

Solutions

TP revised to SAR360/sh; remain overweight.

Overweight

Price Target (SAR): 360

Current: 293.8
Upside/Downside: 22.5% above current

Valuation Multiples	23A	24E	25E
P/E (x)	29.3	25.9	24.0
P/B (x)	10.6	9.1	7.8
EV/EBITDA (x)	19.3	17.3	15.7

Major Shareholders % Ownership

Saudi Telecom Company	79.00
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Price Performance	1M	3M	YTD
Absolute	0.6%	-13.2%	-15.5%
Relative to TASI	-3.1%	-11.2%	-16.1%

Earnings

(SAR mn)	2023A	2024E	2025E
Revenue	11,040	11,879	12,915
YoY %	25.4%	7.6%	8.7%
Gross Profit	2,598	2,690	2,970
GM Margin %	23.5%	22.6%	23.0%
YoY %	29.2%	3.6%	10.0%
EBITDA	1,669	1,817	1,944
EBITDA Margin	15.1%	15.3%	15.1%
Net Income	1,195	1,465	1,489
Net Income Margin %	10.8%	12.3%	11.5%
Adjusted Net Income*	1,195	1,365	1,489
YoY %	13.4%	14.3%	9.1%
EPS	10.0	12.2	12.3
DPS	6.0	6.9	8.6
P/E**	29.3	25.9	24.0
EV/EBITDA	19.3	17.3	15.7
ROE	36%	38%	33%

Source: Company data, Al Rajhi Capital, *FY24 net income adjusted for one-offs in 1Q and 2Q24, **FY24 P/E calculated on basis of adjusted income

Solutions 1HFY24 revenue growth has remained lackluster, increasing by a mere 3.8% YoY. The company has witnessed a slowdown in its core ICT segment and the digital segment revenues, which were down by 2.2% and 1.2% YoY, respectively. On the other hand, IT & managed services cushioned the decline by growing by 17.4% YoY. The rise in competition, the devaluation of Egyptian pound, and two Eids in 2Q contributed to the poor performance in the Core ICT segment. Even though revenues have declined YoY, the company managed to record a profitability growth of 25.3% in 1HFY24 thanks to better-than-expected operating margins and a few one-offs. The one-offs include lower zakat costs and SAR68mn in gains related to fleet management products. Adjusting for these, the profitability grew by only 9.9% YoY.

Going forward, the management has maintained its annual guidance of 8-11% in revenue growth for FY24. To achieve the midpoint of the FY24 target, the revenue needs to grow by 15% in 2HFY24. Although we feel that's not entirely impossible, it's highly unlikely for the group to achieve this high growth in 2H. Hence, we revise down our start of year revenue growth assumption for FY24 from 12% to 8%, implying a 2HFY24 revenue growth of 11%. We feel this is a more achievable growth target due to the upcoming projects in the core ICT segment as well as the initial realization of the Remat contract. In addition, the company boasts a healthy backlog pipeline of SAR12bn, which could lead to growth in 2H. We believe that the slowdown might be seasonal in nature, as the group's hefty backlog and upcoming pipeline of projects are likely to reverse the decline on an annual basis. The company so far has managed to record EBITDA margins of 16.3% for 1HFY24, 1.3 percentage points above the high end of their guidance. Remaining conservative, we have kept EBITDA margins at 15.3% for FY24, assuming ECLs in 4QFY24. Incorporating for the slowdown in 1HFY24, we revise our FY24/25/26e revenue and profitability downwards by 4/5/6% and 5/11/12%, respectively (FY24 has been adjusted for one-offs).

Our liking for the company emerges from the fact that 1) it has a healthy pipeline of recurring revenues, 2) it has a strong balance sheet with healthy cashflow generation, allowing it to consider M&A options, and 3) it is a key beneficiary of Vision 2030 projects. Hence, we maintain our overweight stance with a revised down TP of SAR360/sh, providing an upside of 22.5% to the last closing price.

Figure 1 ARC estimates vs guidance

	FY24e	1HFY24	2HFY24e	Guidance
Revenue Growth (YoY)	7.6%	3.8%	11.2%	8-11%
EBITDA Margin	15.3%	16.3%	14.0%	13-15%

Source: Company data, Al Rajhi Capital estimates

2Q24 results: Solutions revenues grew by 2.6% year-over-year (y-o-y) but fell 1.4% quarter-over-quarter (q-o-q), missing both the company's and consensus estimates by 3.2% and 5.7%, respectively. This y-o-y increase was driven by a 19.1% rise in IT Managed and Operational Services, partially offset by declines of 5.3% and 2.9% in Core ICT and Digital Services. Gross profit decreased by 4.9% y-o-y but rose 12.4% q-o-q, with a gross margin of 25.1% compared to 27.1% in 2Q23, likely due to reduced core business revenue. Despite this, operating profit grew by 3.4% y-o-y and 8.1% q-o-q, achieving a margin of 14.4%, slightly below the estimate of 14.5%.

