

Arabian Contracting Services Co.

Media and Entertainment
ALARABIA AB: Saudi Arabia
25 September 2023



US\$2.496bn Market Cap
30.00% Free Float
US\$7.80mn Avg. Daily Value

Target price 235.00 **25.5% above current**
Current price 187.20 **as at 21/09/2023**

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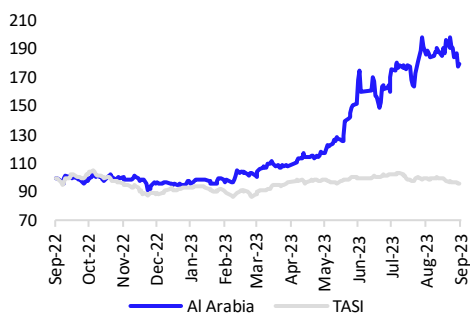
Existing rating

Underweight

Neutral

Overweight

Performance (Rebased to 100)



Key Metrics

(SARmn)	2022A	2023E	2024E
Revenue	1,126	1,235	1,929
Revenue growth	56.3%	9.7%	56.2%
Gross profit	487	589	839
Gross margin	43.2%	47.7%	43.5%
EBITDA	836	949	1,356
EBITDA margin	74.3%	76.8%	70.3%
Net profit	275	369	507
Net margin	24.4%	29.9%	26.3%
EPS	5.5	7.4	10.1
DPS	2.3	2.6	3.5
Payout ratio	41.9%	35.0%	35.0%
P/E	34.1x	25.3x	18.5x
RoE	33.5%	34.8%	36.5%

Source: Company data, Al Rajhi Capital.

Arabian Contracting Services Co.

TP revised up to SAR235/sh; maintain OW

We reiterate our "Overweight" stance on Al Arabia with a revised TP of SAR235/sh, providing an upside of 25.5% to the last closing price. Since our Initiation Report (Nov 2022), the stock has rallied by 71%, with the majority of the rally happening in the last three months (44%). Even though the results have been largely in line with our estimates, the stock managed to outperform the market owing to some material developments lately. The company, previously, was driving its growth mainly from the conversion of their static billboards to digital, with a target of reaching 80% digitization of faces by 2025. Al Arabia is well in line to achieve this target by 2025, if not earlier, as digitization stands at 71% as of 1H23. Going forward, the company is also looking to rapidly expand its market share, as it is very close to signing two long-term contracts, i.e., KKIA and Eastern Province. In addition, the company has also bid for Riyadh's long-term contract and has a high probability of winning it. Lastly, the Faden acquisition is also in the pipeline, which will help the company grow its presence in the indoor advertising space. Keeping in mind the above growth avenues, we build into our forecast the KKIA, Eastern Province, and Riyadh contracts based on educated assumptions, as the details of these contracts are not yet available. For the Faden acquisition, we await final approvals before considering its financial impact. Consequently, we raise our FY23/24/25e earnings to SAR7.4/10.1/12.3 per share and increase our TP to SAR235/sh.

What has changed for Al Arabia?

- Previously, we were assuming that the growth in revenue will mainly be driven by the conversion of static to digital billboards and had assumed revenue to increase by a 5-year CAGR of 11%.
- Now, the company has multiple growth avenues, namely via three contracts: 1) KKIA, 2) Eastern Province, and 3) Riyadh, as well as the Faden acquisition.
- What is important to note here is that nearly all new additions will be in the digital space, helping the company to increase its revenues manifold. Hence, now we expect the revenues to grow at a 5-year CAGR of 19%.
- However, from the cost side, the lease rental for the company will increase nearly 1.8x during the same period when compared with FY22 lease rental.
- KKIA and Eastern Province contracts have been announced, and we await the official signing of these contracts. Moreover, the bidding for the Riyadh contract is done and Al Arabia has a high probability of winning the contract.

Key Assumptions: We cannot stress enough that these contracts are in very early stages, and their terms and conditions have not been revealed completely. For this reason, we have had to make a lot of educated assumptions to quantify the impact of these contracts. Any change in assumptions from our base case can significantly impact FY23/24/25e earnings and, consequently, the valuation. Below are some of the key assumptions:

- We expect the signing of the KKIA and Eastern Province to be done by 4Q23; however, we remain conservative and build it into our forecasts from 1Q24.
- Similarly, we expect the Riyadh contract to be announced by 4Q23. But we have built it into our forecast from 1Q24.
- The KKIA contract is expected to be on a revenue-sharing model; however, the percentage of revenue sharing has not yet been disclosed. We have assumed revenue sharing of 50:50.
- Similarly, the Riyadh contract is expected to be revenue sharing+ min. guarantee; however, the percentage of revenue sharing has not yet been disclosed. We have assumed revenue sharing of 50:50.
- As a result of the aforementioned contracts, we have assumed an average addition of ~250 billboards from FY24–26.
- The Faden acquisition has taken longer than expected to complete and is expected to happen by the year-end or 1Q24e. However, we remain conservative and have not built it into our base case as of yet.
- Our back-of-the hand calculation suggests that Faden consolidation can increase our TP by 4-7%. Again, it is based on subjective assumptions, as the company has not revealed Faden's complete financials.

