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US$22.1bn	32.99%	US$27.8mn
Market Cap.	Free Float	Avg. Daily Value traded

Elm Co.

Initiating Coverage with a TP of SAR1,180/sh

Overweight

Price Target (SAR): 1,180

Current: 1,033.8
Upside/Downside: 14.0% above current

Valuation Multiples	22	23E	24E
P/E (x)	88.9	64.8	49.1
P/B (x)	27.1	21.3	16.3

Major Shareholders	% Ownership
Public Investment Fund	67.00

Price Performance	1M	3M	YTD
Absolute	11.9%	39.5%	26.8%
Relative to TASI	7.3%	27.3%	22.4%

Earnings

(SAR mn)	2023E	2024E	2025E
Revenue	5,766	7,249	8,870
YoY %	*25.2%*	*25.7%*	*22.4%*
Gross Profit	2,363	3,008	3,725
GM Margin %	*41.0%*	*41.5%*	*42.0%*
YoY %	*25.3%*	*27.3%*	*23.8%*
EBITDA	1,398	1,834	2,406
EBITDA Margin	*24.2%*	*25.3%*	*27.1%*
Net Income	1,277	1,683	2,182
Net Income Margin %	*22.1%*	*23.2%*	*24.6%*
YoY %	*37.2%*	*31.8%*	*29.7%*
EPS	16.0	21.0	27.3
DPS	6.0	7.4	12.3
P/E	64.8	49.1	37.9
EV/EBITDA	57.3	43.7	33.3
ROE	37%	38%	37%

Source: Company data, Al Rajhi Capital estimates

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We initiate coverage on ELM with an "Overweight" rating having a TP of SAR1,180/sh and providing an upside of 14% to the last close. ELM is the cornerstone of the digital transformation and development strategy shaping the Kingdom's social and economic activities. We flag ELM as the major beneficiary of the upcoming trends in digitization in various sectors, including tourism, healthcare, car rentals, AI, data centers, and cloud computing. In addition, the upcoming giga projects, smart city development, and global-scale events lend weight to our thesis of continued growth in digitization. The company has managed to benefit from the digitization boom post COVID with revenues growing at a FY20-23E CAGR of 33%. We believe the growth trajectory will continue and forecast a 3-year revenue CAGR of 22%. The stock is trading at a FY24/25e P/E multiple of 49/38x. The company commands a premium based on its 1) existing essential digital products portfolio; 2) long-proven track record of undertaking digitization activities; 3) strong relationships with government entities; and 4) access to the national database. On the financial front, we like the company due to 1) ELM's ability to consistently grow and having tremendous future potential; 2) focus on high-margin digital segments; 3) scalable business; 4) clean balance sheet providing the option to grow inorganically via M&As; and 5) boasting attractive return ratios. Due to the aforementioned reasons, we believe ELM is likely to trade at a higher P/E multiple for a longer period of time. As per our forecast, the company is likely to have a sustainable multiple of 25x by FY27, implying a bottom-line growth of 26%. Hence, we initiate on the name with an Overweight rating.

ELM stands to benefit from continued digitization efforts: ELM provides direct exposure to the booming IT industry in the Kingdom, having strategically important digital products and platforms under its portfolio. There is still room for growth in the digital segment, keeping in view the drive to achieve Vision 2030 targets. We believe that the private sector will also significantly contribute to the next leg of the growth of digitization. We expect ELM to be the major beneficiary of the upcoming trends in digitization in various sectors, including tourism, healthcare, car rentals, AI, data centers, cloud computing, etc. Moreover, the Kingdom's ambition to develop smart cities and the pipeline of giga projects also lend weight to our thesis of continued growth in digitization. In addition, there are several upcoming global events, including the Riyadh Expo and the FIFA World Cup, happening in the next 5 - 10 years within the Kingdom that would require the expertise of an experienced digital product developer.

Limited competition with access to national database: ELM is technically not a monopoly and has several competitors in all three business segments it operates in. However, the company has a first-mover advantage in the digital business, enabling it to establish a very strong footprint within the segment. The strong track record and history of working with the government help ELM achieve major projects. In addition, ELM is one of the few companies with access to the national database, allowing it to maintain its monopoly on products like Asbher, Yakeen, etc. that require access to the national database. The database not only helps the digital segment but also boosts BPO projects, allowing the company to win contracts that require utilization of the national database, like the Makkah route.

Critical portfolio of digital offerings: ELM's existing offerings include several products that have become household names and are absolutely critical for the Kingdom's day-to-day activities. We believe ELM's unique product portfolio has exposure to all the key growth elements of the Kingdom Economy, including tourism, healthcare, car rentals, AI, data centers, cloud computing. The group boasts a diverse portfolio of over 30 products, but the top 6 products contribute nesarly 66% of the overall topline. These products include: Nusuk (Hajj, Umrah trip booking), Absher (automates services provided by the Interior Ministry), Muqeem (entry-exit visa issuances), Yakeen (verification of data for banking transactions.), Fasah (electronic gateway for import-export operations), Tamm (issuance of driving permit in Saudi).

Consistent growth with tremendous future potential: ELM has managed to grow stratospherically in the last 3 years, boasting a 3-year CAGR of 33% (FY20-23e). Revenues jumped from SAR2.5bn in FY20 to SAR5.8bn in FY23e. The tremendous growth has been fuelled by the ever-growing digital business segment, which has increased by a 3-year CAGR of 35%. Going forward, we believe that digital business is likely to remain the main driver of growth, resulting in total revenues growing by a 3-year CAGR of 22% (FY23-26e) during the same period. We believe that a lot of this growth will stem from the upcoming giga projects, smart city solutions, and global events like the Riyadh Expo as well as the FIFA World Cup.

Focus on the higher GP margin segment: ELM has managed to increase its gross margins each year since 2019. The margin has risen from 32.4% in FY19 to 41.0% in FY23e, an increase of 9 percentage points. Thanks to its scalable business model, the margin trend is likely to increase further. Most of the costs associated with developing the digital products have already been incurred, and an increase in transactions and subscriptions will likely directly benefit the gross profitability of the company. We highlight that any increase might be gradual due to the revenue-sharing nature of some of the products. Going forward, we have increased gross margins to 43% by FY27e, driven by growth in the digital business segment.

Inorganic growth to be supported by solid FCFF generation: The IT market is highly fragmented in the MENA region, presenting plenty of opportunity for consolidation. ELM's healthy balance sheet, which boasts zero debt and solid OCFs, will allow it to grow inorganically as well. To put things into context, the company can generate cash flow from operations amounting to SAR1.7bn annually (FY22 and SAR0.9bn in 9MFY23) and had net cash on its books to the tune of SAR2.8bn (including Murabaha deposits) as of 3Q23. The company had announced on 5th June 2023 that it is looking to acquire one of its competitors, Thiqah. We believe ELM is poised to acquire more of its competitors, enabling it to offer a consolidated portfolio of products to its customers and in the process, will further increase its market share.

