Equity Value per share (AED)	4.6	Terminal growth rate	1.5%
Current share price (AED)	3.7	<b>Cost of equity calculation</b>	
% upside/downside	24.5%	Risk-Free Rate	3.2%
		Beta	1
		Equity Risk Premium	5.5%
		<b>Weights</b>	
		Debt	35.5%
		Equity	64.5%

*All figures in USD mn unless otherwise stated*

### About ADNOC Drilling

ADNOC Drilling Company PJSC is the largest national drilling company in the Middle East. Founded in 1971, it is a fully owned company of Abu Dhabi National Oil Company (ADNOC). It provides services of drilling on land and sea as well as construction services across reservoirs. The company has 99 rigs and around 8,000 employees. The onshore operations of the company have land rigs, water wells, workover rigs and offshore operations have owned and rented jackups for the drilling. The company also provides drilling services to the Abu Dhabi National Oil Company (ADNOC).

In 2021, the company was listed on the Abu Dhabi Securities Exchange.

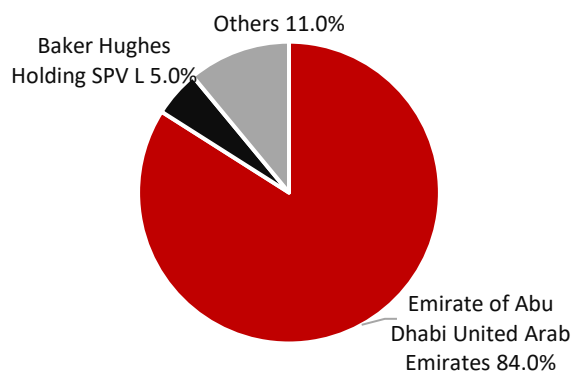
### Operations

ADNOC Drilling works as a support to the mining industries. So far, the company has delivered over 10,000 wells with a total distance of over 76 mn feet.

### Geography

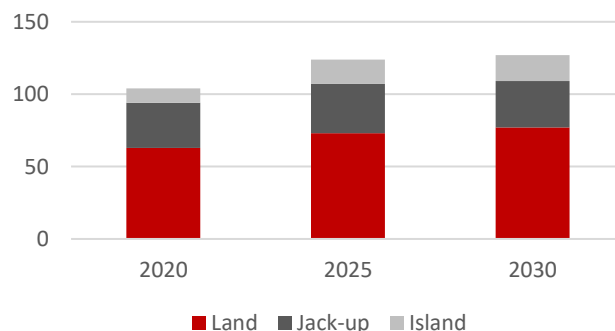
The company works in the United Arab Emirates to access the oil and gas reserves in the country.