A brief overview of the new contracts: We expect more than 1k digital boards to be added by 2025e. Moreover, we assume nearly 100 static billboards will be converted into digital billboards each year. The change is in favor of the topline, as digital billboards have nearly ten faces compared to only two faces on static billboards. The addition of billboards is expected to be driven by three contracts, of which two are already secured by the group (awaiting final signing), and the third is also most likely to be secured by the company by the end of 2023:

- **King Khalid International Airport (KKIA):** Al Arabia has won a 10-year contract for billboards at King Khalid International Airport (KKIA), stepping into JCD's core territory. Although specifics of the deal are undisclosed, we anticipate over 460 digital billboards to feature, capitalizing on the airport's heavy traffic. As per our understanding, 80 billboards from JCD will be available from the moment the contract is signed, while Al Arabia will have the right to expand to another 380 sites, which include both indoor and outdoor units. These billboards might cost double but could yield twice the revenue and are likely to have a high occupancy rate. The contract will be on a revenue-sharing basis, and the exact percentages are not known. The total value of the contract will be announced at the time of signing.
- **Eastern Province (Dammam, Khobar, and Dhahran):** In the Eastern Region (Dammam, Khobar, and Dhahran), the 10-year contract includes 1k billboard sites as well as 1k advertising spaces on buses and taxis for a period of 3 years. As per our understanding, out of the 1k billboard sites, Al Arabia already has 580 sites, and a total of 412 sites will be available on the date of signing. Further 41 sites will be received in 1.5–2 years from various competitors.
- **Remat Al-Riyadh Dev. Co. (Riyadh):** Riyadh Municipality launched its development arm, Remat Al-Riyadh Development Company, in July 2022 to facilitate private sector involvement in billboard site tenders across Riyadh's main streets. The tendering process for this 10-year contract, covering up 3k advertising sites, is already done, and

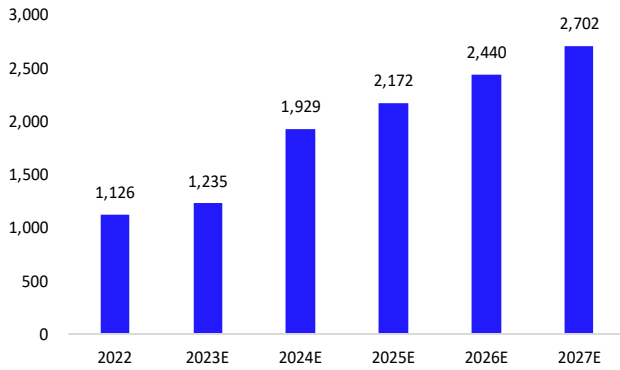
the results are expected very soon. As of now, Al Arabia has 1.3k sites in Riyadh, making it the lead contender to win the contract. On contract signing, the company will receive an additional 227 billboard sites, while 463 sites will be received over a period of 1.5–2 years from other competitors. In addition, additional new 1k advertising sites will also be available to the winner of the contract. The contract will be based on a revenue-sharing model.

All eyes on Faden Acquisition: Al Arabia had announced its intention to acquire 100% of Faden Media, an OOH digital advertising company for SAR1bn, in October 2022. In August 2023, Al Arabia received conditional approval from the General Authority for Competition (GAC) for the acquisition. We expect the acquisition to be completed by the year-end or 1Q24e. The acquisition is expected to be fully funded via debt. Note that any development on Faden provides further upside to our investment case.

Valuations: We value Al Arabia using the Discounted Cash Flow (DCF) methodology to arrive at our revised target price of SAR235/sh. The stock provides an upside of 25.5% from its last closing. The stock has rallied by 75% YTD and 71% since our initiation report. However, we believe that the stock can provide further upside due to multiple triggers. Hence, we maintain our “Overweight” rating.

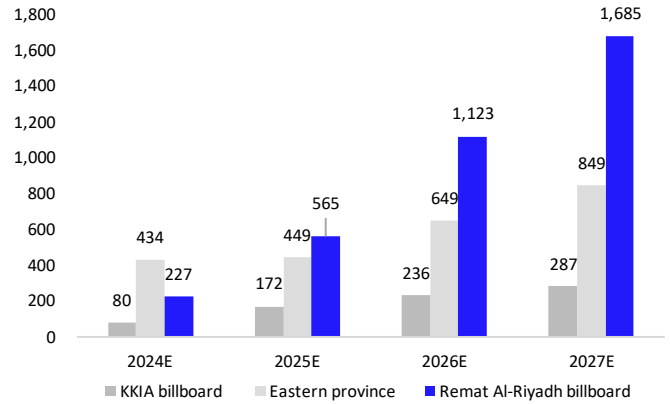
Key Risks: We see the following risks: 1) failure to close the Riyadh Contract; 2) delay in Faden Acquisition; 3) less favorable revenue sharing terms; 4) increased leverage to finance Faden Acquisition; 5) increased working capital requirements due to rapid expansion; 6) increased lease payments; and 7) longer than expected high interest rates.