Valuation: ELM has continued to make new highs since its listing, growing by a whopping 8.1x times. In FY2023, the stock rallied by 145% while being up 27% YTD. Despite strong stock performance, we are of the view that there is still some juice left. We argue that the company that is expected to grow its profitability at a 3-year CAGR of 28%, has strong FCF generation, and superior return metrics than competitors deserve a premium. Our preferred valuation approach is DCF, where we assign a weight of 50% to it while the remaining 50% is assigned to the relative valuation approach. Using the abovementioned approach, we arrive at a weighted average target price of SAR1,180/sh. The stock provides an upside of 14% from its last closing.

Key risks: 1) end of exclusivity to government Database; 2) end of exclusivity in operating government platforms; 3) risk related to revenue sharing; 4) delays in M&As; 5) slower than expected digitization growth; and 6) rising competition.

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Business Model

ELM is broadly a digital products and platform company operating in three main segments: 1) Digital Business, 2) Business Process Outsourcing (BPO), and 3) Professional Services. The recurring revenue for the company stands at 70%, while the company has a backlog of SAR3.1bn for the non-recurring business. The group boasts a diverse portfolio of over 30 products, but the top 6 products contribute nearly 66% of the overall topline. These products include: Nusuk (Hajj, Umrah trip booking), Absher (automates services provided by the Interior Ministry), Muqeem (entry-exit visa issuances), Yakeen (verification of data for banking transactions.), Fasah (electronic gateway for import-export operations), Tamm (issuance of driving permit in Saudi).

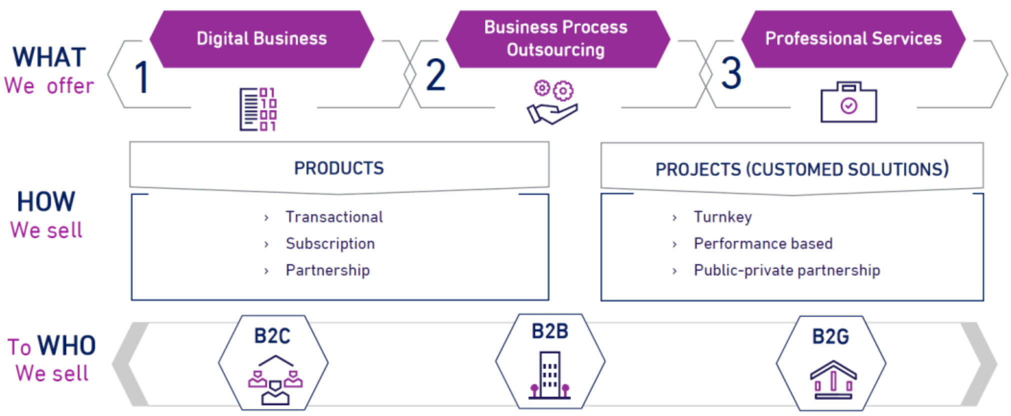
Figure 1 **Top six products**

Absher
فسح
FASAH
تم
Tamm
مقيم
Muqeem
يقين
Yakeen
نسك
nusuk

Source: Earnings presentation

The company drives revenue through three key methods: 1) transactions, 2) subscriptions, and 3) partnerships. Subscription-based revenue accrues over time, while the other methods generate revenue at specific points in time.

Figure 2 **Business Model**



Source: Earnings presentation

Despite having the lowest contribution in total revenues (3.6/2.8% for FY22/23e), Professional Services is one of the most critical segments for the company, acting as a gate opener for all business by generating leads for the other two segments.

To understand the business model of the company, we dive into the largest revenue generator for the company (68.2/73.6% for FY22/23e), i.e., Digital Business. The company has a unique business model where they do not own most of the digital products but operate them on behalf of the government. Further within the digital business segment, there are two more categories: 1) Recurring income portfolios, i.e., products, and 2) Projects, which are usually one-offs. In 9M23 64% of the top line is classified as private, and the reason is that these apps, although government-owned, are generating revenue from the private sector. While the remaining is classified as revenue from the government.

Revenue Model: Each product will have a different revenue model and can be subscription based, transaction, revenue-sharing, or a combination of these. Different products will have different revenue-sharing agreement terms with the relevant stakeholders. These revenue-sharing agreements are usually of longer tenor so that innovation and development can be encouraged within the product.

For instance, most of the services in Absher are complimentary, as they are essential for the Kingdom's residents and businesses. However, some value-added services embedded in Absher, like car transfer services and car plate auctions, generate revenue for the company when a transaction takes place. In addition, businesses must subscribe to Absher to access services related to, but not limited to, the issuance of visas for new expats, exit reentry visa services, etc. In short, Absher can be classified as a subscription-based model with revenue sharing on value-added services. Other products like Yakeen can afford to have lower subscription fees as they generate a huge number of transactions, and hence the revenue generated from these transactions is the main source of income.

Introducing new products or adding value to existing offerings: Developing new products or adding new services within an existing product or platform usually involves initiatives from both sides, i.e., ELM and the relevant government stakeholders. ELM, being the operator, can observe the glitches and bugs, take feedback from customers, and then implement changes. Similarly, if they come up with any new idea, they could contact the relevant stakeholders to get their approval and start working on the new initiatives. On the other hand, if the government has a specific need, they will contact ELM and request them to develop the required solution. For instance, the Nusuk app, ELM, came up with the idea to digitize the processes of Hajj and Umrah, and once the approvals from relevant government stakeholders were obtained, the solution was developed and implemented.

BPO: The business process outsourcing primarily consists of a non-recurring stream of revenue and contributes 28.3/23.7% to the total FY22/23e revenues. The company usually bids for projects that lie within its scope. The length of these contracts can vary from a few months to several years. As of now, the company has a backlog of SAR2.1bn specifically related to BPO projects, and normally BPO processes involve recruiting and other upfront expenses, resulting in lower margins. The last announced contract for the Ministry of Human Resources involving survey work for applicants benefitting from the Social Security Program is worth 25% of FY22 revenues, i.e., SAR1.2bn. The COVID project has nearly phased out, and the company expects demand to pick up from this segment in the near future. Adjusting for the COVID project, the revenue for the segment picked up by 49% YoY in 9MFY23. In addition, access to the national database gives the company an edge, enabling them to win contracts that require access to the database, like Makkah route initiative. Lastly, the segment also has some recurring streams of income, like the Ejada project. The company, due to its expertise and specialization, re-wins contracts for the operation and maintenance of certain projects. Going forward, the company is aiming to completely digitize the BPO processes, and whenever they are working with government entities, they try to digitize those processes as well.

Working Capital: The organization is strongly positioned to finance its operational requirements using internal funds. Within the IT sector, extended receivable periods have been common, particularly with a significant portion of receivables stemming from government entities. Nevertheless, Elm has effectively kept its receivables well below the duration of its payable periods, leading to a negative cash conversion cycle.

Investment Thesis

ELM is strategically positioned in the Kingdom's booming IT industry, with a portfolio of important digital products and platforms.

The company has experienced significant revenue growth in recent years due to the government-led push for digitization.

The Kingdom's fast-tracked digital transformation strategy, accelerated by the COVID-19 pandemic, has led to the development of a robust digital infrastructure and framework across sectors.

