KSA IT Sector, *Opportunities galore…*

12 May 2022

Company	Rating
Arabian Internet & Communication Services Co. (Solutions by STC)	Hold
Al Moammar Information Systems (MIS)	Buy

- **The Saudi IT industry is comprised of both organized and unorganized players in roughly equal proportions. Amongst the local players, Solutions by STC has the largest market share**
- **The Kingdom's spending in its IT sector is less than a percent of its GDP (as in 2018), lower than the average of more mature markets**
- **The development of the IT sector is an important pillar in the economic diversification plan under Vision 2030. Transforming the Kingdom into a regional digital hub is also a goal of the Vision 2030**
- **The ICT sector is set to expand at a rapid pace at least until 2025. Newer technologies like cloud and IoT are expected to grow faster than the industry average**

We initiate coverage on the KSA IT Sector with the only two listed names – **Arabian Internet & Communication Services Co. (Solutions by STC), and Al Moammar Information Systems (MIS).** Overall, we have a favorable view of the sector and expect it to remain on a strong growth trajectory in the foreseeable future, supported by the government's digital transformation drive. We have used two valuation methodologies (DCF, relative valuation – P/E), and applied equal weightage to both the methods to arrive at the target price.

- **IT spending share of GDP in KSA is below the developed markets.** Saudi Arabia's IT spending as % of GDP is below the matured markets and even its neighbor UAE (0.7% vs. 1.3%, and 0.9%, respectively, as of 2018). This indicates the Kingdom needs to keep on investing in the sector as a developed IT market would be imperative, in our view, to achieve its long-term economic goals. The Ministry of Communications & Information Technology (MCIT) has initiated steps in this direction and formulated an ICT strategy for 2023, which is a stepping stone to realizing the broader goals of Vision 2030. Some of its salient objectives are to raise the size of the IT sector by 50%, which is estimated at ~SAR 38bn in 2021, increase the sector's contribution to GDP by SAR 50bn (4.6% of GDP by 2023 vs. 3.6% in 2017), and create over 25,000 jobs.
- **The ambition to develop Kingdom as the region's digital hub is a major catalyst for the sector's growth.** The government intends to make the Kingdom region's digital hub, as part of its broader economic diversification plan. The IT sector can be seen at the forefront to achieve this considering the increasing role technologies like AI, data analytics, IoT, etc. are playing in almost every business. Further, megaprojects like smart cities, changing dynamics of the entertainment industry with higher usage of live streaming services, post-COVID developments like hybrid work environments, and increasing digitization & automation by the private sector to become more nimble and efficient are the additional demand drivers for the sector. Hence, the ICT sector is estimated to gain traction, clocking between 8% and 9% CAGR during 2021-2025 (vs. 4-5% CAGR during 2018-2021).
- **Organized IT players well placed to capitalize on upcoming opportunities.** In our view, both Solutions and MIS are well equipped to benefit from the upcoming opportunities in the IT sector, given their proven capabilities, and availability of requisite infrastructure. Solutions, because of its relationship with STC, gets significant business opportunities internally. Also, with the highest market share of 19%, a good brand presence, and its association with major global IT players works in its favor in attracting more business. On the other hand, MIS's involvement in the data centers project appears to be a major catalyst for the earnings growth going forward, while its diverse segments covering almost every domain of the IT Services sector are expected to expand in tandem with the industry.

Name	Last Px (SAR)	Target Price (SAR)	Upside / (Downside) (%)	P/E'22e, (x)	P/B'22e, (x)	EV/EBITDA '22e, (x)	ROE'22e, (%)	Cash Div Yield, %
Solutions by STC	226.00	**233.50**	3.3%	23.5	9.9	16.6	46.1%	1.8%
Al Moammar Information Systen	120.60	**158.50**	31.4%	18.9	7.2	17.5	42.2%	1.7%
Average				**21.2**	**8.5**	**17.0**	**44.2%**	**1.7%**

Source: Bloomberg, U Capital Research; Last price as of 12 May 2022

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KSA IT Sector

Contents

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Valuation

We have used DCF and relative valuation methodologies with equal weights assigned to each of them to derive the target price for each company. For DCF, we have used a 5-year explicit forecast period (2022-26) and afterward assumed a terminal growth rate of 2% for Solutions and 3% for MIS. The higher terminal growth rate for MIS is considering its smaller size, and stronger growth prospects aided by the data centers project. We have then calculated the present value of future cash flows (Enterprise Value or EV) using the weighted average cost of capital (WACC). After computing EV, we have made the required adjustments such as net debt, minorities, etc. to derive equity value.

For the relative valuation (P/E), we have considered the company's average historical and forward multiples as well as the average multiples of relevant peers. Then, these were adjusted by giving a premium or discount, as required, considering the recent and/or expected movement in the multiples to reflect our assessment of each company's future financial performance. The adjusted multiples are then multiplied by the forecasted EPS.

Valuation

	Solutions	MIS
DCF (50% weight)		
PV of Free Cash Flow (SAR mn)		
Year 1	1,455	172
Year 2	1,359	158
Year 3	1,278	143
Year 4	1,288	155
Year 5	1,343	159
Terminal	28,490	4,579
Total PV of Excess Returns	18,905	3,182
Assumptions		
Risk Free Rate (%)	3.0%	3.0%
Adjusted Beta	0.65	0.65
Risk Premium (%)	10%	10%
Cost of Equity (COE) (%)	9.3%	9.3%
WACC (%)	9.2%	8.2%
Equity value (SAR mn)	27,136	3,629
Outstanding Shares (mn)	120.0	25.0
Target Price (SAR)	***226.1***	***145.2***
P/E based Relative Valuation (50% weight)		
Target P/E multiple for 2022e	*25.00*	*27.00*
EPS 2022e (SAR)	*9.63*	*6.36*
Target Price (SAR)	***240.9***	***171.8***
Weighted Average Target Price (SAR)	**233.5**	**158.5**
Current Market Price (SAR)	*226.0*	*120.6*
Upside/(Downside), %	3%	31%
Recommendation	**Hold**	**Buy**

Source: Company Filings, Bloomberg, U Capital Research; Current market prices as of 12 May 2022

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Risks to Valuation

Key downside risks to our valuations include:

- Below expected growth rate and/or market share of different business verticals.
- More-than-estimated impairment expense, and less-than-expected improvement or deterioration in margins.
- Macro headwinds negatively impacting or constraining the forecasted expansion of the overall market

Key upside risks to our valuations include:

- The more-than-expected growth rate in the existing domains and/or higher-than-forecasted market share gains by the different business verticals
- Less-than-estimated impairment expense, and above-expected expansion in margins.
- IT industry expanding at a more than forecasted rate

Sensitivity Analysis

Our TP for **Solutions** is not sensitive to +/- 0.25% changes to terminal growth or in WACC assumptions (changes about +/-1-2%). Our TP is also not sensitive to +/-0.5x changes in the target P/E multiple, affecting our TP by c. +/-1% with every change.