Figure 1 Revenue Trend (SARmn)



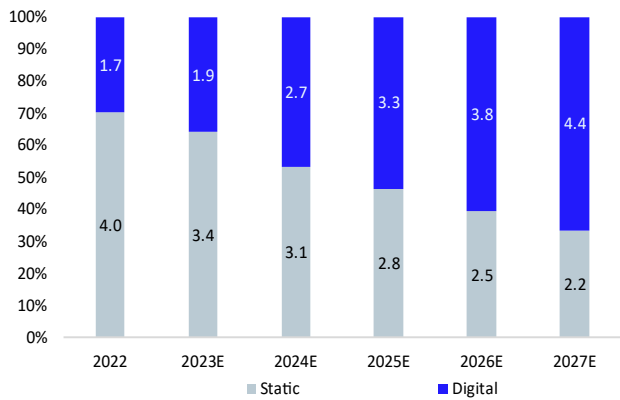
Source: Company Data, Al Rajhi Capital estimates

Figure 2 Billboards growth trajectory



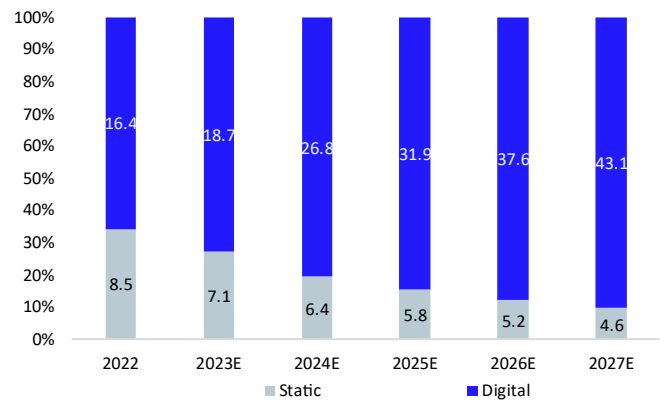
Source: Company Data, Al Rajhi Capital estimates

Figure 3 Billboards – Digital vs Static (000s)



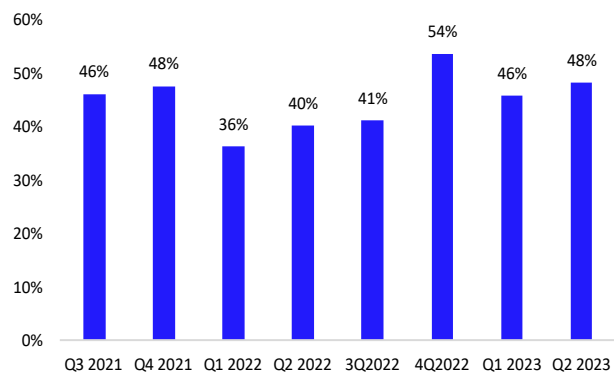
Source: Company Data, Al Rajhi Capital estimates

Figure 4 Faces – Digital vs Static (000s)



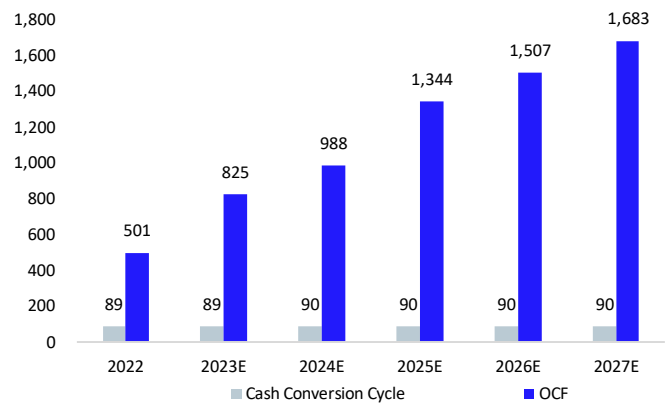
Source: Company Data, Al Rajhi Capital estimates

Figure 5 Quarterly gross margins (%)



Source: Company Data, Al Rajhi Capital estimates

Figure 6 OCF (SARmn) and Cash conversion (days)



Source: Company Data, Al Rajhi Capital estimates

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"Neutral": We expect the share price to settle at a level between 10% below the current share price and 10% above the current share price on a 12 month time horizon.

"Underweight": Our target price is more than 10% below the current share price, and we expect the share price to reach the target on a 12 month time horizon.

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Please note that the achievement of any price target may be impeded by general market and economic trends and other external factors, or if a company's profits or operating performance exceed or fall short of our expectations.

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