

October 13, 2023 04:00 PM GMT

Solutions by STC | Europe

Risk Reward Update

WHAT'S CHANGED

Solutions by STC (7202.SE)	From	To
Price Target	SAR 303.00	SAR 305.00
Bull Case	SAR 406.00	SAR 410.00
Base Case	SAR 303.00	SAR 305.00
Bear Case	SAR 180.00	SAR 182.00

Updated Components

EPS
Investment Thesis
Bull Base Bear Scenarios

Risk Reward for Solutions by STC (7202.SE) has been updated

Reason for change

Forecasts updated ahead of 3Q earnings season. For 3Q, we look for c. 38% total growth (c. 12% organic), with revenues reaching SAR 2,819m (c. 1% above consensus). Our EBITDA forecast of SAR 441m is c. 2% below consensus at SAR 452m, and our stated net income forecast of SAR 332m is c. 3.5% below consensus at SAR 344m. However, we would note that the consensus we reference is Visible Alpha, which has a low number of contributors into the metrics. On the back of recent contract wins around managed services, we have moderately increased our IT Managed and Operational Services forecasts, into the 11-13% corridor for both FY23 and FY24. Combined with updated net financial result forecasts, our adj. diluted EPS forecasts are upgraded c. 2% across FY24-26 (c. 1% for FY23). Reflecting the above and other minor changes, our DCF-derived price target tracks slightly higher to SAR 305 (from SAR 303).

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Solutions by STC (7202.SE, SOLUTION AB)

EEMEA - Technology | Saudi Arabia

Stock Rating	Equal-weight
Industry View	No Rating
Price target	SAR 305.00
Shr price, close (Oct 12, 2023)	SAR 308.80
52-Week Range	SAR 385.00- 216.80

Fiscal Year Ending	12/22	12/23e	12/24e	12/25e
EPS (SAR)**	8.97	11.99	12.32	13.54
Prior EPS (SAR)**	-	11.89	12.13	13.30

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework

** = Based on consensus methodology

e = Morgan Stanley Research estimates

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Risk Reward – Solutions by STC (7202.SE)

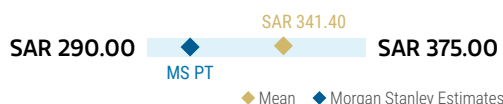
Valuation captures Solutions' KSA ICT services market leadership position

PRICE TARGET SAR 305.00

We value Solutions by STC with a 10-year DCF, using a WACC of 8.5%, and a 2.5% terminal growth rate.

Consensus Price Target Distribution

Source: Refinitiv, Morgan Stanley Research



RISK REWARD CHART



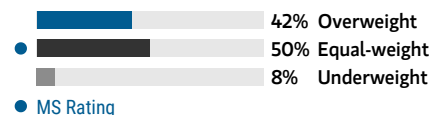
Key: — Historical Stock Performance ● Current Stock Price ◆ Price Target

Source: Refinitiv, Morgan Stanley Research

EQUAL-WEIGHT THESIS

- Strongly positioned to help enable KSA Vision 2030 by enabling technology adoption in the public and private sectors.
- We forecast Solutions to grow revenues organically at a c. 9.5% CAGR FY23-26, slightly ahead of its underlying market growth rate. In the context of IT services, this represents a relatively high rate of growth, reflecting KSA's earlier positioning on the IT adoption maturity curve.
- We continue to expect some cost re-emergence post COVID-19 pandemic and gross margin volatility (as has historically been the case). We expect adj. EBIT margins to remain broadly around the low-teens % level.
- We see the current valuation as fairly capturing the baseline growth opportunity.

Consensus Rating Distribution



Source: Refinitiv, Morgan Stanley Research

Risk Reward Themes

Secular Growth: *Positive*

View descriptions of Risk Rewards Themes [here](#)

BULL CASE

SAR 410.00

Double-digit organic growth momentum

As was the case over FY19-22, Solutions continues to win large new ICT contracts, driving growth materially above the company's guidance. We forecast c. 29% total growth in FY24 and c. 17% in FY25 (vs. 11% in our base case). Operating leverage drives adj. EBIT margins higher and Solutions sustains >13% margins through the mid-term, and reaches ~14.5% in terminal state. The FY23-26 revenue growth CAGR is c. 14%, c. 6.5% FY27-33. Our bull case equates to c. 29x FY24 adj. P/E, or c. 3.4x EV/Sales.