Solutions by STC

WACC \ Terminal growth	1.50%	1.75%	2.00%	2.25%	2.50%
8.8%	235.1	238.2	241.5	245.0	248.9
9.0%	231.5	234.3	237.4	240.6	244.1
9.3%	228.1	230.7	**233.5**	236.5	239.8
9.5%	224.8	227.3	229.9	232.7	235.7
9.8%	221.8	224.1	226.5	229.1	231.9

P/E multiple \ 2022e EPS (SAR)	8.7	9.2	9.7	10.2	10.7
24.00x	216.7	222.7	228.7	234.7	240.7
24.50x	218.8	225.0	231.1	237.2	243.3
25.00x	221.0	227.3	**233.5**	239.8	246.0
25.50x	223.2	229.5	235.9	242.3	248.7
26.00x	225.3	231.8	238.3	244.8	251.3

Our TP for **MIS** is slightly sensitive to +/- 0.25% changes to terminal growth or in WACC assumptions (changes about +/-2-3%). Our TP is not sensitive to +/-0.5x changes in the target P/E multiple, affecting our TP by c. +/-1% with every change.

MIS

WACC \ Terminal growth	2.50%	2.75%	3.00%	3.25%	3.50%
7.7%	159.7	163.2	167.0	171.3	176.1
7.9%	156.0	159.1	162.5	166.3	170.6
8.2%	152.6	155.4	**158.5**	161.9	165.6
8.4%	149.5	152.0	154.8	157.9	161.2
8.7%	146.6	148.9	151.4	154.2	157.2

P/E multiple \ 2022e EPS (SAR)	5.4	5.9	6.4	6.9	7.4
26.00x	142.3	148.8	155.3	161.8	168.3
26.50x	143.7	150.3	156.9	163.5	170.2
27.00x	145.0	151.7	**158.5**	165.2	172.0
27.50x	146.3	153.2	160.1	167.0	173.8
28.00x	147.7	154.7	161.7	168.7	175.7

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Peer Group Valuation

Name	Mkt Cap (SAR mn)	Last Px (SAR)	Px Change 1M, %	Px Change 3M, %	Px Change YTD, %	EV/EBITDA' 22e, (x)	P/E'22e, (x)	ROE'22e, (%)	Div Yield' 22e, (%)	FCF Yield'22e (%)
IT Services										
AL MOAMMAR INFORMATION SYS	3,015.0	120.60	-13	-23	-20	17.5	18.9	42.2%	2.4%	6.0%
ARAB SEA INFORMATION SYSTEMS	1,910.0	191.00	-4	-2	-3	122.1	nm	1.6%	0.3%	0.1%
ELM CO	20,400.0	255.00	15	99	na	na	36.0	na	1.2%	3.4%
MANNAI CORPORATION QSC	3,779.5	8.07	-14	4	70	na	13.3	12.3%	3.7%	18.0%
ARABIAN INTERNET & COMMUNIC	27,120.0	226.00	3	9	20	16.6	23.5	46.1%	2.4%	5.7%
Average						**52.1**	**22.9**	**25.5%**	**2.0%**	**6.6%**
Median						**17.5**	**21.2**	**27.2%**	**2.4%**	**5.7%**

Source: Bloomberg, U Capital Research, na – not available, nm – not meaningful; *valued as of 12 May 2022; #valuation ratios, RoE data for peers is current/TTM

Fig. 1: IT Services - Price to Earnings & Dividend Yield

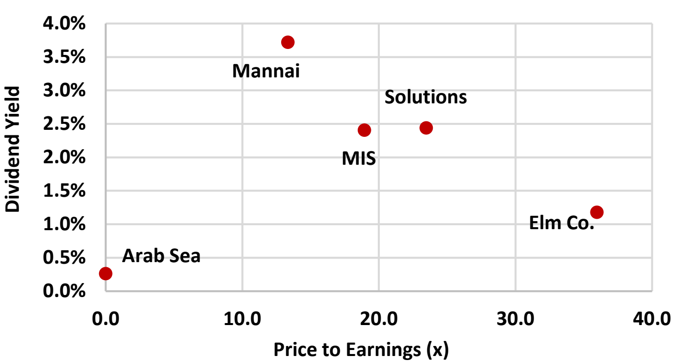
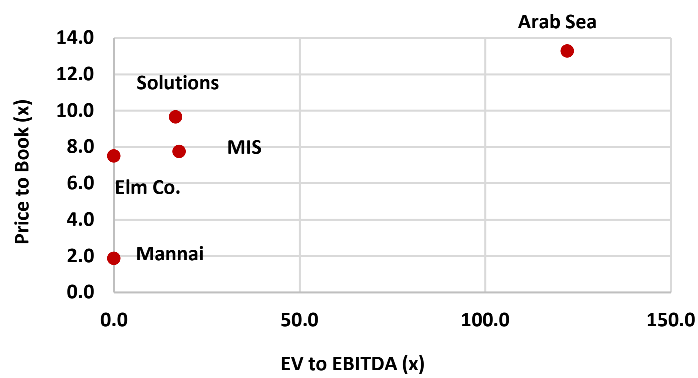


Fig. 2: IT Services – Price to book & EV to EBITDA



Source: Bloomberg, U Capital Research; As of 12 May 2022

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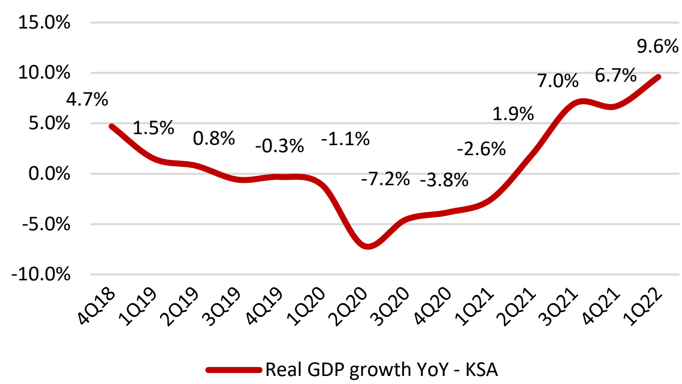
Macro-economic & Sector Overview

The economy is on a healthy recovery path as the pandemic subsides and the outlook improves

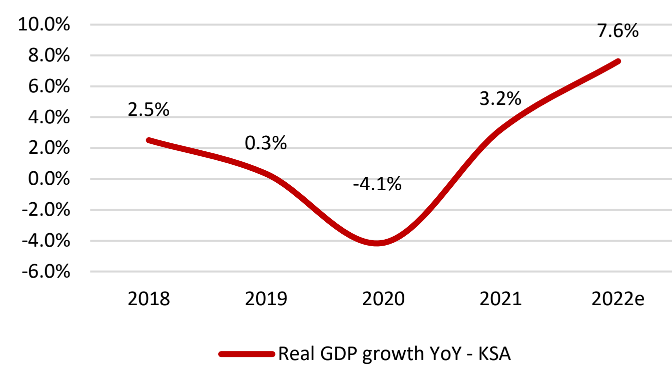
Saudi Arabia's economic growth gained momentum as the real gross domestic product (GDP) expanded 9.6% YoY in 1Q 2022, clocking its highest growth rate in the last 10 years, after expanding by 6.7% YoY in 4Q 2021. The oil sector's GDP climbed 20.4% YoY (aided by a rise in crude oil production, and elevated levels of crude oil prices), whereas non-oil activities grew 3.7% YoY (rollback of COVID restrictions amid gradually normalizing economic situation post the pandemic). In 2021, the Kingdom's real GDP grew by 3.2%, recording the fastest expansion since 2015 and beating the International Monetary Fund's (IMF) estimate of 2.8%. The economy witnessed strong domestic non-government demand as private final consumption expenditure increased 9.7% YoY while gross fixed capital formation jumped 10.1% YoY.