### ADNOC Drilling's shareholding structure



Source: Bloomberg

### Future rig requirements by ADNOC Group



Source: Company financials

## Key financials

(USD mn)	FY19	FY20	FY21	FY22e	FY23e	FY24e
<b>Income Statement</b>						
Sales	2,062	2,098	2,269	2,410	2,757	2,908
COGS	(1,264)	(1,292)	(1,385)	(1,485)	(1,706)	(1,828)
<b>Gross profit</b>	<b>797</b>	<b>806</b>	<b>884</b>	<b>925</b>	<b>1,051</b>	<b>1,080</b>
SG&A expenses	(195)	(215)	(274)	(254)	(270)	(283)
<b>Operating profit</b>	<b>603</b>	<b>591</b>	<b>611</b>	<b>671</b>	<b>781</b>	<b>798</b>
Share of results of investments in associates and JVs	0	0	0	0	0	0
Other income – net	30	3	10	12	14	15
Finance charges	(50)	(24)	(17)	(17)	(23)	(33)
<b>Income before tax</b>	<b>583</b>	<b>569</b>	<b>604</b>	<b>666</b>	<b>772</b>	<b>780</b>
Income tax	0	0	0	0	0	0
<b>Net income for the period</b>	<b>583</b>	<b>569</b>	<b>604</b>	<b>666</b>	<b>772</b>	<b>780</b>
<b>Balance Sheet</b>						
Cash and bank balances	134	953	453	19	346	55
Prepayments and other current assets	1,689	903	960	960	960	960
Trade and other receivables	63	139	102	132	151	159
Inventories	124	177	175	183	210	225
Property, plant, and equipment	3,243	3,261	3,363	3,781	4,266	4,603
Investments in joint ventures	0	0	0	0	0	0
Right of use assets	16	39	34	45	54	47
<b>Total assets</b>	<b>5,422</b>	<b>5,478</b>	<b>5,096</b>	<b>5,128</b>	<b>5,995</b>	<b>6,057</b>
Trade and other payables	394	414	315	356	405	425
Long-term borrowings	1,500	1,500	1,500	1,500	2,250	2,250
Lease liabilities	16	28	19	18	18	18
Share capital	109	109	436	436	436	436
Statutory reserve	0	0	60	127	204	282
Retained earnings	3,274	3,143	2,299	2,216	2,194	2,143
<b>Total stockholders' equity</b>	<b>3,383</b>	<b>3,252</b>	<b>2,795</b>	<b>2,779</b>	<b>2,834</b>	<b>2,861</b>
<b>Total liabilities &amp; stockholders' equity</b>	<b>5,422</b>	<b>5,478</b>	<b>5,096</b>	<b>5,128</b>	<b>5,995</b>	<b>6,057</b>
<b>Cash Flow Statement</b>						
Cash from operating activities	19	1,789	1,179	1,137	1,308	1,380
Cash from investing activities	(101)	(232)	(582)	(867)	(992)	(885)
Cash from financing activities	(109)	(737)	(1,097)	(705)	10	(786)
Net changes in cash	(191)	820	(500)	(434)	326	(291)
Cash at the end of the period	134	953	453	19	346	55
<b>Key Ratios</b>						
Current ratio	4.6	3.6	2.5	1.8	2.2	1.8
Inventory turnover ratio	10.2	8.6	7.9	8.3	8.7	8.4
Debtors' turnover ratio	32.7	20.7	18.8	20.6	19.5	18.8
Creditors turnover ratio	3.2	3.2	3.8	4.4	4.5	4.4
Gross profit margin	38.7%	38.4%	39.0%	38.4%	38.1%	37.1%
Operating margin	29.2%	28.2%	26.9%	27.8%	28.3%	27.4%
Net profit margin	28.3%	27.1%	26.6%	27.6%	28.0%	26.8%
EBITDA margin	47.8%	45.3%	44.8%	46.1%	46.4%	46.6%
Average return on equity	17.2%	17.2%	20.0%	23.9%	27.5%	27.4%
Average return on assets	11.1%	10.8%	11.6%	13.1%	14.0%	13.2%
Debt/Equity (x)	0.4x	0.5x	0.6x	0.6x	0.8x	0.8x
Interest coverage ratio (x)	12.2x	24.1x	36.0x	38.7x	34.1x	24.5x
P/E	-	-	24.4x	24.4x	21.0x	20.8x
EV/EBITDA	-	-	17.0x	15.6x	13.5x	12.8x
EV/Sales	-	-	7.6x	7.2x	6.3x	5.9x
EPS (AED)	0.54	0.13	0.14	0.15	0.18	0.18
Dividend payout ratio	8.8%	486.1%	174.4%	102.5%	92.8%	96.5%
Dividend yield (%)	-	-	7.2%	4.2%	4.4%	4.6%
Net debt (USD 'mn)	1,386	587	1,086	1,516	1,940	2,232
Net debt/ EBITDA	1.41	0.62	1.07	1.37	1.52	1.65
ROCE	12.1%	12.1%	13.8%	15.2%	14.9%	15.1%