ELM stands to benefit from continued digitization efforts: ELM provides direct exposure to the booming IT industry in the Kingdom, having strategically important digital products and platforms under its portfolio. The company primarily works with the government to develop society-critical digitized solutions. The government-led digitization push has provided a great boost to the company's revenues in the last few years. We argue that there is still room for growth in the digital segment, keeping in view the drive to achieve Vision 2030 targets. Moreover, we believe that the private sector will also significantly contribute to the next leg of the growth of digitization. The national strategy for digital transformation, launched in 2006, was fast-tracked during the COVID-19 era, where lockdowns forced everyone to shift online, and digitization became a necessity. The investments made in the digital infrastructure paid off, as the Kingdom was able to quickly develop a digital transformation framework for various sectors, including finance, commerce, logistics, and information technology. Currently, the national strategy for digital transformation is in its third and final phase, which entails a smart government strategy aiming to create a new, seamless government experience.

We expect ELM to be the major beneficiary of the upcoming trends in digitization in various sectors, including tourism, healthcare, car rentals, AI, data centers, cloud computing, etc. Moreover, the Kingdom's ambition to develop smart cities and the pipeline of giga projects also lend weight to our thesis of continued growth in digitization. In addition, there are several upcoming global events, including the Riyadh Expo and the FIFA World Cup, happening in the next 5 - 10 years within the Kingdom that would require the expertise of an experienced digital product developer. In terms of digital competitiveness (as per IMD), KSA still has a long way to go, with 29 countries ahead of the Kingdom, including GCC peers, namely Qatar and the UAE (as of 2023), still ahead of it, implying further room for improvement.

ELM is poised to benefit from upcoming trends in digitization across various sectors such as tourism, healthcare, AI, and cloud computing.

ELM's position as a leading digitalization player is supported by its proven track record, technical capabilities, strong relationships with government entities, and access to the national database, forming a strong USP for continued success.

Going forward, we believe that ELM is set to benefit from government as well as private sector pushes towards developing a digital ecosystem. As the leading digitalization player in the Kingdom, the company has developed a USP based on its 1) long-proven track record of undertaking digitization of community-related activities; 2) strong technical abilities allowing it to develop and implement solutions quickly; 3) strong relationships with relevant government entities and stakeholder groups; and 4) access to the national database.

ELM holds a strong market position, although not a true monopoly, especially in the digital business segment due to its first-mover advantage and extensive government collaboration since its inception in 1988.

ELM's access to the national database is a key advantage, enabling the development of specialized products like Asbher and Yakeen

Despite the risk of non-renewal for access to the national database and existing government digital products, ELM's robust track record and successful history of operation significantly mitigate this risk.

Limited competition with access to national database: ELM is technically not a monopoly and has several competitors in all three business segments it operates in. However, the company has a first-mover advantage in the digital business, enabling it to establish a very strong footprint within the segment. Strong track record and history of working with the government helped ELM achieve major projects. In addition, ELM is one of the few companies with access to the national database, allowing it to maintain its monopoly on products like Absher, Yakeen, etc. that require access to the national database. The database not only helps the digital segment but also boosts BPO projects, allowing the company to win contracts that require utilization of the national database, like the Makkah route. This allows the company to leverage its exclusive access to the national registry to develop more digital solutions or add services to existing products and platforms. We highlight that the risk of non-renewal exists for both access to the national database and the operation of current government digital products. However, we believe that the likelihood of non-renewal is very low given ELM's track record and history of successfully operating existing government products.

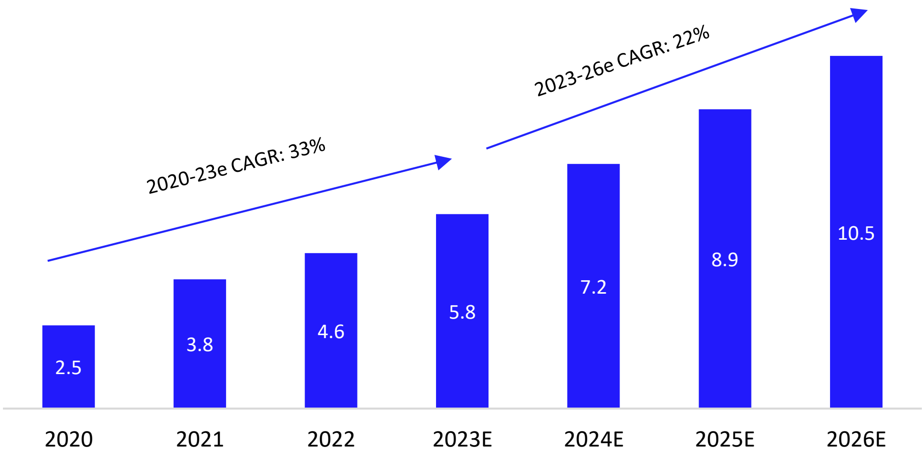
Critical portfolio of digital offerings: ELM's existing offerings include several products that have become household names and are absolutely critical for the Kingdom's day-to-day activities. We believe ELM's unique product portfolio has exposure to all the key growth elements of the Kingdom Economy, including tourism, healthcare, car rentals, AI, data centers, cloud computing. For more clarity, let us dive into a few of ELM's critical offerings. Absher, which is the central platform of the Ministry of Interior, provides several complimentary services to individuals, while some value-added services like car transfers and car plate auctions generate revenue for the company. Additionally, the business offerings of Abhser are booming, with elevated economic and business activity resulting in a steep influx of new employees within the Kingdom. Moving on to other products like Yakeen, it is the platform responsible for data verification for banks, insurance, etc. and has witnessed an upsurge in transactions. Finally, TAMM provides exposure to the uptick in tourism activity within the Kingdom as it is the key authorization authority for car rentals. Since the opening up of the economy post-COVID, religious tourism as well as conventional tourism have increased by leaps and bounds, resulting in a rise in car rental demand.

ELM has demonstrated impressive growth over the past three years, with a 33% Compound Annual Growth Rate (CAGR) in revenue. This growth is largely attributed to the flourishing digital business segment, which itself has seen a remarkable 35% CAGR.

ELM has strategically focused on higher gross margin segments, resulting in a consistent increase in gross margins from 32.4% in FY19 to 41.0% in FY23e.

Consistent growth with tremendous future potential: ELM has managed to grow stratospherically in the last 3 years, boasting a 3-year CAGR of 33% (FY20-23e). Revenues jumped from SAR2.5bn in FY20 to SAR5.8bn in FY23e. The tremendous growth has been fueled by the ever-growing digital business segment, which has increased by a 3-year CAGR of 35%. Going forward, we believe that digital business is likely to remain the main driver of growth resulting in total revenues growing by 26% (FY23-26e) during the same period. We believe that a lot of this growth will stem from the upcoming giga projects, smart city solutions, and global events like the Riyadh Expo as well as the FIFA World Cup.