Fig. 3: GDP remains on a solid growth trajectory



Source: GASTAT, U Capital Research

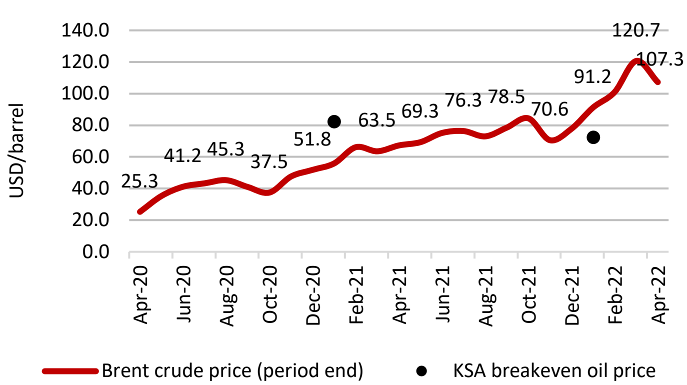
Fig. 4: Real GDP forecast for 2022 raised upwards by the IMF



Source: GASTAT, IMF, U Capital Research

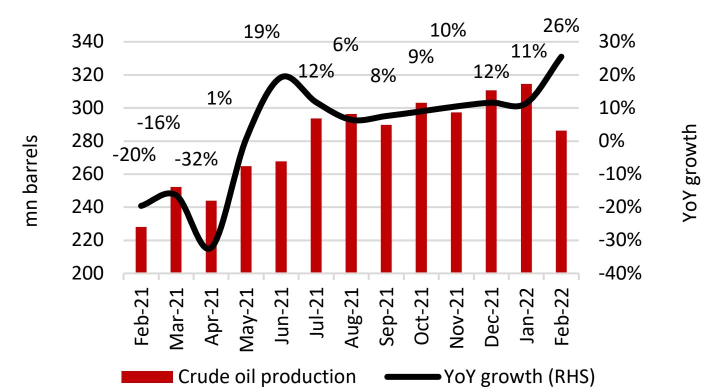
In April, the IMF raised its 2022 and 2023 GDP growth forecast for Saudi Arabia at a time when it downgraded global economic forecasts due to the Russia-Ukraine war, high inflation, and China grappling with the re-emergence of the COVID-19 pandemic. The global lender increased the Kingdom's 2022 economic growth estimate by a sharp 2.8 percentage points to 7.6%, factoring in the gradual rise in oil production following a July 2021 OPEC+ agreement deal to completely phase-out oil production cuts by September 2022, an elevated level of crude oil prices, and an above-expected increase in non-oil output. Saudi Arabia's GDP forecasts for 2023 have also been raised to 3.6% from 2.8%, previously.

Fig. 5: Multi-year high levels of oil prices a boon for the economy



Source: Bloomberg, IMF, U Capital Research

Fig. 6: KSA's crude oil production continues to rise on OPEC+ deal



Source: JODI, U Capital Research

This seems quite likely as the government continues to take initiatives to stimulate the economy. For instance, to ensure long-term growth and as part of its economic diversification plan, Saudi Arabia's Crown Prince Mohammed bin Salman launched a program named 'Shareek' in March 2021. Shareek aims to bring SAR 5tn worth of private investment into the economy by 2030 and is part of a larger SAR 12tn investment program. Further, the Crown Prince also announced a new strategy in March 2022 under which the National Development Fund (NDF) is required to invest SAR 570bn in the Kingdom to stimulate its real GDP growth. Also, to expedite the

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economic diversification process, the NDF has been directed to target tripling non-oil GDP to SAR 605bn by 2030. These initiatives should catalyze domestic demand while creating a more resilient Saudi economy over the medium-to-long term. The IMF estimates Saudi Arabia's breakeven crude oil price to fall to USD 72.4/barrel in 2022 as compared to USD 82.4/barrel in 2021 amid the Kingdom's rising average crude oil production YoY, higher level of crude oil prices, spending cuts taken by the government like a reduction/removal of subsidies, etc. Accordingly, the government estimates to record a budget surplus for the first time in around 10 years in 2022 at ~2.5% of GDP.

Development of the ICT sector to play a key role in the Kingdom's economic diversification plan under Vision 2030

The ICT (information & communication technology) sector can be broken down into two main verticals. 1). IT (information technology) services which include system integration, software & hardware application and support, data center & cloud services, cybersecurity, internet of things (IoT), artificial intelligence (AI), etc. 2). Communication and connectivity services, comprising wireline and wireless voice and data services. The IT Services sector in Saudi Arabia is a fragmented one, where the organized sector accounts for slightly less than half (48% as of 2018) of the total market size. Apart from IT firms like Solutions and MIS, the other key players comprising the organized market are telecommunication companies like Integrated Telecom (ITC), Sahara Net, NourNet, etc., international IT companies, and local system integrators. Among them, Solutions is the market leader with a 13% market share in 2018 (~19% in 2021), followed by local system integrators with a 23% cumulative share as of 2018, international players (2018: 9% share), and telecom firms (2018: c.2% share).

Saudi Arabia is focusing big time on developing its ICT sector under its Vision 2030 program to cement its position as the largest digital economy of the GCC and MENA (the Middle East & North Africa) region. The investments thus incurred/to be incurred to achieve this will aid in boosting the non-oil sector's growth and achieve economic diversification. In this regard, the Kingdom's Ministry of Communication & Information Technology (MCIT) has formulated an "ICT Sector Strategy 2023".

Fig. 7: Major objectives of the Kingdom's ICT strategy 2023

Source: KSA MCIT, U Capital Research

To achieve this, the government has identified several priorities and objectives, such as improving regulation & policies to foster emerging technologies, enhance the Ease of Doing Business in the ICT sector, stimulating demand for IT products and services from the private sector, attracting multinational technology companies to Saudi Arabia to localize their presence, increase local content & support the growth of local IT businesses, enable 5G adoption, increase female participation in the ICT sector, scale-up skill set of the ICT workforce, enhance digital literacy, among others.

Sustained launch of new initiatives to ensure all-round development of the Kingdom's ICT sector

Some of the steps taken by the government toward achieving digital transformation goals and the ICT sector objectives under Vision 2030 are:

- In an event named "Launch" co-hosted by MCIT in 2021, the Kingdom launched various technology programs amounting to more than USD 1.2bn, aimed at improving the digital skills of the younger generation by 2030.
- Another skill enhancement program for students focusing in the fields of cybersecurity, AI, programming, and electronic gaming sector was launched, supported by MCIT.