Source: Company Financials, U Capital Research

Note: Company got listed in October 2021

# Abu Dhabi National Energy Co. (TAQA)

**Target Price: AED 1.9**

**Upside: 35.2%**

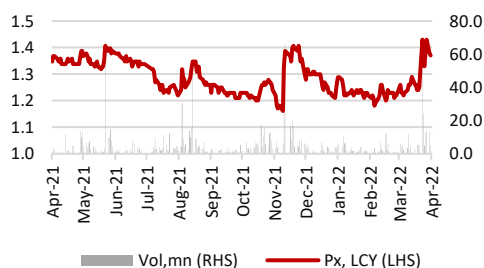
<b>Recommendation</b>	<b>Buy</b>
Bloomberg Ticker	TAQA UH
Current Market Price (AED)	1.4
52wk High / Low (AED)	1.4 / 1.2
12m Average Vol. (mn)	5.3
Mkt.Cap. (AED bn)	154.0
Shares Outstanding (mn)	112,434
Free Float (%)	1.4%
3m Avg Daily Turnover (AED mn)	6.0
6m Average Daily Turnover (AED mn)	7.7
PE 2022e (x)	26.5x
EV/EBITDA 2022e (x)	11.2x
Dividend Yield '22e (%)	3.6%

## Price Performance:

1 month (%)	11.4%
3 months (%)	6.3%
12 months (%)	1.6%

Source: Bloomberg, as of 19th April 2022

Price -Volume Performance



Source: Bloomberg

- One of the leading utility and regional power and water provider in the UAE
- Diversified business model (power, water generation distribution and oil and gas)
- Synergy benefits from partnership between TAQA, ADNOC and Mubadala
- Strong dividend policy to support returns

We initiate coverage on Abu Dhabi National Energy Co. (TAQA) with a Buy rating and a target price of AED 1.9 per share, implying an upside of 35.2% to the last closing price (19<sup>th</sup> April 2022). Our target price implies a P/E'22e of 35.9x. In the past one year, the stock price has remained largely flat and has started rising recently due to higher oil prices, increased demand for oil in the MENA region due to lower demand for Russian oil, stable and predictable revenues, a diversified business model as well as a drive towards sustainability.

## Investment Thesis

**Valuation & Risks:** Our valuation is based on a mix of discounted cash flows (80% weight), and multiples approach (10% weight each to PE and EV/EBITDA based multiples). Key downside risks include low oil and gas prices for long periods, higher than expected capex requirements for renewable energy. Key upside risks include a continued rise in oil and gas prices, cost savings from renewable energy as well as sustained interest from ESG investors.

## Enjoys monopoly position in Abu Dhabi

TAQA holds concession rights in UAE in perpetuity in a way leading to a monopolistic position in ABU Dhabi's water and electricity transmission and distribution network. It also owns the infrastructure and local access network.

## Robust financials

Strong financials underpinned by solid liquidity and cash flows. Annual free cash flow is expected to increase from AED 13.5 bn to 14.4 bn by FY25e. TAQA's completion of Abu Dhabi Power Corporation's asset transfer has led to 95% of TAQA's EBITDA being generated from regulated and quasi-regulated activities.

## Partnership between TAQA, ADNOC and Mubadala to be a game changer

The formation of a partnership to combine renewable energy and green hydrogen portfolios will poise TAQA as a low carbon power and water utilities champion, while providing exposure to green hydrogen activities.

## Key Indicators

Year (In AED mn)	FY19	FY20	FY21	FY22e	FY23e	FY24e
Sales	6,057	23,985	45,690	46,094	46,644	47,224
Gross profit	3,553	5,702	10,565	10,504	10,493	10,494
EBITDA	4,909	10,025	19,481	19,502	19,806	20,130
Operating profit	3,098	4,408	8,308	8,077	8,044	8,026
Net income	3,182	4,017	5,995	5,802	5,832	5,855
EPS	0.04	0.04	0.05	0.05	0.05	0.05
P/E	618.1	37.0	24.9	26.5	26.4	26.3
EV/EBITDA	10.4	23.6	10.8	11.2	11.1	10.9
Dividend yield	6.4%	7.4%	2.0%	3.6%	4.4%	4.7%

### **Leading utility and regional power and water producer of the UAE**

Abu Dhabi National Energy Company PJSC (TAQA) is a global energy and water company predominantly involved in power generation and water desalination, transmission and distribution, and upstream and midstream oil and gas operations. The company has international assets across 4 continents in 11 countries like Canada, Ghana, India, Iraq, Morocco, the Netherlands, Oman, Saudi Arabia, the United Arab Emirates, the United Kingdom, and the United States. The company aims to provide clean power and water to government, businesses, and consumers for a successful and sustainable living. Following a robust foundation and a transformative transaction with the Abu Dhabi Power Corporation in 2020, TAQA has emerged to become one of the top ten integrated utilities player in the EMEA region. The company has a diversified workforce of over 7,000 employees from 60+ nationalities.