The relatively better performance at operational level is largely due to lower operational expenses. Net income surged by 33.2% y-o-y and 28.3% q-o-q to SAR453mn, surpassing estimates by 32.1%, primarily due to one-off income of SAR68mn, and still exceeding expectations even when excluding this additional income

Figure 2 Earnings Summary H1 2024

(SAR mn)	Q2 2024	Q1 2024	Q2 2023	y-o-y	q-o-q	1H24	1H23	y-o-y
Revenue	2,771	2,809	2,701	2.6%	-1.4%	5,580	5,378	3.8%
Gross Profit	696	619	732	-4.9%	12.4%	1,315	1,338	-1.7%
<i>G. margin</i>	25.1%	22.0%	27.1%			23.6%	24.9%	
Op. profit	400	370	387	3.4%	8.1%	770	744	3.5%
<i>Op. margin</i>	14.4%	13.2%	14.3%			13.8%	13.8%	
Net profit	453	353	340	33.2%	28.3%	806	643	25.3%
<i>Net margin</i>	16.3%	12.6%	12.6%			14.4%	12.0%	
Adj Net income	385	322	340	13.1%	19.4%	707	643	9.9%
<i>Adj. Net margin</i>	13.9%	11.5%	12.6%			12.7%	12.0%	

Source: Company data, Al Rajhi Capital

Valuations: We value the stock through DCF methodology using a WACC of 8.9% and terminal growth of 3% which implies a target price of SAR360/share. The stock provides an upside of 22.5% from the last closing price. The dividend yield for FY24 is expected to be 2.4% implying a total return of 25%.

Figure 3 Old vs new estimates (FY24)

	Old	New	Δ
Revenue (SARmn)	12,383	11,879	-4.1%
EPS*	12.0	11.3	-5.4%
TP	390	360	-7.7%

Source: Al Rajhi Capital estimates, *new EPS estimates are adjusted for one-offs

Key Risks: i) continued decline in core ICT segment; ii) delay in realizing new contracts, iii) higher-than-expected fall in margins, and iv) more-than-expected impact of seasonality

Key Financials

Figure 4	Income Statement		
SAR mn	2023A	2024E	2025E
Revenue	11,040	11,879	12,915
<i>y-o-y growth</i>	25.4%	7.6%	8.7%
Cost of Sales	(8,443)	(9,189)	(9,945)
Gross Profit	2,598	2,690	2,970
<i>y-o-y growth</i>	29.2%	3.6%	10.0%
<i>margins</i>	23.5%	22.6%	23.0%
Employee costs	(636)	(661)	(701)
Selling and distribution expenses	(249)	(194)	(274)
Administrative expenses	(326)	(322)	(360)
Others	0	1	(14)
Operating Profit	1,387	1,513	1,621
<i>y-o-y growth</i>	19.5%	9.1%	13.5%
<i>margins</i>	12.6%	12.7%	12.5%
Pre-Tax Income	1,405	1,569	1,693
Zakat	(210)	(108)	(203)
Net Income	1,195	1,461	1,489
<i>margins</i>	10.8%	12.3%	11.5%
Net Income	1,195	1,365	1,489
<i>y-o-y growth</i>	13.4%	14.3%	9.1%
EPS	10.0	12.2	12.3

Source: Al Rajhi Capital estimates

Figure 6	Key Ratios		
	2023A	2024E	2025E
ROA (%)	10.4%	11.5%	10.6%
ROE (%)	36.0%	37.6%	32.9%
P/E	29.3x	25.9x	24.0x
EV/EBITDA	19.3x	17.3x	15.7x
Dividend yield	2.0%	2.4%	2.9%
Receiveable days	144	144	144
Payable days	143	143	143

Source: Al Rajhi Capital estimates

Figure 5	Balance sheet		
SAR mn	2023A	2024E	2025E
Cash and cash equivalents	2,588	3,423	4,304
Murabaha time deposits	850	850	850
Accounts receivable	4,364	4,695	5,104
Prepayments and other assets	554	554	554
Contract assets	1,691	1,820	1,979
Inventories	249	270	293
TOTAL CURRENT ASSETS	10,296	11,613	13,084
Intangible assets	626	598	571
Right-of-use assets	50	43	38
Property and equipment	390	276	153
TOTAL NON-CURRENT ASSETS	1,066	917	762
TOTAL ASSETS	11,362	12,530	13,846
Accounts payable and accruals	3,315	3,604	3,905
Deferred revenue	3,049	3,280	3,566
Contract liabilities	380	413	448
Zakat payable	240	240	240
Bank Overdraft & ST Borrowing	211	211	211
CURRENT LIABILITIES	7,195	7,749	8,371
Long-Term Debt	499	499	499
Lease liabilities	19	14	11
End of service indemnities	450	484	527
NON-CURRENT LIABILITIES	968	998	1,037
SHAREHOLDERS EQUITY	3,324	3,893	4,531
Minority	29	44	62
TOTAL LIABILITIES	11,362	12,530	13,846

Source: Al Rajhi Capital estimates

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