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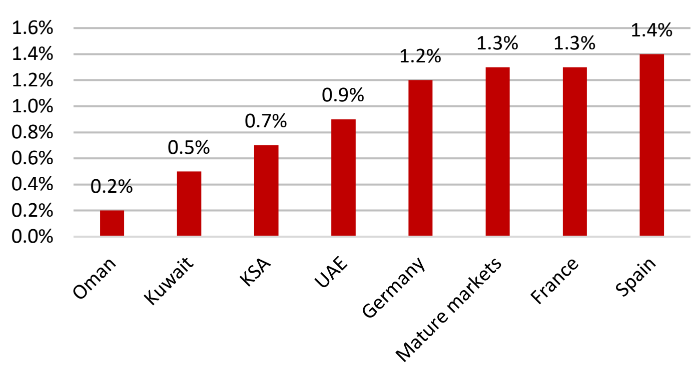
- MCIT also announced the establishment of the National Technology Development Programme with a budget of SAR 2.5bn.
- Furthermore, MCIT along with two partners launched two technology events – LEAP and @HACK. The LEAP event was held in Riyadh in February 2022 whereas @HACK will be held in November 2022 under which an ethical hacking training session will be conducted to help tackle hostile cyberattacks. In the LEAP event held earlier this year, Saudi Arabia announced it would invest USD 6.4bn in future technologies and entrepreneurship.
- The Kingdom also launched an advanced connectivity technology WiFi 6E, which is expected to significantly boost the overall contribution of WiFI to Saudi's GDP to over USD 18bn by 2030 as compared to USD 4.7bn in 2021.
- Another important announcement made at the event was that a spectrum auction for 5G mobile services will be organized by the Communications & Information Technology Commission during 1H 2022, which is likely to push 5G technology contribution to GDP by more than 10x from USD 1.4bn in 2021 to over USD 15bn by 2030.
- Separately, the Digital Content Council unveiled a USD 1.1bn initiative – Ignite – intending to boost the size of the Kingdom's digital content sector in the field of advertising, gaming, video, and music. The event also witnessed several business announcements from the private sector. Some of the notable ones were:
    - NEOM Tech & Digital Company revealed plans to launch metaverse platform XVRS, which is a part of its USD 1bn investment in AI-driven technology
    - STC launched MENA HUB to invest USD 1bn in data center infrastructure and submarine cables
    - Logistics firm J&T Express Group, in association with its partners, announced to invest USD 2bn to build its MENA headquarters in Riyadh, and develop e-commerce industry parks, sorting centers, and other facilities.

In our opinion, such events and programs will play an important role in achieving many of the government's long-term objectives like attracting foreign capital and technologies, increasing participation of the local players, developing new ideas and content, nurturing relevant skills among locals, etc., thereby ensuring a well-rounded development of the ICT sector.

The ICT sector is forecasted to remain on a rapid growth path…

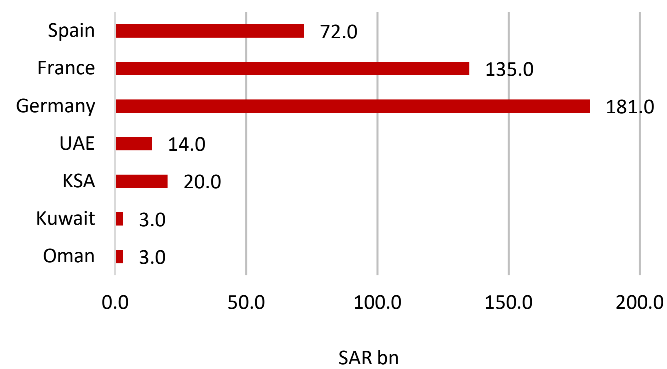
While the Kingdom's IT sector is witnessing brisk activities in the recent years, it lags developed markets in terms of IT services spending's share in the GDP (0.7% vs. 1.3% average of developed markets, as of 2018) as well as the overall size of the IT Services sector (~SAR 20bn vs. more than SAR 100bn in France and over SAR 150bn in Germany, as of 2018).

Fig. 8: KSA lags in terms of IT spending as % of GDP…



Source: Solutions IPO Prospectus, U Capital Research; *data is for 2018

Fig. 9: …as well as the size of the IT Services market



Source: Solutions IPO Prospectus, U Capital Research; *data is for 2018

This suggests there remains ample scope for the expansion of the overall IT sector of Saudi Arabia. According to the latest data from the International Data Corporation (IDC), spending on ICT in the Kingdom grew by 8% from 2019 to reach USD 32.1bn in 2021 and is expected to expand by 2.3% YoY to reach USD 32.9bn in 2022. Further, Governor of the Communications & Information Technology Commission (CITC), Mohammed Al-Tamimi said that over the next five years, all the major digital technologies like IoT, and cloud services, will record significant growth as a result of which their cumulative market size will grow at around 10% 5-year CAGR to reach USD 27bn by 2025.

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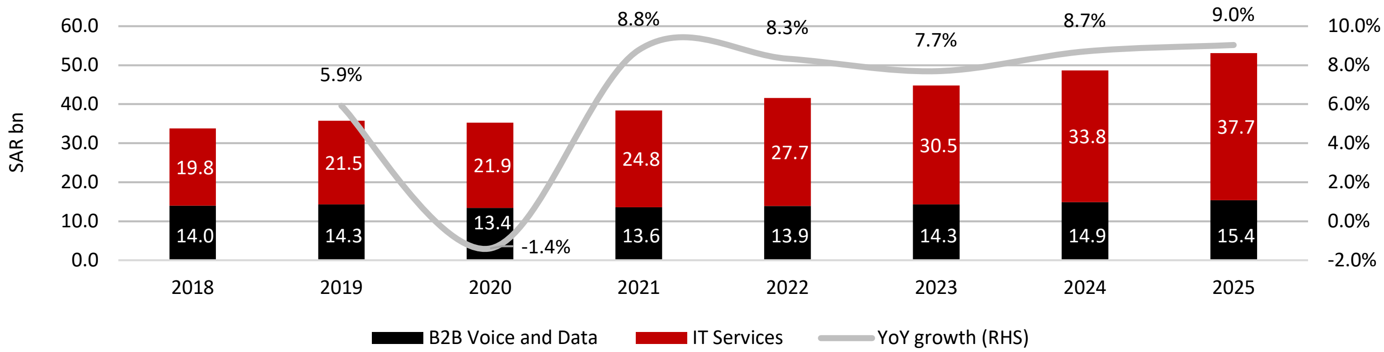
…clocking mid-to-high single-digit growth to reach over SAR 50bn by 2025

Saudi Arabia's business-to-business (B2B) ICT services market grew at ~4% CAGR from 2018 to reach an estimated ~SAR 38bn in 2021. However, spearheaded by the efforts of the authorities to buoy the sector, the ICT sector growth is estimated to move into a higher gear and it is expected to reach a size of SAR 53bn by 2025, clocking 8.4% CAGR between 2021 and 2025, roughly double the rate achieved during 2018-2021. The overall ICT services market includes the IT sector and B2B Voice & Data sector. In the backdrop of the Kingdom's ambition to become a digital hub of the region, the IT sector is expected to witness the majority of the activity. Thus, most of the ICT sector's forecasted growth is expected to be driven by the IT sector. B2B Voice & Data sector is estimated to remain largely stable, growing at a marginal rate of ~1% on average. Nevertheless, this still would provide a good business opportunity for the players like Solutions, in our view, which has ventured into the BPO business.

