

Equipment House

Margins remain a concern, remain Underweight

Equipment House has a strong order backlog (current SAR 2.0 bn, >2.0x of its current revenues) and is expected to see notable jump in revenues in 2024 (+22% y-o-y). However, rising competition in the space and the company's move to grow its order backlog notably in the recent years has bought in some compromise on the margins front. Moreover, the bulk of the order inflow has come from the relatively weaker margins in the non-medical O&M business, that includes supplying staffing solutions for the maintenance of the building. At the same time, the rise in SAIBOR has weighed on its interest cost as the company borrows for working capital needs. Moreover, delay on the government receivables has also been a concern. We slightly raise our revenue estimates for 2024 but trim our gross margins forecasts (now 17.4% versus 21% before) as uninspiring margin performance in 2023, particularly Q4 2023, as well as rising labor inflation makes us cautious. On a y-o-y basis, some margin improvement in 2024 is possible as the mix of trading revenues (better margins) increases, subsidiaries (reported as other activities) to make normalized margins in 2024 and we expect meat and food segment, that has been making losses to breakeven in 2024. At the same time, the benefits of operating leverage (G&A costs to grow at a slower pace) should help the operating margin. However, we do not consider any ECL reversals or provisions in 2024/2025. Thus, operating margin estimates for 2024 are 7.8%, lower than 8.6% in 2023 (ECL reversals helped operating profits in 2023).

Underweight

Price Target (SAR): 46.0

Current: 57.5

Upside/Downside: 20.0% below current

Valuation Multiples	23	24E	25E
P/E (x)	42.9	35.9	29.2
P/B (x)	3.6	3.5	3.3
ROE (%)	8.0	9.7	11.5

Major Shareholders % Ownership

Bandar Saud Mohammed Al-Arifi	7.46
Barakat Saud Mohammed Al-Arifi	6.47
Bashir Saud Mohammed Al-Arifi	6.11

Price Performance	1M	3M	YTD
Absolute	10.6%	27.2%	20.4%
Relative to TASI	10.1%	21.2%	15.3%

Earnings

(SARmn)	2023	2024E	2025E
Revenue	799	978	1,077
Revenue growth	12.0%	22.3%	10.2%
Gross Profit	133	170	190
Gross margin	16.7%	17.4%	17.7%
EBIT	69	76	85
EBIT margin	8.6%	7.8%	7.9%
Net Income	40	48	59
Net Income margin	5.0%	4.9%	5.5%
Net Income growth	128.8%	19.6%	23.0%
EPS	1.3	1.6	2.0

Source: Company data, Al Rajhi Capital

Figure 1 Q4 2023 Results

(SAR mn)	Q4 2023	Q4 2022	Y-o-Y	Q3 2023	Q-o-Q	ARC est	vs ARC
Revenue	232	189	23%	212	9%	215	8%
Gross profit	35	34	4%	37	-4%	40	-11%
Gross margin	15.3%	18.0%		17.5%		18.5%	
Operating profit	23	(23)	NM	25	-7%	22	
Operating margin	10.0%	-11.9%		11.8%		10.0%	
Adj.* Operating Profit	13	17	-26%	14	-9%	17	-24%
Adj. Operating margin	5.4%	9.0%		6.5%		7.7%	
Net profit	13	(26)	NM	17	-25%	14	
Net margin	5.6%	-13.9%		8.1%		6.6%	
Adj.* Net profit	2	15	-85%	6	-62%	9	-75%
Adj. Net margin	1.0%	8.0%		2.8%		4.3%	

Source: Company data, Al Rajhi Capital; Note:* Adjusted for one-off ECL provisions and reversals

Q4 2023 Results: SMEH's Q4 2023 revenues grew 23% y-o-y coming at SAR 232mn, this was 8% above our expectations of SAR 215mn. The increase can be attributable to receiving and commencing new projects that were announced during previous periods. However, gross profit of SAR 35mn (+4% y-o-y, -4% q-o-q), came in 11% lower than our expectations. Gross margins were weak at 15.3% versus our expectations of 18.5% and preceding quarter's (Q3 2023) 17.5%. Despite weak gross profits, the reported profitability numbers were broadly in line as we believe ECL reversals were more than our expectations (SAR 11mn reversals vs. ARC estimate: SAR 5mn reversals). However, both adjusted operating profit and net profit came below expectations.