### **Gross generation capacity likely to grow to 30GW by 2030**

The Generation business of TAQA consist of more than 23 GW of gross operating power generating capacity with 1.2 GW of renewable energy in store and approximately 913 MIGD of water desalination capability with an additional 205 MIGD under development. TAQA aims to increase its gross power generation capacity to 30 GW in the UAE and add around 15 GW of international capacity by 2030. TAQA is optimally placed to capture growth opportunities in the UAE with special rights to future generation projects with a minimum 40% stake until 2030. The projects will be tendered by EWEC.

### **Transmission and Distribution shows robust operational performance**

With over 80,000+ Kms of power networks, 19,000+ kms of water pipeline and over a mn individual end-user connections, TAQA's Transmission and Distribution business line is the exclusive provider of power and water to Abu Dhabi. The business unit showed robust operational performance in power and water. The duration of service interruptions decreased to an average of 81.2 minutes showing a 3.4% improvement in 2021. The company targets to invest an additional amount of AED 40 bn by 2030, for the maintenance and growth of its UAE regulated asset base. Additionally, TAQA will focus on optimization and digitization across its value chain. In 2022, the prime focus of Transmission and Distribution unit will be towards enhancing the customer experience and new value-added services.

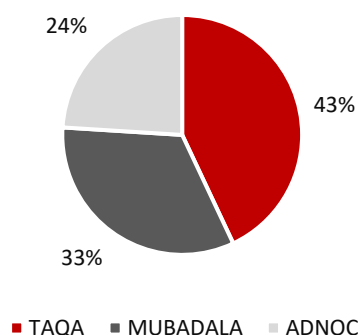
### **Global Oil and Gas production delivered robust gains in 2021**

TAQA's global oil and gas production was 122,400 barrels of oil equivalent (boepd), which represents a 4% rise in 2021. Despite the logistics disruptions induced by the Covid-19 pandemic, the oil and gas business delivered a strong operational performance and an increased production volume, which enabled the business to take complete advantage of higher commodity prices. Robust base management across the European portfolio will continue to deliver exceptional performance and an increased demand of oil and gas will boost the future production.

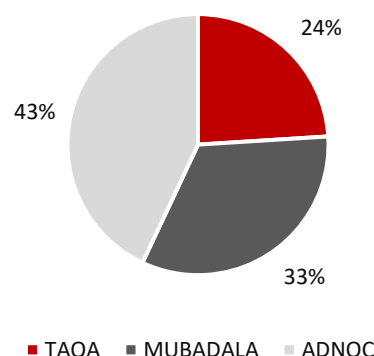
### **Partnership between TAQA, ADNOC and Mubadala will accelerate TAQA's growth**

Formation of a strategic partnership between TAQA, ADNOC and Mubadala to combine their renewable energy and green hydrogen portfolios appears to be a game changer. The transaction will establish TAQA as a low carbon power and water utilities champion, while providing exposure to green hydrogen activities. Masdar will function as an exclusive partner for renewable and green hydrogen to TAQA, ADNOC and Mubadala. Pro-forma for Masdar acquisition, the transaction will permit TAQA to surpass its renewable energy targets of 30% of its portfolio. Furthermore, the partnership will accelerate TAQA's international growth through renewable energy and allow instant access to over 23 GW of renewable capacity on the first day. The green hydrogen projects are likely to increase the demand for renewable power.