Fig. 10: IT Services is expected to drive overall ICT sector growth

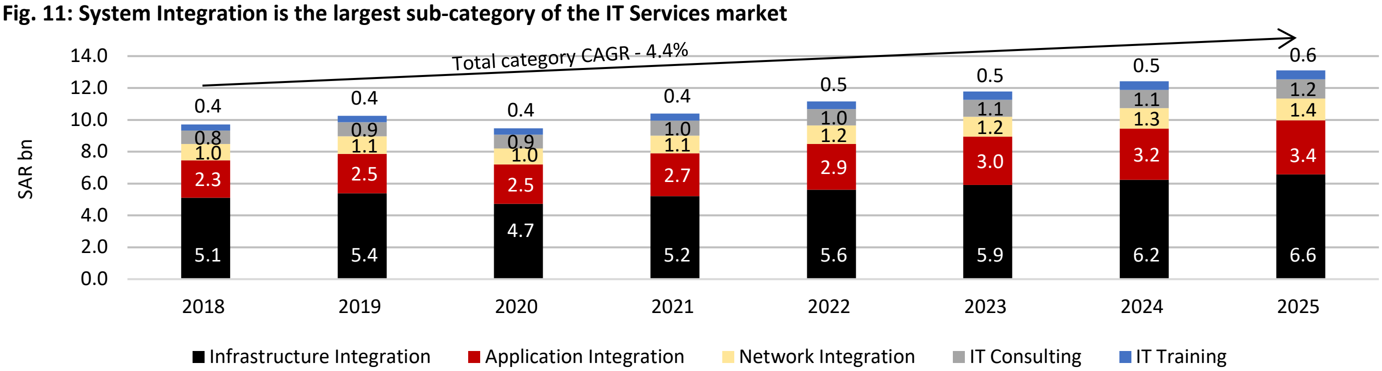


Source: Solutions IPO Prospectus, U Capital Research

As discussed above, the ICT sector's expansion would be led by the IT Services which is forecasted to clock nearly 11% CAGR during 2021-25 (2018-21: 7.8% CAGR). The IT Services sector comprises several domains like System Integration, IoT, Cloud, etc. that have different dynamics which will be at play in driving their growth. For instance:

- **System Integration:** This represents the biggest category within in overall IT Services market and it also includes hardware used in the system integration. Being the largest, it is expected to grow at a nominal 5-year CAGR of ~6% to reach ~SAR 13bn by 2025 (2018-21: 2.3% CAGR). Digitization exercise of the government and large corporate, mega projects, and mega smart cities like NEOM, are some of the key drivers for this segment.

Fig. 11: System Integration is the largest sub-category of the IT Services market



Source: Solutions IPO Prospectus, U Capital Research

- **IoT and Digital:** This category comprises newer and in-demand technologies like IoT, AI, and Big Data. This vertical is estimated to be among the fastest-growing, along with the Cloud & Data Centers vertical. Within this, IoT represents the largest segment which is forecasted to grow at ~22% CAGR to reach around SAR 6.1bn by 2025 from an estimated SAR 2.8bn in 2021 (2018-21: 20.4% CAGR), accounting for over 75% of the total IoT & Digital market. Demand for this category is emanating from smart energy management, industrial robotics, the emergence of virtual technologies like e-learning, virtual classrooms, digital ID, remote health monitoring, mega infrastructure projects like Riyadh Metro, Amaala, Qiddiya, Red Sea Project, etc. AI is also estimated to clock

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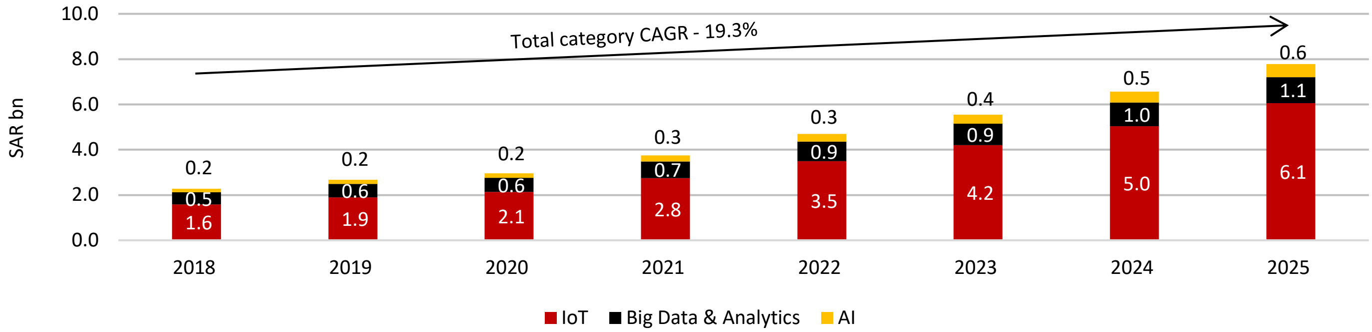
~22% CAGR during 2021-25 (2018-21: 20.6%), while Big Data & Analytics is expected to grow at a relatively lower CAGR of ~12% between 2021 and 2025 (2018-21: 10.5%).

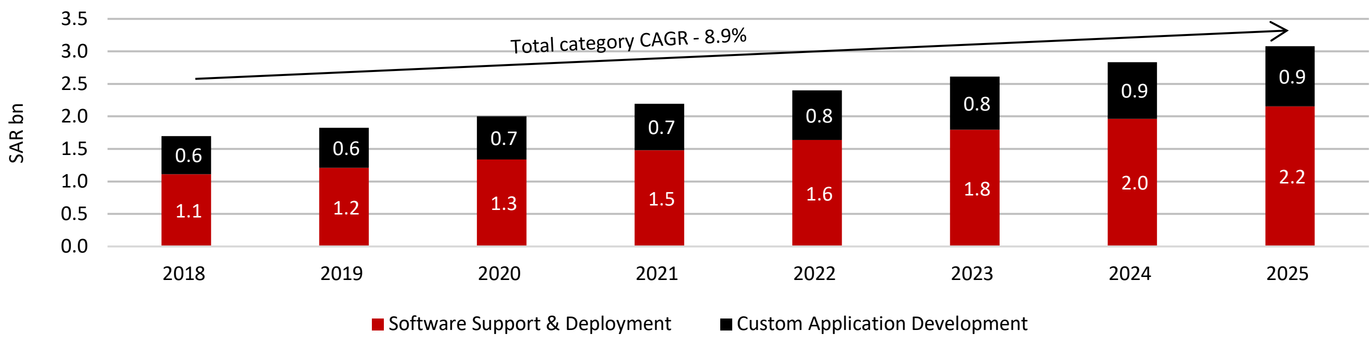
Fig. 12: IoT is the primary growth driver for this segment



Source: Solutions IPO Prospectus, U Capital Research

➢ **Application Services:** This can be segregated into software deployment & support which is a larger market, and custom application development. Overall application services are forecasted to reach ~SAR 3.0bn by 2025 as compared to ~SAR 2.2bn in 2021, clocking 8.9% CAGR, the same as achieved during 2018 and 2021. Digitization is also a major driver for this segment, particularly in cases where applications are required for sharing ideas and data.

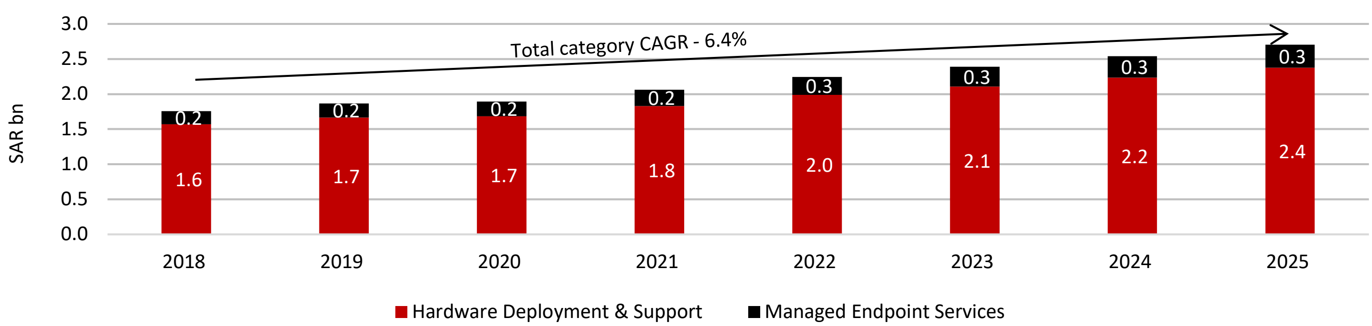
Fig. 13: Software delivery and support are expected to expand at a CAGR of c.10%, higher than the category average



Source: Solutions IPO Prospectus, U Capital Research

➢ **Equipment Services:** This can be broken down into hardware deployment & support representing a larger market (over 80% of the total Equipment Services category), and managed endpoint services such as server maintenance and support. This segment would expand at 7% CAGR from 2021 to reach about SAR 2.7bn in 2025 (2018-21: 5.5% CAGR). The digitization need of medium-sized enterprises is one of the primary demand drivers for this category.