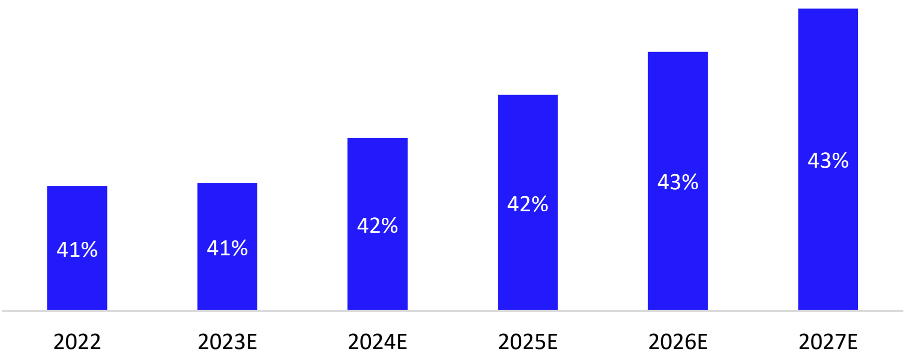
Figure 3 **Revenue (SARbn) and growth**



Source: Company Data, Al Rajhi Capital estimates

Focus on the higher GP margin segment: ELM has managed to increase its gross margins each year since 2019. The margin has risen from 32.4% in FY19 to 41.0% in FY23e, a rise of 9 percentage points. Thanks to its scalable business model, the margin trend is likely to increase further. Most of the costs associated with developing the digital products have already been incurred, and an increase in transactions and subscriptions will likely directly benefit the gross profitability of the company. We highlight that any increase might be gradual due to the revenue-sharing nature of some of the products. Going forward, we have increased gross margins to 43% by FY27e, driven by growth in the digital business segment.

Figure 4 **GP margins to increase to 43% by FY27e**



Source: Company Data, Al Rajhi Capital estimates

ELM has consistently outperformed management guidance, showcasing its strong growth trajectory. Despite potential challenges in accurately estimating revenues due to the nature of transactions on its operating platforms, the company's track record instills confidence in sustaining robust growth in the digital business segment.

Comfortably surpassing management guidance: Elm has consistently surpassed management guidance in 2022 and is poised to exceed its 2023 projections as well. While management may adopt a conservative approach, much of Elm's revenue hinges on transactions occurring on its operating platforms, making accurate estimations challenging. Nevertheless, the ongoing trend of outperforming guidance provides confidence that the growth trajectory in digital business will remain strong.

Figure 5 **Guidance vs Reported**

	2022		2023	
	Guidance	Actual	Guidance	9M23 actual
Revenue	10-12%	20%	21-23%	28%
EBIT Margin	18-21%	21%	22-24%	24%

Source: Company data, Earnings Presentation

Inorganic growth to be supported by solid FCFF generation: The IT market is highly fragmented in the MENA region, presenting plenty of opportunity for consolidation. ELM's healthy balance sheet, which boasts zero debt and solid OCFs, will allow it to grow inorganically as well. The company is actively looking at a pipeline of M&A, local as well as global, that aligns with its current product offerings. To put things into context, the company can generate cash flow from operations amounting to SAR1.7bn annually (FY22 and SAR0.9bn in 9MFY23) and had net cash on its books to the tune of SAR2.8bn (including Murabaha deposits) as of 3Q23.

The company has announced on 5 June 2023 that it is looking to acquire one of its competitors, Thiqah. We believe ELM is poised to acquire more of its competitors, enabling it to offer a consolidated portfolio of products to its customers and, in the process, increasing its market share.

Valuation

We employ a weighted average methodology, assigning equal weight to discounted cash flow and a relative valuation approach, to assess the group's value. Using the above-mentioned approach, we arrive at a weighted average target price of SAR1,180/sh. The stock provides an upside of 14% from its last closing.

Figure 6 **Valuation**

Valuation Methodology	Fair Value (SAR)	Weightage	Weighted value per share*	Upside
DCF	1,194	50%	597	16%
Relative Valuation (PE)	1,172	50%	586	13%
Fair Value (SAR)		**100%**	**1,180**	
CMP (SAR)			1,034	18-Feb-24
Upside/(Downside)			**14%**	

Source: Al Rajhi Capital estimates; *The target price is rounded off to SAR1,180/sh

For our Discounted Cash Flow (DCF) analysis, we utilize a Weighted Average Cost of Capital (WACC) of 8.5% and a terminal growth rate of 4%. Our rationale for a higher terminal growth rate is to capture the group's promising future growth potential in the digital segment as well as growth via inorganic expansion. Consequently, this calculation yields a DCF target price of SAR 1,193 per share, indicating an upside of 16%.

Relative Valuation: We apply a Price-to-Earnings (P/E) methodology to evaluate Elm, employing a target multiple of 48.5x on the average EPS for FY24/25e. This yields a target price of SAR 1,172 per share, indicating a potential upside of 13%.

Conclusion: ELM is trading at a premium to its peers at a FY24/25e P/E multiple of 49/38x. Solutions, 2P and MIS are trading at FY24/25e P/E of 28/25,24/19, and 35/39. We argue that ELM deserves a premium to its peers due to it being a digital pure play and having superior profitability and return profile. In addition, the digital business segment has tremendous growth potential while its existing product portfolio is critical for business and society operations. Moreover, the company has a clean balance sheet with strong FCF generation.

As for its peer i.e. Solutions, the stock is trading at FY24 P/E multiple of 28x and has a 3-year CAGR of 15% implying a PEG ratio of 1.9x. On the other hand, ELM with a 3-year CAGR of 28% is trading at a lower PEG ratio of 1.8x. Applying solutions PEG ratio to ELM, we can come up with an implied P/E multiple of 53x for FY24e. We believe that ELM commands a premium to this implied P/E multiple owing to slower growth in Solutions when compared to ELM. In addition, Solutions business model focuses on services and IT infrastructure rather than digital segment which have higher margins.

Key Risks

1. **End of exclusivity to government Database:** Elm's current dominance in the digitization market stems primarily from its privileged position as the sole listed entity with access to this database. Should other companies obtain similar access, Elm's dominance could be challenged or even diminished.

2. **End of exclusivity in operating government platforms:** Elm manages key government platforms such as Absher and Nusuk, generating revenue through value-added services on a profit-sharing model. However, if the government were to award contracts to alternative entities or opt for in-house operation of these platforms, Elm's revenue streams could be significantly jeopardized.

3. **Risk related to revenue sharing:** The Company engages in significant agreements with the government and other customers to provide technology services, often sharing income derived

from these services. However, potential challenges in pricing determination and marketing effectiveness may hinder revenue generation, impacting the Company's financial stability and prospects.

4. **Longer than expected time taken to complete M&A deals:** With the group's revenue streams primarily tied to government-related digitization, Elm, buoyed by its robust cash reserves and debt-free status, is poised to explore inorganic growth avenues. However, unsuccessful completion of future or ongoing deals (e.g., Thiqah acquisition) may impede the group's growth trajectory.

5. **Slower than expected digitization growth:** The group's non-digital business segments, such as the BPO sector, exhibit a low level of digitization and rely heavily on manual labor. Should the company fail to enhance digitization within this sector, it risks hindering the group's growth and exposing it to heightened competition within this specific segment.

6. **Rising Competition:** KSA is under radar of all major global IT players. ELM is not immune to rising competition within the segment from local as well as international players. New players can take market share from ELM especially in BPO segment.