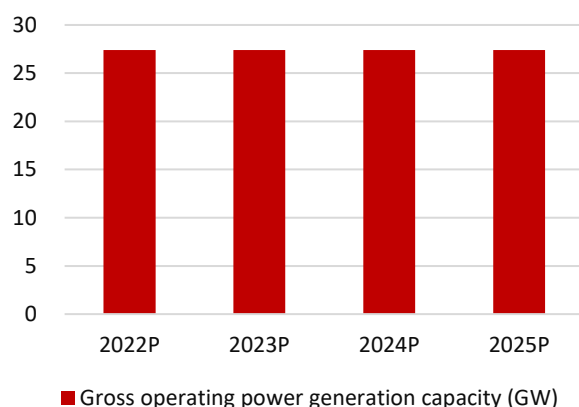
## Renewable



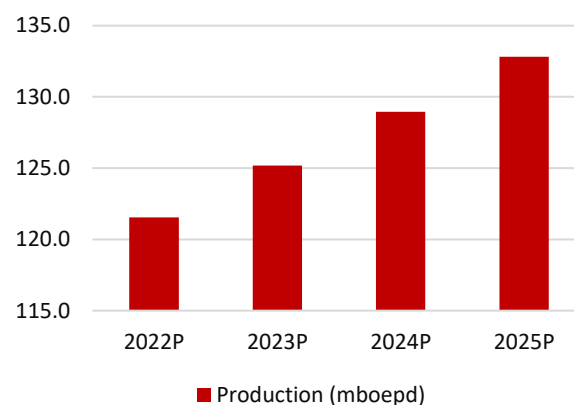
## Green Hydrogen



## Gross operating power generation capacity (GW)



## Global Oil & Gas production



## Delivering on strong dividend policy

In FY 2021, the company paid USD 505mn (AED 1.65 per share) to date with a proposed annual cash dividend of USD 337mn (AED 1.10 per share) in FY 2021. Additionally, a special cash dividend of USD 612mn (AED 2.00) for FY 2021 has been proposed for an approval from shareholders, amid strong performance for the year. In FY 2022, a 20% interim dividend payout is expected after Q1, Q2 and Q3 results and a 40% annual dividend payout is expected post the AGA in the following year.

## Large projects underway to fuel future growth

TAQA is a national champion and one of the biggest integrated listed utility companies in the EMEA region, equipped with a best-in-class management team which aims to create value. It has an exclusive access to generation and transmission and distribution opportunities in Abu Dhabi with an approach to a value-added growth in international markets. TAQA's net zero emission target for 2050 will lead to an increase in its renewable portfolio. In 2022, the company plans to complete F3 and Al Dhafra Solar PV (new power and water plants), complete activation of 500 MVA transformer (Mahawi Area), implement a new procurement strategy, development of the availability of harmonized customer payment solutions and deliver a transformer shift to oversee network loads.

## Relative valuation

We have given an equal weightage of 10% each to the P/E and EV/EBITDA multiples. At average median peer P/E multiple of 20x and EV/EBITDA multiple of 16.5x, we arrive at target price of AED 1 and AED 2.2 per share respectively.

## Discounted Cash Flow

	FY22e	FY23e	FY24e	FY25e	Terminal Value
Pegged on	April 19, 2022				
Time period index	0.70	1.70	2.70	3.70	3.70
<b>Free cash flow</b>					
NOPAT	7,236	7,207	7,191	7,186	
Depreciation	11,425	11,762	12,104	12,451	
Changes in Working Capital	135	21	3	41	
Less: Capex	(6,914)	(6,997)	(7,084)	(7,175)	
Free cash flow to firm (FCFF)	11,883	11,993	12,214	12,503	302,815
<b>Discounted FCFF</b>	11,430	10,915	10,516	10,185	246,683

Enterprise Value	289,731
Less: Net debt (Includes lease liabilities)	74,834
Equity Value	214,897
Shares O/S	112,434
Equity Value per share	1.9
Current share price	1.2
% upside/downside	54.1%

### Assumptions

WACC	5.7%
Cost of debt / Lease Liabilities	2.0%
Cost of Equity	7.3%
Terminal growth rate	1.5%

### Cost of equity calculation

Risk-Free Rate	3.2%
Beta (2 year weekly)	0.75
Equity Risk Premium	5.5%

### Weights

Debt	30.6%
Equity	69.4%



## About TAQA

The Abu Dhabi National Energy Company, PJSC (TAQA) is a UAE-based government-owned company. It was launched in 1998. The company has operations in power, water, oil and gas and is present in 11 countries around the world. The company works in power generation, transmission and distribution and production of oil and gas. The company was listed on Abu Dhabi Securities Exchange (ADX) in 2005. It currently employs more than 7,000 employees.

