Perfect Presentation for Commercial Services Co.

Investment Update

Perfect Presentation: After a 55.4% total return on our initial recommendation, we revise our rating to "Neutral"; upgrade TP to SAR 212.0/share

Perfect Presentation (2P) has gone from strength to strength in the past few years. The company has done well to reap the benefits of huge potential in the sector, which has resulted in robust growth in the number of contracts and backlog. Given the company's expected recognition of existing backlogs and a further inflow of new projects, we expect strong topline growth in the next two years. Additionally, the company's entry into new business lines is expected to help diversify revenue stream, improve working capital conditions, and further and open new growth opportunities. We also believe that the company is likely to deliver healthy margins, as it is well versed to cater to additional projects with existing capacity.

2P posted a strong set of results for Q4-22. The company's revenue grew 26.3% Y/Y (+38.9 Q/Q) to reach SAR 288.1mn, primarily driven by growth in the Operating and Maintenance (O&M) segment, which was the chief contributor towards the top line in FY22. GP margin witnessed an expansion of 176bps Y/Y (-26bps Q/Q) supported by the volume of contracts with shared services being able to allocate costs among different business functions, as the firm indicated an initiative towards 'lean' operations to utilize operational capacity. Bottom line increased 11.4% Y/Y (+43.8% Q/Q) to SAR 46.4mn, supported by the increase in revenue and GP margin expansion, to post the second highest net income margin of 16.1% among its sector peers; 13bps away from the highest among its peers.

A surge in the number of contracts and backlog, and impressive win rate are expected deliver double digit growth in FY23-24. 2P's contracts with its clients doubled during FY19-22, while the backlog expanded 2.9x during the same period. Out of the existing backlog of SAR 1,730mn almost 80% is expected to be recognized by FY24, thus providing a good revenue visibility in the short-to-medium term. Additionally, the company has developed relations with existing clients and has a solid track record of executing government contracts, which along with an impressive win rate of 70% would keep the inflow of new contracts. Thus, we forecast a revenue CAGR of 17.5% during FY22-24.

2P operates in a sector with wide headroom for penetrating market share in its existing business lines, and the additional business lines are set to take off in FY23 and FY24. As of FY22, the firm's chief contributor towards revenues is its Operating and Maintenance (O&M) segment. The O&M segment grew by 66.5% Y/Y in FY22 to constitute 38% of FY22 revenues. All other segments grew momentously for the same period as well; Software & Development by 62.2% Y/Y in FY22, and Customer Experience (CX) slowing its yearly momentum at 14.0% Y/Y growth, both being outpaced by O&M. The increase in volume in the long contract O&M business did however increase the segment's GP Margin by almost 300bps by years end from 2019 levels. With management indicating towards a lean-operations style of management, and indicating further capacity available among its existing workforce, we expect margins to improve in the long run after facing a brief stepping cost from rolling off its new Networking and Cyber Security segments (set to contribute to revenue in FY24 after being prepared for throughout FY23). In addition to the new channels to be introduced, 2P expects to roll out its IoT B2C smart home business, which aims to improve the firm's receivables and thus working capital and liquidity from instant payments from retail consumers.

Recommendation	**Neutral**
Target Price (SAR)	**212.0**
Upside / (Downside)*	**-1.4%**

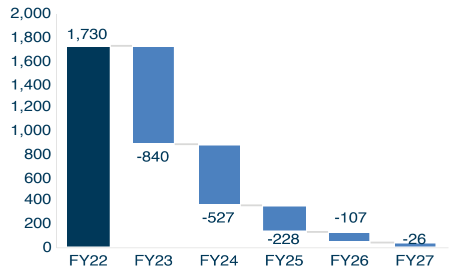
Source: Tadawul *prices as of 3rd April 2023

Key Financials

SARmn (unless specified)	FY21	FY22	FY23E	FY24E
Revenue	655	927	1,143	1,280
Growth %	35.9%	41.4%	23.3%	12.0%
Gross Profit	116	180	227	257
Net Profit	81	131	161	184
Growth %	25.2%	62.8%	22.1%	14.6%
EPS	40.37	8.75	10.70	12.26