Valuations: Given that bulk of the growth is expected to come from O&M business alone, we now value the company on P/E methodology from SOTP earlier. The company has a notable order backlog and the market is pricing in the benefits of sharp growth in the revenues in the near future. To capture the growth in the next 2-3 years, we use the average EPS of 2024-2026 and apply a sustainable multiple of 23x (average growth beyond 2025 expected to be mid to high single digit) to derive our fair value of SAR 46/share (from SAR 45.35/share before). We maintain our Underweight recommendation on the stock and believe any signs of margin improvement or growth in high margin businesses such as medical O&M, subsidiaries and order inflow in trading business provide upside risks to our target price.

Figure 2 **Valuations**

P/E	Multiples
EPS - 2024/2025E/2026E (SAR)	2.0
Target P/E multiple	23x
Target price per share (SAR)	46.0
CMP (SAR)	57.5
Upside/(Downside)	-20.0%

Source: Al Rajhi Capital estimates

Financials

Figure 3 Income Statement

SARmn	2024E	2025E	2026E
Revenue	978	1,077	1,153
<i>y-o-y growth</i>	22.3%	10.2%	7.0%
Cost of sales	(808)	(887)	(944)
Gross Profit	170	190	209
<i>y-o-y growth</i>	27.8%	11.8%	9.7%
<i>margins</i>	17.4%	17.7%	18.1%
Selling and marketing expenses	(12)	(14)	(15)
General and admin. Expenses	(82)	(92)	(98)
Operating profit	76	85	96
<i>y-o-y growth</i>	11.0%	11.0%	13.0%
<i>margins</i>	7.8%	7.9%	8.3%
Finance cost	(29)	(24)	(22)
Pre-Tax Income	55	68	82
Zakat	(8)	(10)	(12)
Net Income/Net Profit (Losses)	48	59	71
<i>y-o-y growth</i>	19.6%	23.0%	19.2%
<i>margins</i>	4.9%	5.5%	6.1%
EPS	1.6	2.0	2.4
DPS	1.0	1.0	1.1

Source: Al Rajhi Capital estimates

Figure 5 Cash Flow Statement

SARmn	2024E	2025E	2026E
Cash flow from Operations	(19)	38	50
Cash flow from Investing	(41)	(45)	(48)
Cash flow from Financing	24	27	27
Change in cash	(36)	20	29
Cash and Cash Equivalents at the end of the year	37	56	85

Source: Al Rajhi Capital estimates

Figure 6 Key Ratios

SARmn	2024E	2025E	2026E
ROA	6.9%	6.9%	0.0%
ROE	9.7%	11.5%	12.9%
Current Ratio	1.9x	1.8x	1.8x
Asset turnover ratio	0.9x	0.9x	0.9x
Inventory turnover ratio	6.7x	6.5x	6.4x
Receivables turnover ratio	1.9x	1.8x	1.8x
Payable turnover ratio	8.9x	8.5x	8.8x
Cash Conversion Cycle (Days)	209	213	216
Debt-Equity Ratio	0.6x	0.7x	0.7x
BVPS	16.5x	17.4x	18.6x
P/E	35.9x	29.2x	24.4x
P/B	3.5x	3.3x	3.1x

Source: Al Rajhi Capital estimates

Figure 4 Balance sheet

SARmn	2024E	2025E	2026E
Property, plant and equipment	43	47	49
Right of use of assets	40	48	53
Investment properties	32	32	32
Intangible assets	4	4	4
Total Non-current assets	118	130	138
Cash and cash equivalents	37	56	85
Trade receivables	567	614	657
Contract assets	196	215	231
Inventories	129	142	151
Prepaid expenses and other debt balan	87	95	94
Deferred expenses	12	12	12
Dues from Related Parties	19	19	19
Total Current assets	1,046	1,154	1,249
Total Assets	1,165	1,284	1,387
Short-term loans	267	321	378
Trade creditors	99	109	107
Payable expenses and other creditor ba	156	171	173
Provision for Legal Zakat	12	12	12
Other Current Liabilities	22	22	23
Total Current liabilities	556	635	693
Long-term loan	10	10	10
Employee Defined Benefit Liabilities	87	96	103
Lease liabilities	18	20	22
Total Non-current liabilities	114	126	135
Total Liabilities	670	761	827
Share capital	200	200	200
Statutory reserve	37	37	37
Retained earnings	262	291	329
Total Shareholders' Equity	499	528	565
Non-controlling equity	(4)	(5)	(6)
Total liabilities and equity	1,165	1,284	1,387

Source: Al Rajhi Capital estimates

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