Financial Analysis

Revenue analysis: From 2018 to 2022, the group experienced impressive revenue growth, with a Compound Annual Growth Rate (CAGR) of 24%. The BPO segment led this expansion, boasting a remarkable 31% growth rate, followed closely by Professional Services and Digital Business at 30% and 22% CAGR, respectively. Notably, the revenue contribution from BPO increased from 20% in 2019 to 43% in 2021, primarily driven by a COVID-19-related project. However, as this project concludes, we anticipate a gradual decrease in BPO's contribution to approximately 20%. Conversely, while Digital Business saw its lowest contribution at 55% in 2021, it has been steadily climbing, reaching 73% in the first nine months of 2023. Looking ahead to FY23-28e, we forecast Digital Business to lead with a robust growth rate of 22%, followed by Professional Services and BPO at 11% and 9% CAGR, respectively, resulting in an overall 5-year revenue CAGR of 19%.

Cost and gross margin analysis: Between 2018 and 2021, the group maintained an average gross margin of 35%. However, this margin saw a notable increase to 41% in 2022 and has remained stable at a similar level through 9M23. This upward trend can largely be attributed to the decreasing contribution of BPO services in the revenue mix. BPO services, being labour-intensive, incur higher costs related to employee expenses. Consequently, the proportion of employee costs within the cost of sales decreased to 53% in 2022 from an average of 57% between 2018 and 2021. We anticipate that as the contribution of BPO to revenues diminishes, the proportion of employee costs within the cost of sales may decline further to around 40%, although it is expected to experience a slight increase in the long term due to wage inflation. Nevertheless, this trend is forecasted to have a positive impact on the group's gross margins, potentially increasing them from the current 41% (9M23) to approximately 45% by 2030.

Expected Credit Losses expense: The provision expense has typically represented an average of 1.5% of group revenues. However, it began to escalate during the COVID period, reaching its peak at 3.2% in 2022. Nonetheless, it has started to stabilize in the first three quarters of 2023, with an average expense of 1.5% as a percentage of sales. We anticipate that this cost category should continue to normalize and eventually decrease below the 1.5% threshold.

Selling and Distribution Expenses: Elm allocated an average of 4.3% of its revenues to marketing, selling, and distribution efforts during the period from 2018 to 2022. We anticipate that the proportion of marketing expenses will remain consistent relative to revenues. However, in absolute terms, these expenses are expected to increase in tandem with the expanding topline, with a projected CAGR of 15% between 2023 and 2028, thereby supporting the group's expansion initiatives.

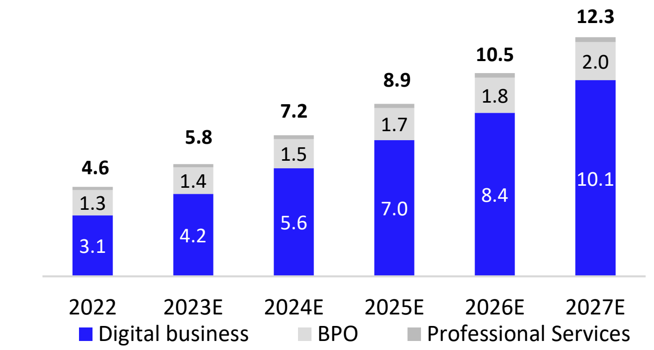
General & administrative expenses Furthermore, General and Administrative (G&A) expenses represent the largest operating expense for the group, averaging 9.5% of the group's sales during 2018-22. As sales increase over time, the proportion of G&A expenses is expected to decrease. Nevertheless, in absolute terms, they may experience an increase at a CAGR of 15% between 2023 and 2028.

Working Capital: The group has demonstrated a commendable 19% Compound Annual Growth Rate (CAGR) from 2018 to 2022, aligning with its increasing revenues. We anticipate that the working capital will continue to expand at a CAGR of 13% between 2023 and 2028. With a robust cash balance of SAR0.6bn in 2022, the group is well-positioned to fund its working capital needs through internal resources.

Capex: The group allocated an average of 3.2% of its revenues to capital expenditures (Capex) between 2018 and 2022. Capex expenses reached their peak in 2020, with the group dedicating 5.5% of its sales to Capex. We anticipate that the percentage spent on Property, Plant, and Equipment (PPE) will remain close to historical averages over the next couple of years before stabilizing at a lower rate in the long term.

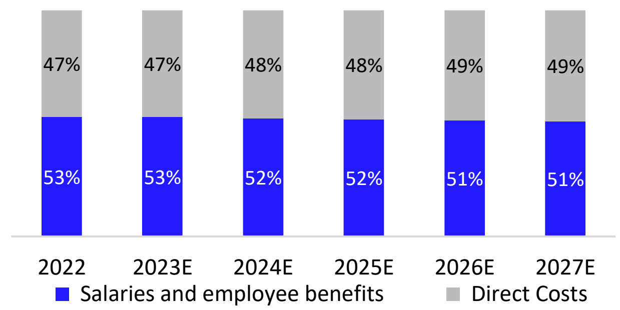
Debt: ELM is a company free of debt, presenting an ideal opportunity to finance inorganic expansion.

Figure 7 **Revenue by segment (SARbn)**



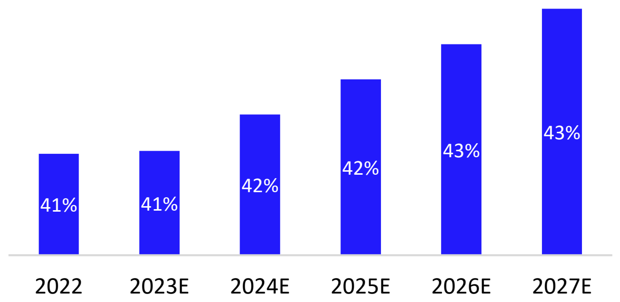
Source: Company Data, Al Rajhi Capital Estimates

Figure 8 **Cost Bifurcation**



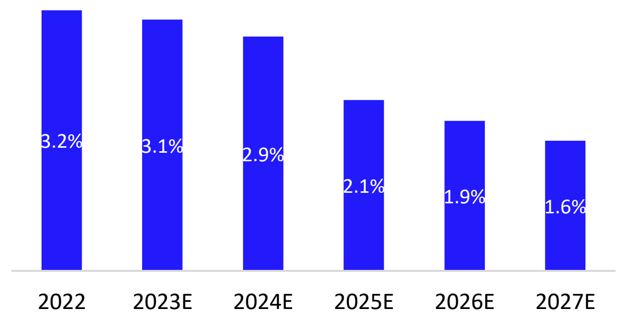
Source: Company Data, Al Rajhi Capital Estimates

Figure 9 **Gross margin evolution**



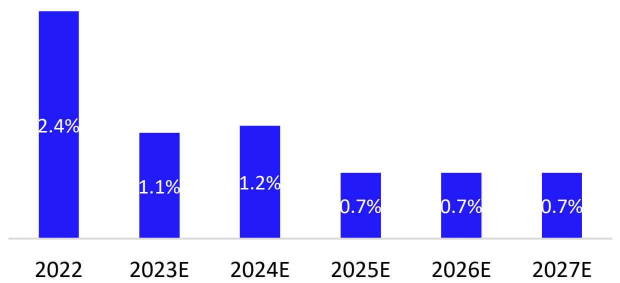
Source: Company Data, Al Rajhi Capital Estimates

