Solutions by STC

P&L beat. FCF underwhelming.

30 October 2023 | Equity | Saudi Arabia | Computer Services

SOLUTION AB

Maintain Rating	Price	Price Objective	Upside	Market Cap	Average Daily Value
UNDERPERFORM	304.20	295.00	-3.0%	36,504	10.92
	SAR	SAR		SAR(mn)	USD(mn)

all data as of 30 October 2023

Key takeaways

- Solutions delivered 37 % top line growth in 3Q23 but ex M&A we think this is below 10%
- Gross profit was up 4 p.p. We question the sustainability of such performance going forward
- FCF delivery was muted. We maintain our Underperform rating.

Maintain Underperform post mixed results

4 key takeaways from Solutions 3Q23 results (based on the company's release as full financials not yet available): i) revenue +37.1% Y/Y, 0.7 above BofAe ii) EBITDA +40.4% Y/Y, 7.4% above BofAe. iii) net income +29.0 Y/Y, 7.2% above BofAe iv) 3Q23 FCF was 61% below BofAe v) Whilst 3Q Revenue/EBITDA/EPS were 2.2/12.4/12.5% above company compiled consensus BofA we would be cautious on assuming that gross profit uptick in 3Q23 is sustainable We maintain our Underperform rating with 6% downside to our SAR295 PO

M&A was a key growth driver. Digital disappoints

3Q23 revenue grew 37.1% Y/Y to SAR2795m vs +29.5% in 2Q23. We think organic growth was <10% versus 3/6% in 2Q/1Q23. Segment wise: (i) core ICT services were 7.7% ahead BofAe and grew 45.4% Y/Y vs 28.9% in 2Q23. Assuming 100% of Giza is booked there, organic revenue growth was likely c.4% Y/Y vs -7.1% in 2Q. (ii) IT managed and operational services were 2.1% above BofAe and grew 53.1% Y/Y vs 40.8% in 2Q23. Assuming 100% of CCC is booked there, organic revenue growth was 29.6% vs 13.0% in 2Q23 (iii) Digital services revenue was 19.6% below BofAe and decreased 4.0% Y/Y vs +15.8%/+13.7% in 2Q23/1Q23

Gross profit & EBITDA margin tick upward

Gross margin was 14.7% above BofAe likely driven by softer lower-margin digital business and gross profit margin increased by 4 p.p to 28.5% in 3Q23 driven by revenue mix, cost optimization and some high margin projects. EBITDA margin was 18.5% up 40bps Y/Y and EBITDA was 7.4% above BofAe,

EPS growth below EBITDA but improving QOQ

Net income was SAR387m +29% Y/Y up from 25% Y/Y in 2Q23. This is faster than Elm at +18% for 3Q23 but includes CCC/Giza consolidation.

FCF generation muted

Solutions reported SAR141m FCF (vs SAR359m BofAe), which compares with SAR1,098m in 3Q22 and SAR60m in 2Q23. With net income 2.75x higher than income we think working capital outflows might form part of the explanation. The company also mentioned an investment in Nile during the quarter (one-off) as well as an increase in contract asset.Net cash position has reduced to -SAR1.9bn from -SAR2.3bn in 2Q23.

Stock Data

Price	304.20 SAR
Price Objective	295.00 SAR
Date Established	17-Oct-2023
Investment Opinion	B-3-7
52-Week Range	216.80 SAR-392.20 SAR
Mrkt Val / Shares Out (mn)	36,504 SAR / 120.0
Average Daily Value (mn)	10.92 USD
Free Float	20.0%
BofA Ticker / Exchange	XMETF / SAU
Bloomberg / Reuters	SOLUTION AB / 7202.SE
ROE (2023E)	40.8%
Net Dbt to Eqty (Dec2022A)	-95.6%

3Q23 results review

Exhibit 1: Solutions 3Q23 results review
Revenue 2.2 above consensus, Net income 12.5%

SAR m	3Q23A	3Q23E	A vs E	3Q22A
Revenue	2,795	2,775	0.7%	2,039
Core ICT Services	1,474	1,369	7.7%	1,014
IT Managed and Operational Services	897	879	2.1%	586
Digital Services	424	527	-19.6%	439
Cost of revenue	(1,999)	(2,081)	-3.9%	(1,540)
Gross profit	796	694	14.7%	499
Gross margin	28.5%	25.0%	3.5pp	24.5%
OpEx incl. D&A	(358)	(283)	26.5%	(186)
Operating Profit (EBIT)	438	411	6.7%	313
D&A	(79)	(71)	11.6%	(55)

EBITDA margin	18.5%	17.4%	1.1pp	18.1%
Net profit	387	361	7.2%	300
Net margin	13.8%	13.0%	0.8pp	14.7%
Capex	(41)	(55)	-26.1%	(30)
As % of revenue	1.5%	2.0%	-0.5pp	1.5%
FCF (Co definition)	141	359	-60.7%	1,098
FCF margin	5.0%	12.9%	-7.9pp	53.9%
Net debt/(cash) - Co definition (ex-leases)	(1,908)	(2,716)	-29.7%	(2,818)

Source: Company report, BofA Global Research estimates, Company for consensus

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Price Objective Basis & Risk

Solutions by STC (XMETF)

Our discounted cash flow (DCF)-based price objective (PO) is SAR295. We assume a terminal growth of 3.0% and weighted-average cost of capital (WACC) of 8.8%. We see the following upside risks to our PO: (i) Saudi digitalization spending (including in the public sector) growing faster than expected, (ii) wider than forecasted margin expansion driven by operating leverage and revenue mix, (iii) the cloud business tracking ahead of expectations that might warrant higher stock multiples, (iv) better working capital trends, so FCF generation. Downside risks are: (i) faster transition to the cloud pressuring core ICT and managed services, (ii) volatile Saudi and Egypt macro, (iii) intensifying competition with local and international players, (iv) more competition could mean higher employee attrition and so pressure on personnel expenses, (v) execution risks related to the acquisition of Giza Systems.

Analyst Certification

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