Fig. 14: Hardware deployment drives most of the activity in this category



Source: Solutions IPO Prospectus, U Capital Research

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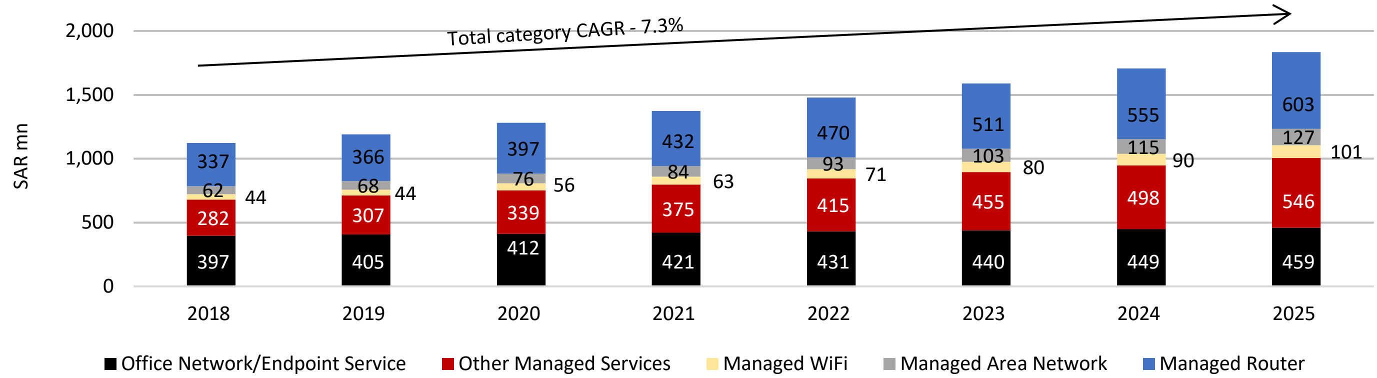
- **Managed Networks:** Demand for this category emanates from the multi-vendor environment, 24X7 monitoring, operational requirements post the set-up of a business, etc. Office network & endpoint infrastructure services, managed WiFi, managed area network, managed router, and other managed services are the five sub-segments of this category. Overall, this category is expected to grow by around 7.5% on average between 2021 and 2025 to reach ~SAR 1.8bn (2018-21: 7.0% CAGR). Among the various sub-categories, managed WiFi is estimated to register the highest CAGR in the range of 12-13% during 2021 and 2025, followed by managed area network which is expected to clock ~11% CAGR during 2021-25.

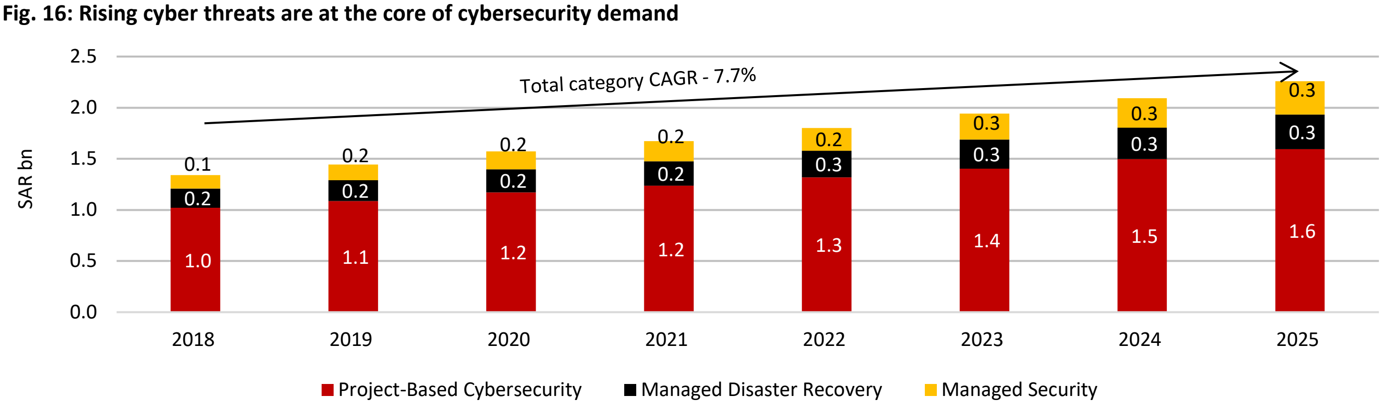
Fig. 15: Except for Office Network/Endpoint Service, all other segments are estimated to post strong growth rates



Source: Solutions IPO Prospectus, U Capital Research

- **Cybersecurity:** In the backdrop of a growing connected environment and an exponential increase in digital transactions, particularly monetary transactions, cybersecurity needs have increased tremendously. Apart from this, in the context of Saudi Arabia, the demand for cybersecurity is also expected to come from the government's push to set up the National Cybersecurity Authority (NCA) as well as the establishment of the Cybersecurity Framework by the Saudi Central Bank. Overall, this category is forecasted to reach SAR 2.3bn by 2025 from SAR 1.7bn in 2021, registering a CAGR of 7.8%, marginally higher than the 7.7% CAGR clocked during 2018-21.

Fig. 16: Rising cyber threats are at the core of cybersecurity demand



Source: Solutions IPO Prospectus, U Capital Research

- **Cloud and Data Centre:** With the government's digital transformation push, development of smart urban centers, initiatives to make the Kingdom a commercial hub, a hybrid working environment involving office and home in the aftermath of the COVID-19 pandemic, increase in online gaming, video streaming services, among others, connectivity requirements have increase manifold which in turn has boosted physical and virtual data storage demand for instant access and sharing. In addition, regulatory demand for banks to set up in-house data management is also an important driver of this category in Saudi Arabia. As per a report from consultancy Knight Frank, available data storage space capacity, in terms of megawatts (MW) per million people in Saudi Arabia stands at 1.71, which is below the GCC average of 3.41 and much lower than the European average of ~106. Thus, recognizing the supply-demand imbalance in local data storage space, MCIT has this year launched a USD 18bn data center strategy for setting up large-scale data centers, with an ultimate aim to transform the Kingdom as the regional data center hub. We reckon MCIT to be a

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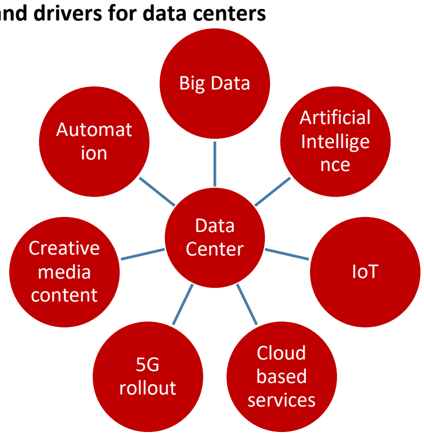
major beneficiary of this development, as it has been selected among the first batch of key investment partners to implement this strategy, and it has also allied to develop data centers in various stages across Saudi Arabia.