Figure 10 **ECL as % of revenues**



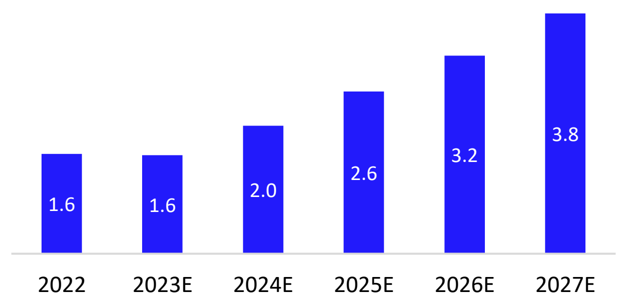
Source: Company Data, Al Rajhi Capital Estimates

Figure 11 **Capex as % of sales**



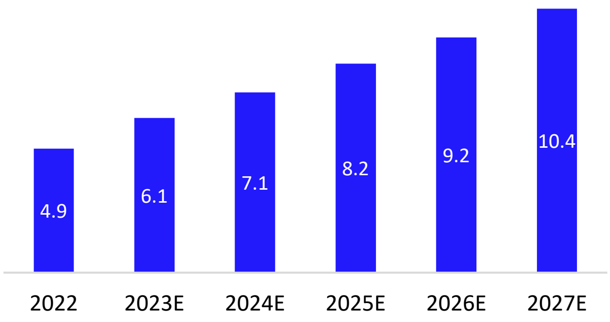
Source: Company Data, Al Rajhi Capital Estimates

Figure 12 **FCF (SARbn)**



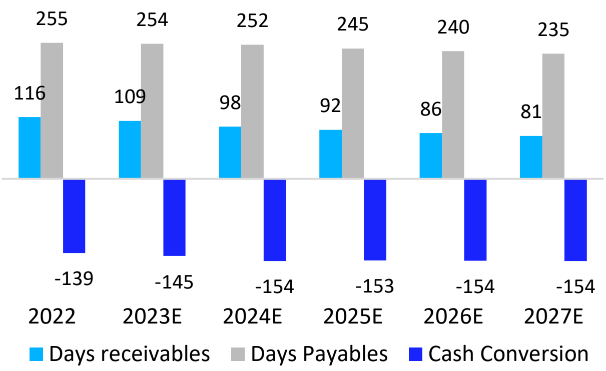
Source: Company Data, Al Rajhi Capital Estimates