Source: Company reports, AlJazira Capital

Backlog and expected revenue recognition (in Mn)



Source: AlJazira Capital, Company reports

Key Ratios

	FY21	FY22	FY23E	FY24E
GP Margin	17.7%	19.5%	19.9%	20.1%
Net Margin	12.3%	14.2%	14.0%	14.4%
P/E (x)	NM	20.0	20.1	17.5
P/B (x)	NM	10.4	8.8	6.6
EV/EBITDA (x)	NM	19.1	18.4	15.8
Div Yield (%)	NM	1.4%	1.5%	2.0%

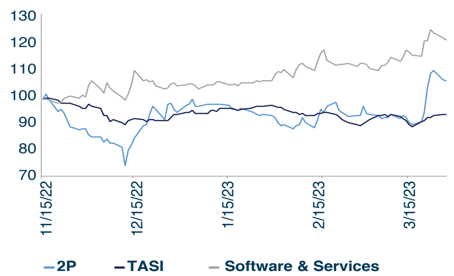
Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (SAR bn)	3.23
YTD %	22.7
52 Week (High / Low)	222.0/137.8
Shares Outstanding (mn)	15

Source: Company reports, Aljazira Capital

Price Performance



Source: Tadawul, Aljazira Capital

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Working capital conditions remain an overarching theme for 2P. The firm's receivables collection days rose to 112.8 days (TTM), while still favorably the lowest among its peers, it continues to impede the firm's working capital position; which constricted its operating cashflows to a deficit for the year. A 97% of 2P's total debt of SAR 157.4mn is thus dedicated to short term facilities to manage its working capital conditions. However, the firm has historically managed an interest coverage of 20.72x throughout the past three years; 2P's profitability will be able to widely absorb future finance costs from the increased debt taken on by the firm (2P signed for increasing credit facilities to be worth almost SAR 285mn in FY22). While receivables days are positively lower than the sector's median of 152 days (FY22), an improvement in the firm's receivable days and working capital conditions could improve the stock's valuation. 2P still remains attractive in its return profile, leading the sector at an ROAE of 63.6% (FY22), and an ROAA of 20.9%. We await to observe the roles the new business lines will have in the firm's revenue, and working capital structures in the coming periods as well.

Q4-22 Conference Call Takeaways:

- **R&D costs for the B2C IoT business have already been incurred** and are expected to be operational by Q4-23 after receiving regulatory approvals.
- **Hiring and preparation for the Cybersecurity segment began early this year.** Networking segment to begin being built by Q3-23. Both segments are expected to be operational by FY24.
- **Management open to growth via acquiring businesses.**
- **Dividend policy** to continue.
- **Management expects margins to be supported** by existing headroom for output capacity from its teams able to service contracts.
- **CX segment in place to benefit from the Quality of Life** Vision 2030 initiative.

AJC view and valuation: We believe that 2P is likely to continue its growth momentum on the back of solid business fundamentals and a positive sector outlook. The company has further strengthened its position in the Customer experience segment. O&M and Software development have seen good traction and are expected to be key growth drivers in the future. However, the company's growth prospects seem to be factored in at the current market price, which has increased by 55.4% since our initial recommendation. Based on our updated estimates, post FY22 earnings and using blended valuation with 50% weightage to DCF and 25% each to FY23E EV/EBITDA (16.7x) and P/E (22.0x) multiples, we arrive at a TP of **SAR 212.0/share.** Thus, we revise our recommendation to "**Neutral**".

