الراجحي المالية
alrajhi capital

US$1.3bn	81.80%	US$9.4mn
Market Cap.	Free Float	Avg. Daily Value traded

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Perfect Presentation

TP revised to SAR31/sh; downgrade to Neutral.

Neutral

Price Target (SAR): 31.0

Current: 32.85
Upside/Downside: 5.6% below current

Valuation Multiples	24E	25E	26E
P/E (x)	27.6	23.0	18.9
P/B (x)	9.6	7.4	5.8
EV/EBITDA (x)	22.8	19.1	16.0

Major Shareholders	% Ownership
The Ideal for Business Company	22.82
Saleh Ibrahim Hamad Al Mazroua	9.1

Price Performance	1M	3M	YTD
Absolute	-0.5%	6.0%	31.8%
Relative to TASI	2.2%	3.5%	29.0%

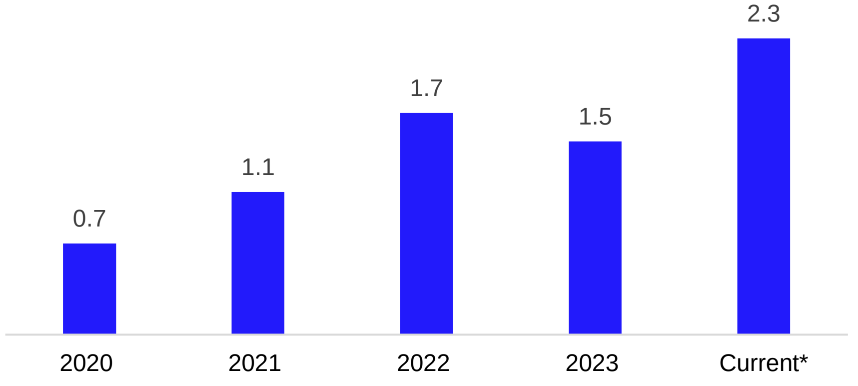
Earnings

(SARmn)	2024E	2025E	2025E
Revenue	1,422	1,633	1,877
Revenue growth	25.9%	14.8%	14.9%
Gross profit	272	322	382
Gross margin	19.1%	19.7%	20.3%
EBITDA	220	263	314
EBITDA margin	15.5%	16.1%	16.7%
Net profit	178	214	261
Net margin	12.5%	13.1%	13.9%
EPS	1.2	1.4	1.7
DPS	0.3	0.4	0.5
Payout ratio	27.6%	27.6%	27.6%
P/E	27.6x	23.0x	18.9x
RoE	40.0%	36.4%	34.3%

Source: Company data, Al Rajhi Capital

We downgrade 2P to "Neutral" after its stellar price performance, increasing by 49% since our initiation report and 32% YTD. The positive momentum in the stock can be mainly attributed to the Ministry of Investment contract won by the company on 6-Nov-23. However, FY23 was a tough year for 2P, where it saw margin contraction owing to rising competition and a changing revenue mix. The company managed to increase its revenue by 26% YoY, which was in line with the last published note. The reduction in revenue from the customer experience segment and the increase in software development revenues meant that the company increased its topline at the expense of margins. We were expecting gross margins of 19.6% last year as against the actual 18.6% recorded. To add to its woes, the whole Software & Service sector has undertaken major change in its ECL model. 2P was no different, where expected credit losses jumped by nearly 3x YoY to SAR12.6mn. We believe that ECL provisioning can remain elevated in the near future. Despite all the negatives, the company managed to add new contracts, albeit at a slower pace, managing to lock in a backlog of SAR1.5bn by FY23 year-end as against SAR1.7bn in FY22. It is pertinent to mention here that the backlog calculation doesn't include the major contract from the Ministry of Investment worth SAR2.0bn spanning over 4 years and having an annual limit of maximum SAR0.5bn. Taking the annual limit into consideration and a few other contracts announced YTD, the backlog currently stands at SAR2.3bn. We have included the recently announced contracts in our assumptions but remain conservative on the gross level margins, reducing them by 0.7/0.3%. We believe that all the positives are priced in at these levels, with the stock currently trading at a FY24/25 P/E multiple of 27.6/23.0x. Overall, we roll forward our TP and assume an increase in backlog, which increases our TP to SAR31/sh, providing a downside of 5.6% the last close. Hence, we remain "Neutral" on the stock.

Figure 1 **2P backlog evolution (SARbn)**



Source: Company data, Al Rajhi Capital; * based on recent announcements

FY23 results: In FY23, 2P experienced a notable 21.8% YoY increase in revenues. This surge was primarily propelled by an impressive 81.7% YoY growth in the Software Development Segment (SWD), complemented by a steady 7.8% YoY expansion in Operations and Maintenance services (O&M). However, these gains were partially offset by an 11.5% YoY decline in the Customer Experience (CX) segment.

Additionally, the introduction of the Management Services (MS) segment contributed SAR27mn in revenues for the first time. Despite these advancements, the shift in revenue mix unfavourably impacted gross margins, which decreased to 18.6% from 21.5% in FY22. Notably, the CX segment maintained the highest gross margin at 19.7%, surpassing SWD (16.8%) and O&M (15.2%). Operating margins experienced a modest 7.7% YoY growth, dampened by the adverse effects of increased ECL provisioning, totalling SAR12.6mn compared to SAR4.4mn in FY22. Consequently, lower operating margins coupled with elevated finance costs contributed to a 1.6% YoY decline in net income.