BASE CASE

SAR 305.00

Growth in-line with the market

After MSe c. 17% org. growth in FY22, Solutions continues to deliver strong growth. We forecast c. 9% org. for FY23 (26% total growth), c. 10% for FY24. Adj. EBIT margins compress vs. FY22 levels, reflecting M&A impacts and project mix. Adj. EBIT margins ease from MSe 14.4% in FY22 to 13.2% by FY26, as gross margins normalise. The FY27-33 revenue growth CAGR is c. 6%. Adj. EBIT margins improve gradually to ~13.5% in terminal state. Our base case equates to c. 25x FY24 adj. P/E, c. 2.7x EV/sales.

BEAR CASE

SAR 182.00

Increased competition drives below-market growth

Beyond FY23 (where stated growth is 22%), Solutions' top-line growth moderates below the wider market, driven by increased competition. Adj. EBIT margins compress to <13% in FY23, and to around 10% in terminal state, as mix shift weighs, currently higher-margin work commoditises, and margin improvements in more nascent divisions (e.g. digital) prove relatively limited. The FY23-26 revenue CAGR is c. 6%, c. 3% FY27-33. Our bear case represents c. 17x FY24 adj. P/E, or c. 1.6x EV/Sales.

Risk Reward – Solutions by STC (7202.SE)

KEY EARNINGS INPUTS

Drivers	2022	2023e	2024e	2025e
Group y/y revenue growth (%)	22.2	25.8	11.4	8.9
Group adj. EBIT margin (%)	13.2	14.4	13.2	13.2
Group stated EBITDA margin (%)	15.8	15.5	15.5	15.5

INVESTMENT DRIVERS

- Large new contract wins
- Relative growth of high versus low margin business segments
- Expansion of activities in private sector end market
- M&A inside KSA or in other GCC countries
- Delivery quality on large contracts already being serviced
- 3Q23 results

GLOBAL REVENUE EXPOSURE



Source: Morgan Stanley Research Estimate
View explanation of regional hierarchies [here](#)

MS ALPHA MODELS

1/5
MOST

3 Month
Horizon

Source: Refinitiv, FactSet, Morgan Stanley Research; 1 is the highest favored Quintile and 5 is the least favored Quintile

RISKS TO PT/RATING

RISKS TO UPSIDE

- New contract wins particularly with the KSA government
- International expansion into other GCC countries in the mid-term
- Bolt-on M&A

RISKS TO DOWNSIDE

- Slowdown in contract wins or contract losses once they reach the end of their term
- Weaker than expected delivery on existing large contracts leading to margin compression
- Impairments/provisions on contracts/inventory
- Longer working capital cycles than expected

OWNERSHIP POSITIONING

Inst. Owners, % Active	52.4%	<div style="width: 52.4%;"></div>
HF Sector Long/Short Ratio	2x	<div style="width: 200%;"></div>
HF Sector Net Exposure	6%	<div style="width: 6%;"></div>

Refinitiv; MSPB Content. Includes certain hedge fund exposures held with MSPB. Information may be inconsistent with or may not reflect broader market trends. Long/Short Ratio = Long Exposure / Short exposure. Sector % of Total Net Exposure = (For a particular sector: Long Exposure - Short Exposure) / (Across all sectors: Long Exposure - Short Exposure).