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Key Financial Table

Amount in SAR mn, unless otherwise specified	FY20	FY21	FY22	FY23E	FY4E	FY25E
Income statement						
Revenues	482	655	927	1,143	1,280	1,367
Y/Y	**61.8%**	**35.9%**	**41.4%**	**23.3%**	**12.0%**	**6.8%**
Cost	(391)	(539)	(747)	(916)	(1,022)	(1,091)
Gross profit	**91**	**116**	**180**	**227**	**257**	**276**
Operating Expenses						
Selling and distribution expenses	(5)	(8)	(9)	(11)	(12)	(13)
General and administrative expenses	(20)	(20)	(29)	(36)	(40)	(43)
Impairment loss in trade receivables	(3)	(2)	(4)	(5)	(6)	(6)
Operating profit	**63**	**86**	**138**	**175**	**199**	**214**
Y/Y	**155.1%**	**36.6%**	**60.1%**	**26.6%**	**13.9%**	**7.5%**
Financing Expense (net)	(2)	(4)	(4)	(8)	(8)	(8)
Other income/expenses	5	2	2	-	-	-
Income before zakat	**66**	**84**	**136**	**166**	**191**	**206**
Zakat	(2)	(4)	(5)	(6)	(7)	(7)
Net income	**65**	**81**	**131**	**161**	**184**	**199**
Y/Y	**179.4%**	**25.2%**	**62.8%**	**22.1%**	**14.6%**	**8.2%**
Balance sheet						
Assets						
Total current assets	218	383	673	861	1,021	1,134
Property plant & equipment	98	117	131	148	163	177
Other non-current assets	1	2	3	3	3	3
Total assets	**317**	**501**	**807**	**1,012**	**1,188**	**1,314**
Liabilities & owners' equity						
Total current liabilities	182	313	522	611	665	667
Total non-current liabilities	24	28	32	34	37	42
Paid -up capital	20	20	150	150	150	150
Retained earnings	78	127	90	187	288	387
Total owners' equity	111	160	254	366	486	605
Total equity & liabilities	**317**	**501**	**807**	**1,012**	**1,188**	**1,314**
Cashflow statement						
Operating activities	49	97	(22)	79	163	174
Investing activities	(37)	(22)	(20)	(21)	(21)	(19)
Financing activities	(5)	(16)	40	(30)	(47)	(91)
Change in cash	7	59	(2)	27	94	63
Ending cash balance	**11**	**69**	**67**	**95**	**189**	**252**
Liquidity ratios						
Current ratio (x)	1.2	1.2	1.3	1.4	1.5	1.7
Quick ratio (x)	1.2	1.2	1.3	1.4	1.5	1.7
Profitability ratios						
Gross profit margin	18.9%	17.7%	19.5%	19.9%	20.1%	20.2%
Operating margin	13.1%	13.2%	14.9%	15.3%	15.5%	15.6%
EBITDA margin	13.6%	13.6%	15.4%	15.7%	16.0%	16.1%
Net profit margin	13.4%	12.3%	14.2%	14.0%	14.4%	14.6%
Return on assets	24.9%	19.7%	20.1%	17.7%	16.7%	15.9%
Return on equity	71.0%	59.6%	63.6%	51.8%	43.2%	36.5%
Leverage ratio						
Debt / equity (x)	0.7	0.6	0.6	0.5	0.4	0.3
Market/valuation ratios						
EV/sales (x)	NM	NM	2.9	2.9	2.5	2.3
EV/EBITDA (x)	NM	NM	19.1	18.4	15.8	14.4
EPS (SAR)	32.3	40.4	8.8	10.7	12.3	13.3
BVPS (SAR)	55.6	79.9	16.9	24.4	32.4	40.3
Market price (SAR)*	NM	NM	175	215	215	215
Market-Cap (SAR mn)	NM	NM	2,628	3,225	3,225	3,225
P/E ratio (x)	NM	NM	20.0	20.1	17.5	16.2
P/BV ratio (x)	NM	NM	10.4	8.8	6.6	5.3

Source: Company filings, AlJazira Capital Research
Note: * Updated based on Interim Results

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RESEARCH DIVISION

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RATING TERMINOLOGY

1. Overweight: This rating implies that the stock is currently trading at a discount to its 12 months price target. Stocks rated "Overweight" will typically provide an upside potential of over 10% from the current price levels over next twelve months.
2. Underweight: This rating implies that the stock is currently trading at a premium to its 12 months price target. Stocks rated "Underweight" would typically decline by over 10% from the current price levels over next twelve months.
3. Neutral: The rating implies that the stock is trading in the proximate range of its 12 months price target. Stocks rated "Neutral" is expected to stagnate within +/- 10% range from the current price levels over next twelve months.
4. Suspension of rating or rating on hold (SR/RH): This basically implies suspension of a rating pending further analysis of a material change in the fundamentals of the company.

Disclaimer