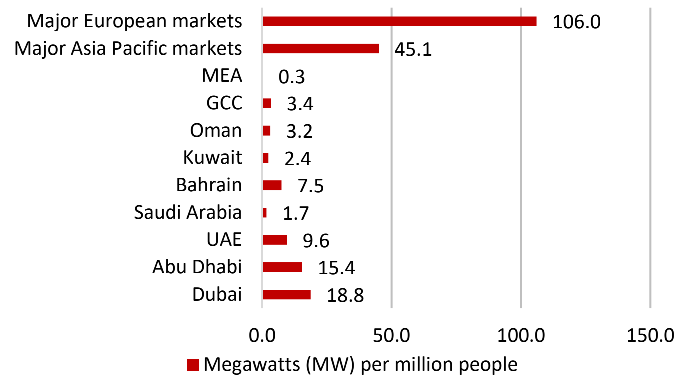
Overall, this category is estimated to clock a 5-year CAGR of ~20% to reach nearly SAR 7bn by 2025 (2018-21: 20.8% CAGR). Within this, Datacenter Managed Services is forecasted to continue growing at ~10% average annual rate during 2021 and 2025. Public and Private Cloud, on the other hand, are expected to register ~25% CAGR during 2021-25 (2018-21: between 30% and 31% CAGR). Given that Cloud is a relatively nascent technology, it is expected to grow at similar rates globally. According to a report by IDC, the worldwide public cloud market is expected to grow to USD 809bn by 2025 as compared to USD 317bn in 2021, implying an annual growth rate of 21%. Public cloud finds more preference among enterprises owing to factors such as lower ownership costs, little maintenance, and higher flexibility and scalability. According to government estimates, spending on cloud-related services would account for up to 30% of the total spending in the Kingdom's ICT sector by 2030. While the global IT giants like Microsoft, and Amazon, have superior capabilities and experiences in offering cloud and other similar hi-tech services, they prefer operating through partnership routes in the Kingdom rather than on their own, amid the cultural differences. Needless to say, this offers significant potential opportunities for the local IT companies such as Solutions and MIS.

Fig. 17: Demand drivers for data centers



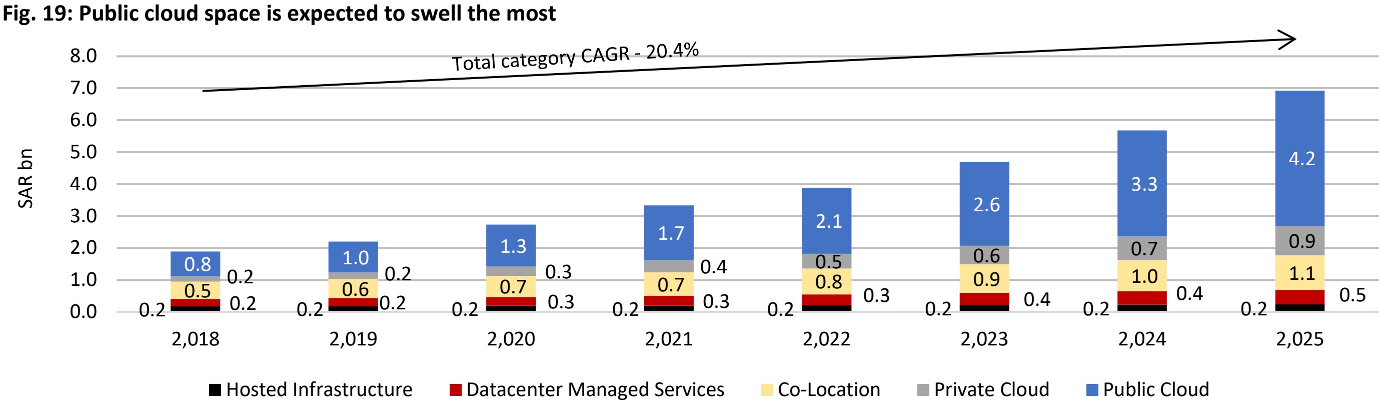
Source: Knight Frank, U Capital Research

Fig. 18: KSA lags GCC average in per capita data storage space



Source: Knight Frank, U Capital Research

Fig. 19: Public cloud space is expected to swell the most



Source: Solutions IPO Prospectus, U Capital Research

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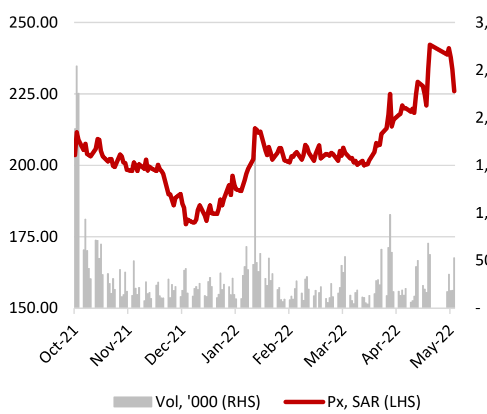
Solutions by STC

Target Price: SAR 233.5/share
Upside: 3.3%

Recommendation	**Hold**
Bloomberg Ticker	SOLUTION AB
Current Market Price (SAR)	226.00
52wk High / Low (SAR)	246.800/166.000
12m Average Vol. (000)	N/A
Mkt. Cap. (USD/SAR mn)	70,512/27,120
Shares Outstanding (mn)	120.0
Free Float (%)	20%
3m Avg Daily Turnover (SAR'000)	53,534.8
6m Avg Daily Turnover (SAR'000)	51,933.8
P/E'22e (x)	23.5
P/B'22e (x)	9.9
Dividend Yield '22e (%)	2.4%
Price Performance:	
1 month (%)	2.7
3 month (%)	9.1
12 month (%)	N/A

Source: Bloomberg, valued as of 12 May 2022

Price-Volume Performance



Source: Bloomberg

- **Solutions by STC is likely to further boost its leadership position in a fragmented Saudi IT services market**
- **The backing of a strong client (STC) offers various advantages, such as exposure to a large clientele, high brand presence, cross-selling opportunities, etc.**
- **The company has generated industry-beating performance and is set to replicate it going forward in an expanding market, given its market-leading position**
- **Profitability is expected to maintain the improving trend of the last two years, thus further strengthening an already solid balance sheet and cash flows**

We initiate coverage on **Solutions by STC (Solutions)** and assign a **Hold** rating with a target price of SAR 233.5 per share, offering an upside of 3.3%. Currently, the stock trades at a P/E of 23.5x, based on our FY22 estimates. Solutions has successfully leveraged its relationship with its parent STC and built on it to become the largest player in the Kingdom's IT market, with a market share of c.19% during FY21. The company has outpaced the industry growth in the past and looks well set to capitalize on the upcoming opportunities, driven by Saudi's digitization drive, with its time-tested capabilities and diverse offerings. Having said that, we opine the company's current valuation levels, post ~20% appreciation in the stock price YTD till 12 May, has already discounted most of the near-term positives, which forms the basis for our current stance on the name.