Figure 2 **4Q23/FY23 results summary**

(SAR mn)	Q4 2023	Q3 2023	Q4 2022	*y-o-y*	*q-o-q*	FY23	FY22	*y-o-y*
Revenue	**388**	**270**	**288**	***34.7%***	***43.5%***	**1,130**	**927**	***21.8%***
Gross Profit	**59**	**57**	**71**	***-16.5%***	***4.9%***	**210**	**199**	***5.5%***
G. margin	*15.3%*	*21.0%*	*24.7%*			*18.6%*	*21.5%*	
Op. profit	**58**	**44**	**58**	***-0.2%***	***31.3%***	**174**	**161**	***7.7%***
Op. margin	*14.9%*	*16.3%*	*20.1%*			*15.4%*	*17.4%*	
Net profit	**39**	**34**	**46**	***-16.5%***	***15.4%***	**129**	**131**	***-1.6%***
Net margin	*10.0%*	*12.4%*	*16.1%*			*11.4%*	*14.2%*	

Source: Company data, Al Rajhi Capital

Valuations: We employ a dual approach, utilizing both Discounted Cash Flow (DCF) and relative valuation methods, each assigned equal weighting, to assess the company's value. Combining these methodologies yields a final valuation of SAR31/sh, representing a downside of 5.6% based on the last closing price.

Key Risks: i) high dependence upon government clients; ii) decline in revenues from legacy segments may impact margins; iii) elevated provisions for expected credit losses may impact bottom line; and iv) increasing competition in the region.

Key Financials

Figure 3 **Income Statement**

(SAR mn)	2024E	2025E	2026E
Sales	**1,422**	**1,633**	**1,877**
Y-o-Y	*25.9%*	*14.8%*	*14.9%*
Cost of Sales	(1,150)	(1,311)	(1,495)
% of revenues	*80.9%*	*80.3%*	*79.7%*
Gross Income	**272**	**322**	**382**
Y-o-Y	*29.3%*	*18.4%*	*18.4%*
GPM	*19.1%*	*19.7%*	*20.3%*
SG&A	(47)	(54)	(62)
% of revenues	*3.3%*	*3.3%*	*3.3%*
Impairement loss on receivable:	(10)	(11)	(13)
Operating Expenses	**(57)**	**(65)**	**(74)**
% of revenues	*4.0%*	*4.0%*	*4.0%*
Operating Income	**215**	**257**	**307**
Y-o-Y	*28.0%*	*19.6%*	*19.5%*
OPM	*15.1%*	*15.7%*	*16.4%*
Financial costs	(37)	(42)	(43)
Other income/(expense)	9	9	9
Profit before tax	**187**	**224**	**273**
Zakat & Tax	(8)	(10)	(12)
% of PBT	*4.4%*	*4.4%*	*4.4%*
Net Income	**178**	**214**	**261**
Y-o-Y	*35.1%*	*20.2%*	*21.7%*
NPM	*12.5%*	*13.1%*	*13.9%*
EPS (SAR/sh)	**1.2**	**1.4**	**1.7**

Source: Al Rajhi Capital estimates

Figure 4 **Cash Flow Statement**

(SAR mn)	2024E	2025E	2026E
Cash from operations	162	172	236
Capex	-27	-28	-28
Free cash flow	**135**	**144**	**208**

Source: Al Rajhi Capital estimates

Figure 4 **Balance sheet**

(SAR mn)	2024E	2025E	2026E
Assets			
Trade receivables	487	537	591
Contract assets	505	564	629
Prepayment and other debt balances	35	40	46
Cash and cash equivalents	178	345	547
Total current Assets	**1,208**	**1,489**	**1,817**
Property, plant and equipment, net	171	193	216
Intangible assets, net	29	31	34
Total non-current assets	**200**	**225**	**250**
Total assets	**1,407**	**1,714**	**2,066**
Liabilities			
ST Debt	351	437	506
Trade payables	142	144	164
Accruals and other payables	241	277	318
Contract liabilities	85	100	116
Provision for Zakat and income tax	7	7	7
Due to related parties	21	25	28
Total current liabilities	**848**	**989**	**1,140**
End of service benefit obligations	43	53	66
Non current portion of long term loans	3	3	3
Total non-current liabilities	**45**	**56**	**69**
Shareholders' equity			
Capital	150	150	150
Statutory and other reserve	26	26	26
Retained earnings	335	490	679
Total equity	**511**	**666**	**855**
Total liabilities	**1,407**	**1,714**	**2,066**

Source: Al Rajhi Capital estimates

Figure 5 **Key Ratios**

Key metrics	2024E	2025E	2026E
Current ratio	1.4x	1.5x	1.6x
Receivables turnover ratio	2.9x	3.0x	3.2x
Payables turnover ratio	6.5x	3.8x	2.7x
Operating cycle (days)	81	81	76
EV/EBITDA	22.8x	19.1x	16.0x
P/E	27.6x	23.0x	18.9x
P/B	9.6x	7.4x	5.8x
ROE	40.0%	36.4%	34.3%

Source: 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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