## Segments

TAQA has 3 main business units,

- Power and Water Generation – The company has a total of 23 GW of power plants spread across different countries and in UAE, it has water desalination units of a total capacity of 913 MIGD capacity (205 MIGD under development). Through these plants, the company caters to more than 90% of the entire UAE's power and water requirements.
- Transmission and Distribution – In the transmission and distribution business, the company has a power transmission network of more than 80,000 km length and a water pipeline network of more than 19,000 km length.
- Oil and Gas – In the oil and gas business, TAQA's global production is around 122,400 BOEPD.

## Geography

TAQA has a presence in around 11 countries in the world including Canada, Ghana, India, Iraq, Morocco, Netherlands, Oman, Saudi Arabia, the UK, the US and UAE.

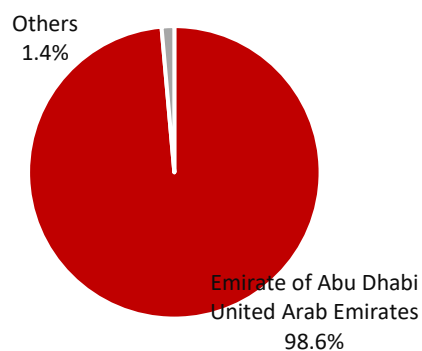
- In Canada, the company has operated and non-operated onshore oil and gas assets with an average production of 72,260 BOEPD
- Similarly in the UK, TAQA has operated and non-operated offshore oil and gas assets with an average production of 37,955 BOEPD and in the Netherlands, offshore and onshore oil and gas assets and storage facilities with an average production of 3,374 BOEPD
- In the US, the company has wind and gas-fired power plants of capacity 205 MW and 832 MW respectively
- The oil field in Iraq has an average production of 8,795 BOEPD
- In Saudi Arabia, the company has gas and cogeneration power plant capacity of 250 MW and 940 MW respectively and a water desalination capacity of 5.25 MIGD
- In Ghana, the company has a tri-fuel power plant of capacity 330 MW and in Morocco the company has a coal power plant of capacity of 1,000 MW
- TAQA's Indian lignite power plant has a capacity of 250 MW

## Dividend

TAQA in 2021, paid out a total dividend of AED 0.063 throughout the year. The dividend yield for the year was 4.77% and for the year 2020 was 1.04%.

Year	Total Dividend (AED)	Dividend Yield (%)
2021	0.063	4.77%
2020	0.015	1.04%
2019	NA	NA