Figure 13 **Working capital evolution (SARbn)**



Source: Company Data, Al Rajhi Capital Estimates

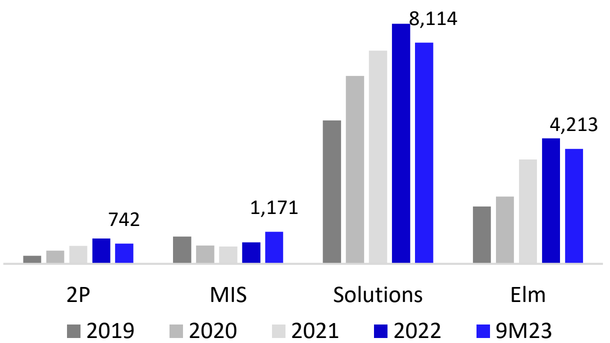
Figure 14 **Cash Conversion cycle**



Source: Company Data, Al Rajhi Capital Estimates

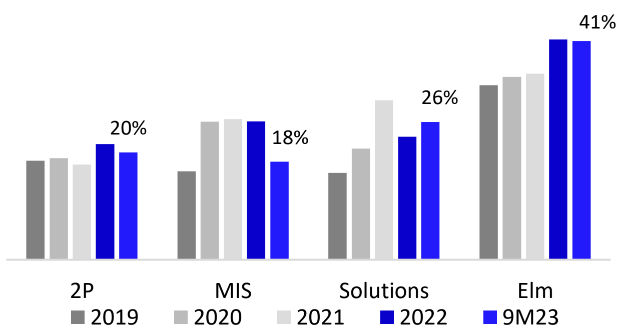
Listed Competitors in Charts

Figure 15 **KSA IT Revenues (SARmn)**



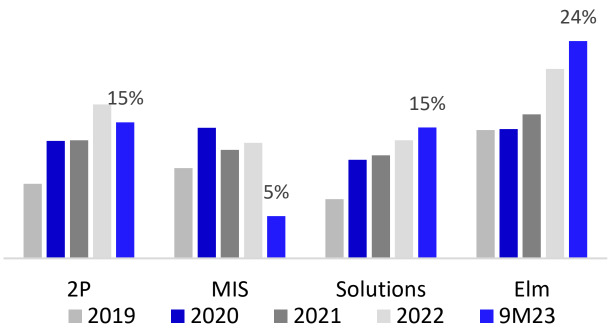
Source: Company Data

Figure 16 **KSA IT Gross Margins**



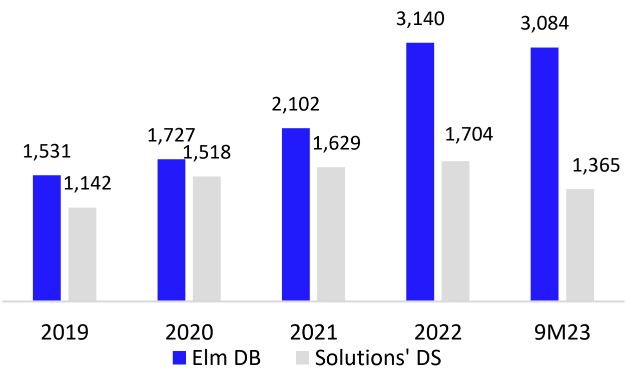
Source: Company Data

Figure 17 **KSA IT operating margins**



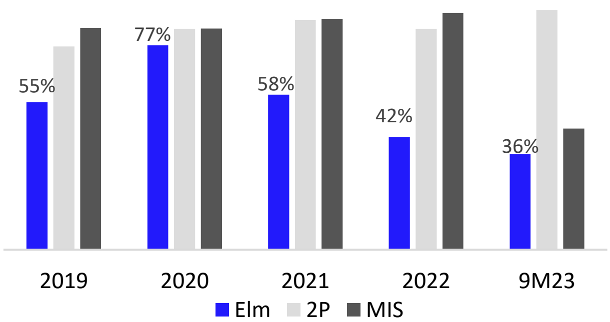
Source: Company Data

Figure 18 **Elm vs Solutions Digital Segments (SARmn)**



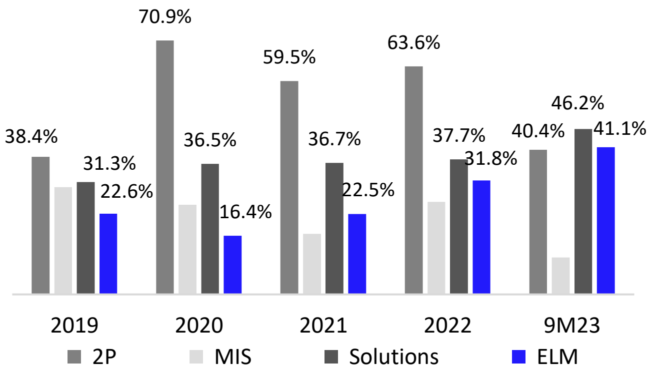
Source: Company Data

Figure 19 **KSA IT revenue Government contribution**



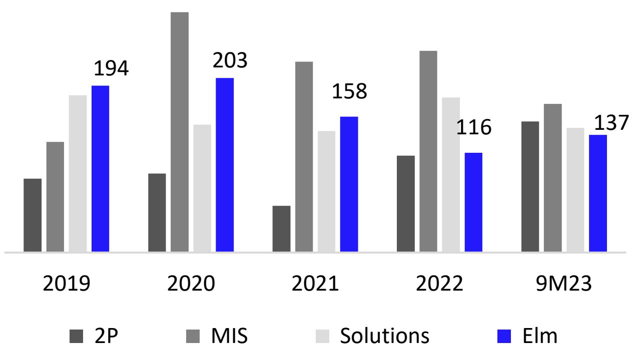
Source: Company Data

Figure 20 **KSA IT ROE**



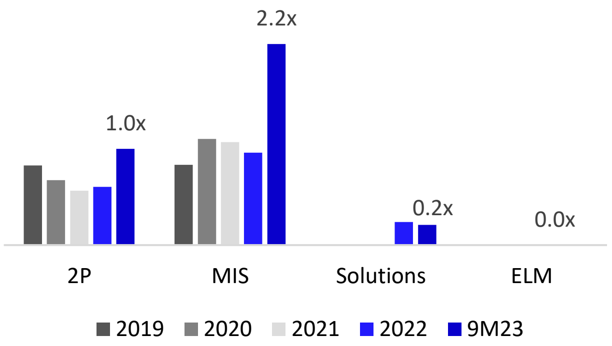
Source: Company Data

Figure 21 **Receivable Days**



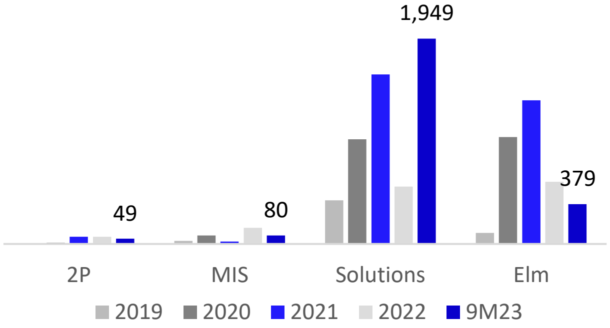
Source: Company Data

Figure 22 **Debt/Equity**



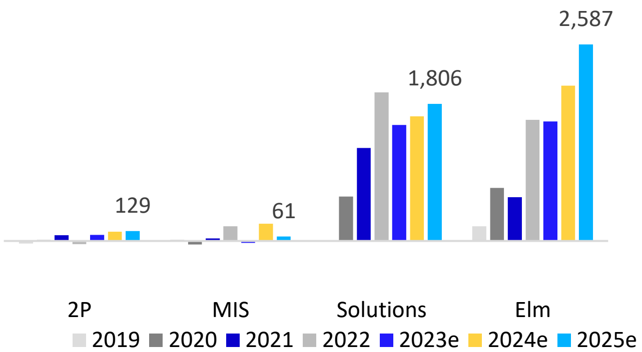
Source: Company Data

Figure 23 **KSA IT company Cash (SARmn)**



Source: Company Data

Figure 24 **FCF (SARmn)**



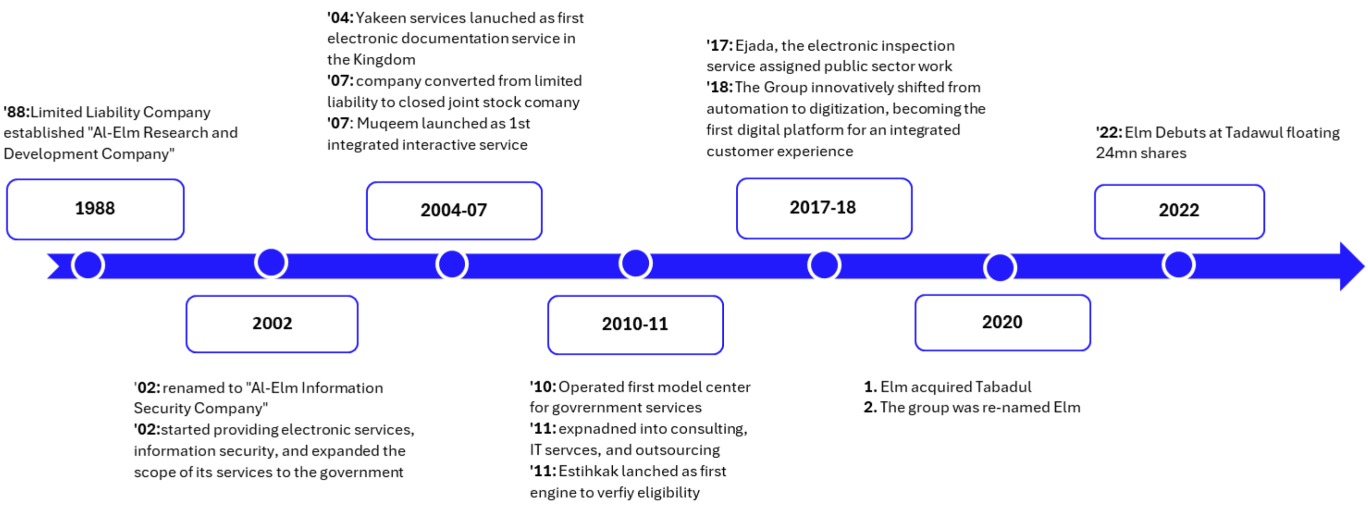
Source: Company Data

Disclosures: Please refer to the important disclosures at the back of this report.

Company Overview

Elm Company was established in 1988, changed to its current name in 2020. Previously, it categorized its revenues across Products Suites, Business Process Outsourcing (BPO), Digital Delivery Suite, Professional Services, and Nationalization & Upskilling. The group presently classifies its business activities into three primary segments:

Figure 25 **Elm Timeline**



Source: Company IPO prospectus, Al Rajhi Capital

Digital Business (DB): In the DB segment, the group offers custom technical as well as product-based solutions.

In the Technical Services category, the company provides technical solutions that meticulously analyze problems at their core and deliver the requisite products utilizing cutting-edge digital technology tailored to suit societal needs. Elm adopts an approach that doesn't rely on importing solutions but, instead, addresses customer requirements by leveraging top-notch technical solutions and national expertise. The company strives to thoroughly comprehend problems and implement effective solutions. Some of the examples of solutions provided in this category are formulating restructuring plans, implementing, and managing changes, re-engineering procedures, quality control, development, and training. Additionally, the services extend to areas like e-security, e-portal development, system development and operation, and facilitating interconnections between government and non-governmental entities, with a focus on processing technical infrastructure.