MS ESTIMATES VS. CONSENSUS

FY Dec 2023e



◆ Mean ◆ Morgan Stanley Estimates

Source: Refinitiv, Morgan Stanley Research

Risk Reward Reference links

1. View explanation of Options Probabilities methodology - [Options_Probabilities_Exhibit_Link.pdf](#)
2. View descriptions of Risk Rewards Themes - [RR_Themes_Exhibit_Link.pdf](#)
3. View explanation of regional hierarchies - [Microsoft PowerPoint - Exhibit Links.pptx](#)
4. View explanation of 'Indicator of Change' methodology - [ESG_Indicator_of_Change_External_Link.pdf](#)
5. View explanation of Theme/Exposure methodology - [ESG_Sustainable_Solutions_External_Link.pdf](#)
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(as of September 30, 2023)

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	Count	% of Total	Count	% of Total IBC	% of Rating Category	Count	% of Total Other MISC
Overweight/Buy	1350	37%	281	43%	21%	608	39%
Equal-weight/Hold	1673	46%	303	46%	18%	709	46%
Not-Rated/Hold	3	0%	0	0%	0%	1	0%
Underweight/Sell	608	17%	68	10%	11%	225	15%
Total	3,634		652			1543	

Data include common stock and ADRs currently assigned ratings. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months. Due to rounding off of decimals, the percentages provided in the "% of total" column may not add up to exactly 100 percent.

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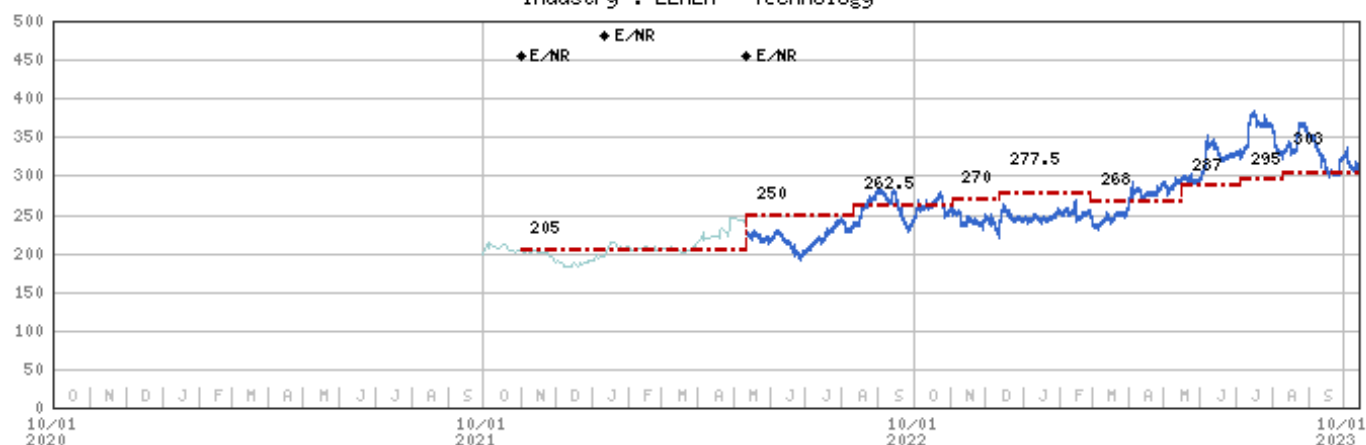
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Stock Price, Price Target and Rating History (See Rating Definitions)

Solutions by STC (7202.SE) - As of 10/12/23 in SAR
Industry : EEMEA - Technology



Stock Rating History: 11/1/21 : E/NR; 1/11/22 : E/NR; 5/12/22 : E/NR

Price Target History: 11/1/21 : 205; 5/12/22 : 250; 8/10/22 : 262.5; 11/2/22 : 270; 12/12/22 : 277.5; 2/28/23 : 268; 5/16/23 : 287; 7/5/23 : 295; 8/10/23 : 303

Source: Morgan Stanley Research Date Format: MM/DD/YY Price Target --- No Price Target Assigned (NA)

Stock Price (Not Covered by Current Analyst) — Stock Price (Covered by Current Analyst) ■

Stock and Industry Ratings (abbreviations below) appear as ♦ Stock Rating/Industry View

Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) No Rating Available (NA)

Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

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INDUSTRY COVERAGE: EEMEA - Technology

COMPANY (TICKER)	RATING (AS OF)	PRICE* (10/12/2023)
George W Webb Solutions by STC (7202.SE)	E (05/12/2022)	SAR 308.80

Stock Ratings are subject to change. Please see latest research for each company.

* Historical prices are not split adjusted.