### TAQA's shareholding structure



**Source: Bloomberg**

## Key financials

(AED mn)	FY19	FY20	FY21	FY22e	FY23e	FY24e
<b>Income Statement</b>						
Sales	6,057	23,985	45,690	46,094	46,644	47,224
COGS	(2,504)	(18,283)	(35,125)	(35,590)	(36,151)	(36,729)
<b>Gross profit</b>	<b>3,553</b>	<b>5,702</b>	<b>10,565</b>	<b>10,504</b>	<b>10,493</b>	<b>10,494</b>
SG&A expenses	(455)	(1,294)	(2,257)	(2,427)	(2,449)	(2,469)
<b>Operating profit</b>	<b>3,098</b>	<b>4,408</b>	<b>8,308</b>	<b>8,077</b>	<b>8,044</b>	<b>8,026</b>
Other income – net	85	932	1,477	1,408	1,410	1,413
Finance charges	(1)	(1,581)	(3,094)	(3,009)	(2,945)	(2,904)
<b>Income before tax</b>	<b>3,182</b>	<b>3,759</b>	<b>6,691</b>	<b>6,476</b>	<b>6,509</b>	<b>6,534</b>
Tax	0	258	(696)	(674)	(677)	(680)
<b>Net income for the period</b>	<b>3,182</b>	<b>4,017</b>	<b>5,995</b>	<b>5,802</b>	<b>5,832</b>	<b>5,855</b>
<b>Balance Sheet</b>						
Cash and bank balances	220	8,519	8,772	10,457	12,327	14,635
Derivative financial instruments	0	49	11	11	11	11
Trade and other receivables	61	6,703	6,534	6,592	6,670	6,735
Inventories	94	3,599	3,518	3,565	3,621	3,669
Property, plant, and equipment	42,873	125,949	122,397	119,298	115,962	112,388
Investments in joint ventures	0	2,429	1,683	2,188	2,196	2,204
Operating financial assets	0	9,740	9,047	9,047	9,047	9,047
<b>Total assets</b>	<b>49,199</b>	<b>186,927</b>	<b>180,197</b>	<b>177,998</b>	<b>175,269</b>	<b>172,695</b>
Trade and other payables	2,755	14,918	16,228	16,465	16,618	16,730
Interest bearing loans and borrowings - current	0	8,856	2,843	3,832	5,165	6,961
Interest bearing loans and borrowings	0	66,198	61,369	56,892	52,742	48,895
Share capital	5,992	112,434	112,434	112,434	112,434	112,434
Legal reserve	2,996	0	0	0	0	0
Retained earnings	3,182	4,925	7,284	7,464	6,551	5,097
<b>Total stockholders' equity</b>	<b>42,980</b>	<b>61,909</b>	<b>65,904</b>	<b>66,084</b>	<b>65,171</b>	<b>63,717</b>
<b>Total liabilities &amp; stockholders' equity</b>	<b>49,199</b>	<b>186,927</b>	<b>180,197</b>	<b>177,998</b>	<b>175,269</b>	<b>172,695</b>
<b>Cash Flow Statement</b>						
Cash from operating activities	1,729	10,713	20,293	19,570	19,719	19,987
Cash from investing activities	(1,409)	5,065	(2,475)	(5,861)	(5,444)	(5,529)
Cash from financing activities	(161)	(7,412)	(17,510)	(12,023)	(12,404)	(12,150)
Net changes in cash	159	8,366	308	1,685	1,870	2,308
Cash at the end of the period	220	8,321	8,422	10,457	12,327	14,635
<b>Key Ratios</b>						
Current ratio	1.2	0.8	1.0	1.0	1.0	1.0
Inventory turnover ratio	1.7	9.9	9.9	10.1	10.1	10.1
Debtors' turnover ratio	2.9	7.1	6.9	7.0	7.0	7.0
Creditors turnover ratio	0.6	2.1	2.3	2.2	2.2	2.2
Gross profit margin	58.7%	23.8%	23.1%	22.8%	22.5%	22.2%
Operating margin	51.1%	18.4%	18.2%	17.5%	17.2%	17.0%
Net profit margin	52.5%	16.7%	13.1%	12.6%	12.5%	12.4%
EBITDA margin	81.0%	41.8%	42.6%	42.3%	42.5%	42.6%
Average return on equity	11.9%	7.2%	8.4%	7.9%	8.0%	8.2%
Average return on assets	4.3%	3.40%	3.27%	3.2%	3.3%	3.4%
Debt/Equity (x)	0.0x	1.10x	0.89x	0.8x	0.8x	0.8x
Interest coverage ratio (x)	3098.0x	2.79x	2.69x	2.7x	2.7x	2.8x
P/E	37.7x	37.04x	24.90x	26.5x	26.4x	26.3x
EV/EBITDA	16.8x	23.56x	10.84x	11.2x	11.1x	10.9x
EV/Sales	13.6x	9.85x	4.62x	4.8x	4.7x	4.6x
EPS (AED)	0.04	0.04	0.05	0.05	0.05	0.05
Dividend payout ratio	88.2%	275.3%	50.0%	96.9%	115.7%	124.8%
Dividend yield (%)	6.5%	7.4%	2.0%	4.0%	4.4%	4.7%
Net debt (AED 'mn)	(220)	67488	56193	51086	46471	42192
Net debt/ EBITDA	-0.04	6.73	2.88	2.62	2.35	2.10
ROCE	7.0%	2.8%	5.3%	5.3%	5.4%	5.6%

Source: Company Financials, U Capital Research

## 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 (U Capital)

Website: [www.u-capital.net](http://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](mailto:research@u-capital.net)

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