SMEH
Healthcare: Healthcare provider
EQUIPMEN AB: Saudi Arabia
14 August 2023

الراجحي المالية
alrajhi capital

US$0.420bn	59.26%	US$8.95mn
Market Cap	Free Float	Avg. Daily Volume

Target price	68.00	14% below current
Current price	79.20	as at 14/08/2023

Existing rating

Underweight | Neutral | Overweight

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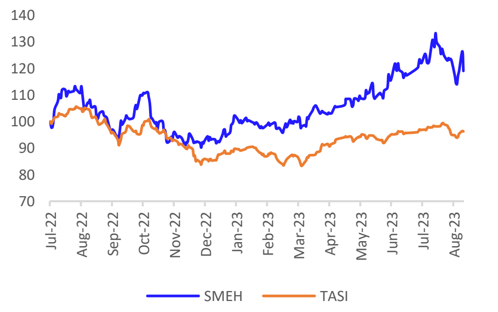
Performance (Rebased to 100)



Earnings

(SARmn)	2023E	2024E	2025E
Revenue	778	946	1,097
Revenue growth	9%	22%	16%
Gross Profit	143	195	226
Gross margin	18%	21%	21%
EBIT	51	89	102
EBIT margin	7%	9%	9%
EBITDA	73	116	135
EBITDA margin	9%	12%	12%
Net Income	23	61	72
Net Income margin	3%	6%	7%
Net Income growth	34%	160%	18%
EPS	1.2	3.1	3.6
DPS	1.0	1.0	1.0

Source: Company data, Al Rajhi Capital.

Equipment House

TP reduced to SAR 68/sh and downgrade to UW

SMEH's order backlog of about SAR 2.0 bn (implied book to bill of 3.0x on 2022 rev.), provides a strong topline visibility. However, the execution so far this year has been much weaker than our anticipation. In our initiation report, we had highlighted that Q1 earnings could be weak and improvement should be seen starting Q2 2023 with notable improvement in H2 2023. However, the earnings in the last two quarters, especially Q2, have been much weaker, with gross margins being notably below our expectations. In the press release, the company has mentioned that the operating performance is hurt by execution of some legacy orders that have low pricing. And the company expects financial performance to improve in H2 2023, starting Q4 2023. However, on the back of weak execution of new orders and lack of clarity on the impact of legacy orders on the margins, we reduce our estimates for 2023E for both top-line and gross margins. We now expect revenues of SAR 778 mn and gross margins of just 18.4% versus our earlier assumptions of SAR 927 mn and 22.0%. We expect the contribution from new orders to be seen mostly in 2024E and 2025E, but we trim our gross margins for 2024E and 2025E to 20.7% and 20.6%, respectively, from 21.9% and 21.7%, before. We would wait for clarity on margins and better execution of the order backlog before we revise our gross margin estimates. We roll forward our valuations to next year and 2025E when the earnings should reflect the sustainable earnings. However, as we reduce our estimates, we also cut our target price to SAR 68/share from SAR 77/share before. The downside from the current market price is 14%, implying Underweight recommendation on the stock.

Q2 2023 results: Q2 2023 revenues rose by 8% y-o-y and 16% sequentially to SAR 191 mn, below our projected SAR 200 mn, but the nature of the business's contractual aspects can cause revenue volatility based on order execution timing. Gross profit of SAR 30 mn (-36% y-o-y, -3% q-o-q), was the key disappointment coming 21% below our expectations. Operating profit was SAR 8 mn (-63% y-o-y, -33% q-o-q), lower than our expected SAR 17 mn. As a result, net profit, further impacted by finance costs, came in at only SAR 1 mn, falling short of our SAR 11 mn projection. Overall, margins faced challenges stemming from elevated medical staff salaries in 2023, weak pricing from legacy orders, and notable impact from increased expected credit loss (ECL) provisions (expected to reverse due to government deals).

Q2 2023 Earnings

(SAR mn)	Q2 2023	Q2 2022	*Y-o-Y*	Q1 2023	*Q-o-Q*	ARC est	*vs ARC*
Revenue	191	176	*8%*	165	*16%*	200	*-5%*
Gross profit	30	47	*-36%*	31	*-3%*	38	*-21%*
Gross margin	*16%*	*27%*		*19%*		*19%*	
Operating profit	8	22	*-63%*	12	*-33%*	17	*-51%*
Operating margin	*4%*	*13%*		*7%*		*8%*	
Net profit	1	16	*-91%*	6	*-78%*	11	*-87%*
Net margin	*1%*	*9%*		*4%*		*6%*	

Source: Company data, Al Rajhi Capital

Valuations: Based on our combined approach of sum-of-the-parts (SOTP) methodology and price-to-earnings (PE) multiples, giving equal weight to both, our fair value for the stock is SAR 68/share. The O&M business is valued at an 18x EV/EBIT multiple based on average EBIT projections for 2024e/2025e, reflecting the anticipated execution of the current order backlog. Recognizing the stability and visibility of the O&M segment, we attribute the highest multiple of 18x to it. The construction and subsidiary businesses, being more volatile, are assigned multiples of 12x and 14x, respectively. The trading segment follows the same 14x multiple. Given its narrow profit margins, the catering business is valued at a conservative 10x multiple. Using the SOTP method, we arrive at a fair value of SAR 69 per share. In terms of PE valuation, we have assigned a 20x multiple to average EPS for 2024e/2025e. Using PE method, we arrive at a fair value of SAR 67 per share. On blended methodology using equal weight we arrive at a target price of SAR 68 per share, downside of 14% to current market price, implying Underweight rating.

Figure 2 **Valuations (SAR mn except for per share number)**

SOTP	Operating profit 2024/2025e	EV/EBIT multiple (x)	EV
O&M	72.1	18x	1,298
Construction	8.7	12x	105
Food supply	0.1	10x	1
Subsidiaries	5.3	14x	74
Trading	8.8	14x	123
Enterprise value			**1,602**
Less: Net debt			198
Less: Pension liab.			64
Add: Investment properties			32
Total equity value			**1,371**
Shares O/S			20
Fair value per share			**69**
CMP			79
Upside/(downside)			-13%

P/E	
EPS - 2024/2025E (SAR)	3.3
Target P/E multiple (x)	20x
Target price per share (SAR)	67

Valuation Method	Fair Value per share (SAR)	Weightage	Weighted value per share (SAR)
SOTP	69	50%	34
P/E	67	50%	33
Target price (SAR)			**68**
CMP (SAR)			79
Upside/(Downside)			-14%

Source: Al Rajhi Capital

Risks: Weak execution, competitive pricing impact, and uncertain revenue and profit projections pose risks to SMEH's financial performance and target price.

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

"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.

"Target price": We estimate target value per share for every stock we cover. This is normally based on widely accepted methods appropriate to the stock or sector under consideration, e.g. DCF (discounted cash flow) or SoTP (sum of the parts) analysis.

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