The Products category encompasses over 30 offerings spanning various functional domains such as security, transportation, health, and management. The company specializes in developing solutions in the form of Technical Services, Portals, E-Products, and associated support. Collaborating with public, private, and governmental entities, the company has successfully crafted sophisticated services that address existing challenges and bridge service gaps by transitioning traditional procedures into electronic transactions. These solutions are conveniently accessible through direct subscription to a range of packages and are customizable to meet the specific preferences of the customer. Some of the group's key products are:

- **Absher:** The foremost electronic services platform in the Kingdom, initiated its journey in 2010 by offering Ministry of Interior services to individuals, marking the Kingdom's initial steps towards digital transformation. Now integral to achieving Vision 2030, Absher expanded its services to include Absher - Business for the private sector and Absher - Government for other governmental entities. Operated under a NIC-led system, Elm spearheaded the platform's development to enhance work processes and automate services, benefiting citizens, residents, visitors, as well as business and government sectors.

- **Fasah:** A unified electronic gateway for import and export operations, streamlines international trade processes by automating procedures, enabling all stakeholders to submit necessary information and documents at a centralized point to meet regulatory requirements for import, export, and transit. Serving a vast network of over 44,000 importers and exporters, 3,000 customs brokers, 13 port operators, 150 freight forwarders, 30 car dealers, and 40 private laboratories, Fasah significantly enhances efficiency and transparency in trade facilitation.

- **Yakeen:** Facilitates entities in verifying the information of individuals they engage with, including customers, visitors, employees, and applicants. This not only diminishes the risks of fraud and impersonation but also ensures the acquisition of updated data aligning with official records. Through this verification process, Yakeen enhances the overall quality of data, resulting in more accurate and reliable information. Furthermore, it streamlines transaction processes by significantly reducing the time and effort required for their completion).

- **Muqeem:** The "Muqeem" service provides organizations with the convenience of reviewing resident workers' data and conducting transactions seamlessly online, from any location and at any time. Users can issue, cancel, re-print single exit re-entry visas, or finalize exit visas. The service also allows for the issuance or renewal of various residence permits, review and printing of passports or Traffic Department reports, and access to interactive services, subscriptions, transactions, and payments. Additional features include sponsorship transfers, profession modifications, residence permit printing, and the completion of different forms, which can be electronically filled out by entering the Iqama number.

- **Tamm:** Provides vehicle owners in Saudi Arabia with a convenient platform to access real-time information about their vehicles directly from official government sources. Users can inquire about vehicle details, add or cancel the actual driver, check paid traffic fines, review vehicle insurance, issue or cancel international driver authorization, verify new vehicle information, inspect vehicle VIN numbers, review driving licenses, issue or cancel driver authorization, verify vehicle and owner data, and facilitate the issuance and renewal of driving licenses. This comprehensive service streamlines various aspects of vehicle management and regulatory compliance for users.

- **Nusuk**: Nusuk is an app that helps people plan their trip to important religious sites like Makkah and Madina for Umrah. It's the first app of its kind that's officially recognized. With Nusuk, anyone from anywhere can easily plan their whole trip, starting from applying for the necessary visa to booking hotels and flights. It's like having a travel planner in your pocket, making it simpler and smoother to organize your journey.

BPO: This segment involves managing and fully operating, or providing partial support for, services in specific domains. Additionally, the Group is strategically transitioning towards digital visualization as part of its ongoing efforts to stay at the forefront of industry trends and innovations.

Professional Services: The group provides Consultancy Services which meticulously evaluate the identified problem, seeking optimal global practices to effectively address it. The process involves a thorough comparison to derive practical ideas and identify administrative and technical methods that align with the best practices globally. The goal is to ascertain internationally accepted standards across various fields of work, ensuring a comprehensive and informed approach to problem-solving. This also includes data analysis services.

Key Financials

Figure 26 **Income Statement**

SAR mn	2023E	2024E	2025E
Revenue	**5,766**	**7,249**	**8,870**
y-o-y growth	*25.2%*	*25.7%*	*22.4%*
Cost of Sales	(3,403)	(4,241)	(5,144)
Gross Profit	**2,363**	**3,008**	**3,725**
y-o-y growth	*25.3%*	*27.3%*	*23.8%*
margins	*41.0%*	*41.5%*	*42.0%*
Selling and marketing expense	(315)	(370)	(442)
General & administrative expense	(471)	(594)	(690)
ECL & Other expenses	(180)	(210)	(188)
EBITDA	**1,398**	**1,834**	**2,406**
D&A	(142)	(160)	(161)
Operating Profit	**1,256**	**1,674**	**2,245**
y-o-y growth	*29.1%*	*33.3%*	*34.1%*
margins	*21.8%*	*23.1%*	*25.3%*
Interest income	127	126	128
Interest expenses	(5)	(4)	(5)
Other	24	24	15
Pre-Tax Income	**1,402**	**1,820**	**2,384**
Zakat	(125)	(137)	(202)
Net Income	**1,277**	**1,683**	**2,182**
y-o-y growth	*37.2%*	*31.8%*	*29.7%*
margins	*22.1%*	*23.2%*	*24.6%*
EPS	16.0	21.0	27.3

Source: Al Rajhi Capital estimates

Figure 27 **Balance sheet**

SAR mn	2023E	2024E	2025E
Accounts Receivables	1,722	1,943	2,232
Contract Assets	1,060	1,204	1,342
Prepaid Expenses and other current assets	280	326	355
Other Financial assets	33	33	33
Murabaha deposits	2,428	2,428	2,428
Cash and Cash Equivalents	1,066	2,430	4,303
TOTAL CURRENT ASSETS	**6,588**	**8,364**	**10,692**
Property and Equipment	370	416	435
Capital WIP	128	182	162
ROU	145	156	172
Intangible Assets	166	163	182
Investment in associates	0	1	1
Other financial assets	231	231	231
TOTAL NON-CURRENT ASSETS	**1,040**	**1,149**	**1,184**
TOTAL ASSETS	**7,629**	**9,513**	**11,877**
Accounts payable and other current liabilities	2,369	2,930	3,453
Contract liabilities	621	652	798
Zakat	192	225	248
Liabilities of purchasing property	25	25	25
Lease liabilities	13	12	13
Due to related parties	31	36	44
CURRENT LIABILITIES	**3,252**	**3,880**	**4,581**
Lease liabilities	121	104	113
End of service benefits provision	378	447	508
NON-CURRENT LIABILITIES	**498**	**551**	**620**
SHAREHOLDERS EQUITY	**3,879**	**5,081**	**6,675**
TOTAL LIABILITIES	**7,629**	**9,513**	**11,877**

Source: Al Rajhi Capital estimates

Figure 28 **Cash Flow Statement**

SAR mn	2023E	2024E	2025E
Cash flow from Operations	1,638	2,130	2,649
Cash flow from Investing	(653)	(232)	(151)
Cash flow from Financing	(508)	(534)	(624)
Change in cash	477	1,364	1,874

Source: Al Rajhi Capital estimates

Figure 29 **Key Ratios**

	2023E	2024E	2025E
ROA (%)	36.9%	37.6%	37.1%
ROE (%)	16.7%	17.7%	18.4%
P/E	64.8x	49.1x	37.9x
EV/EBITDA	57.3x	43.7x	33.3x
Dividend yield	1.9%	2.5%	3.1%
Receiveable days	109	98	92
Payable days	254	252	245

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.

"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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