Investment Thesis

Valuation and risks: Our target price is based on blended valuation methodologies – (i) Discounted Cash Flow (DCF) and (ii) Relative Valuation (using P/E multiple). Key downside risks to our valuation include i) below-expected performance of the business verticals, ii) less-than-estimated improvement in operating efficiency, and iii) higher-than-expected impairments. Key upside risks to our valuation include i) more-than-expected expansion in market share of different verticals, ii) better-than-forecasted revenue growth, and iii) higher-than-estimated expansion in margins.

Expected to maintain the lead: Solutions is a dominant player in the Kingdom's ICT market i) clocked 25% revenue CAGR during FY18-FY21, outperforming the overall ICT services industry CAGR of 4% ii) The company is expected to continue outperforming the industry growth, albeit at a slower pace, iii) Focus on entering new related verticals with high-margin products to ensure sustained growth, accompanied by profitability improvement iv) solid balance sheet with no debt v) prudent working capital management, with reducing receivable days, vi) healthy cash flows are expected to continue on the back of an improvement in profitability, should be able to easily fulfill capex requirements which are likely to remain low vii) Ample liquidity to ensure sustained dividend payments

Year	FY19	FY20	FY21	FY22e	FY23e	FY24e
Revenues (SAR mn)	5,257.3	6,891.4	7,815.8	8,807.5	9,691.0	10,658.5
Net income (SAR mn)	393.8	701.8	832.9	1,156.2	1,354.0	1,542.0
Gross margin	16.1%	20.6%	21.9%	22.0%	22.3%	22.5%
Net profit margin	7.5%	10.2%	10.7%	13.1%	14.0%	14.5%
RoE	27.0%	44.1%	39.7%	46.1%	44.5%	41.8%
FCF (SAR/share)	4.2	3.4	8.3	12.8	13.1	13.4
DPS (SAR/share)	80.0	3.3	4.0	5.5	6.3	7.0
Dividend Yield	NA	NA	2.1%	2.4%	2.8%	3.1%
P/E (x)	0.0x	0.0x	27.1x	23.5x	20.0x	17.6x
P/BV (x)	0.0x	0.0x	9.9x	9.9x	8.1x	6.7x

Source: Company Reports, U Capital Research **P/E and P/B from 2022 onwards calculated on price of 12/05/2022*

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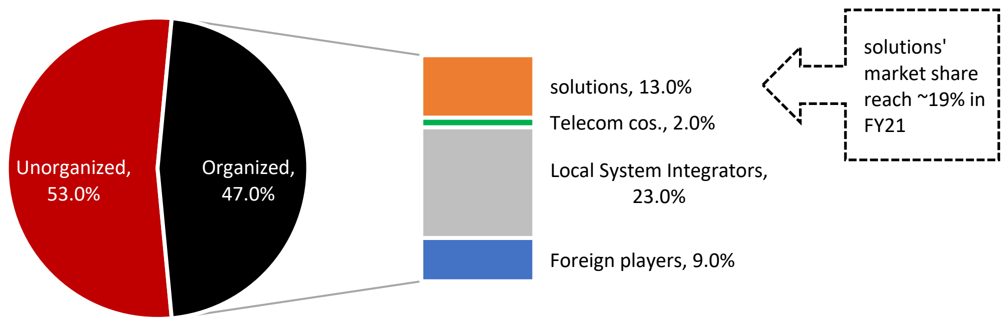
Solutions further cements its already strong market position

Saudi Arabia has a fragmented IT services market, wherein the unorganized sector forms more than half of the total market. In the organized sector, Solutions by STC has a lion's share. On the back of more than 20 years of operating history, strong parent support, a solid customer base, a large number of partners (150+, including global IT giants like Microsoft, IBM, SAP, etc. which help alleviate competition), and a diverse offering of solutions and services, the company has gained market share over the years (~19% in FY21 vs. ~13% in FY18). The International Data Corporation (IDC) has ranked Solutions as the number one IT service provider in the Kingdom for a sixth consecutive year, according to the company's FY21 annual report.

Fig. 20: Solutions further boost its market standing



Source: Company Reports, U Capital Research; *data for FY18

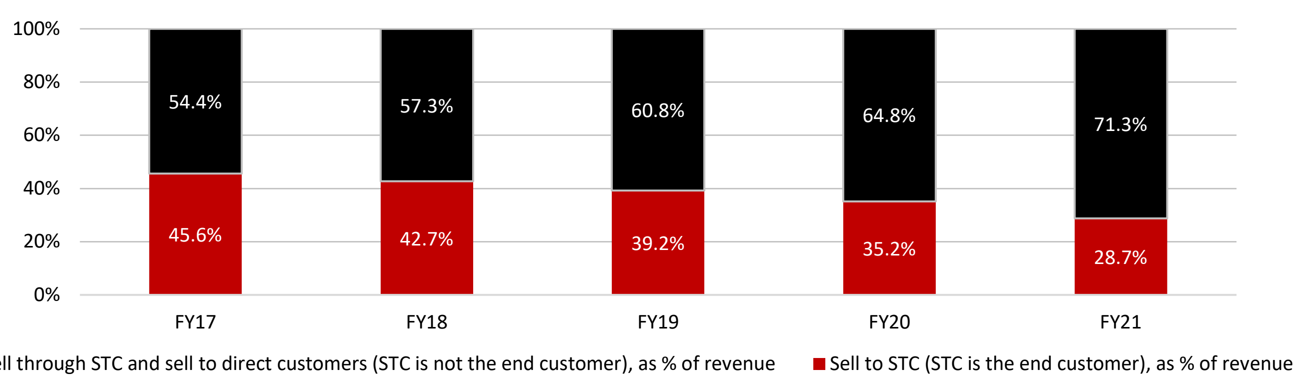
The increase in the company's market share is a testimony to its superior capability and execution levels, a satisfied customer base, and solid brand positioning.

Another point worth noting here is that Solutions earn over 50% (54% in FY21) of its revenue from the government and government-related entities (GREs), though this share is gradually coming down with an increase in the business from the private sector. Given that the government has been pushing digitization as part of its Vision 2030 program, and in the backdrop of an improved fiscal position driven by higher oil prices, we expect sovereign spending on the Kingdom's digital transformation to rise going forward. This culminates in more growth opportunities for the company, considering that it generates a large part of its business from the government and GREs.

A healthy relationship with the parent augments business opportunities

Solutions by STC has a strong relationship with its parent Saudi Telecom Company (STC), which is the top telecom operator in Saudi Arabia. Solutions has immensely benefitted from its association with STC, in our view, as it generates a decent revenue (~29% in FY21) by catering directly to the parent. In addition, Solutions also get various indirect benefits such as access to STC's large institutional customer base comprising of government entities and private firms, cross-selling opportunities, brand reach & awareness, etc. Thus, the parent STC also indirectly plays an important part in the revenue generation of Solutions.

Fig. 21: Revenue share from the direct sale to parent STC gradually coming down



Source: Company Reports, U Capital Research

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We contend that Solutions would continue to benefit from its relation with STC going forward as well. For instance, Solutions has inked several contracts with STC over the last six months amounting to nearly SAR 700mn and can benefit further from new ventures of STC like its plan to build new data centers with a cumulative 125 MW capacity. Solutions currently generate a majority of its revenue from the Kingdom and only a meager amount from outside (around 0.15% of the total revenue from Kuwait and Bahrain during FY20). However, the company could leverage STC's overseas presence to achieve a higher level of geographical diversification. While the revenue generated from STC has kept growing over the past few years, except in FY21 (down 7.3% YoY), we note that its share of Solutions' total revenue is gradually coming down, implying a diversification of revenue stream.

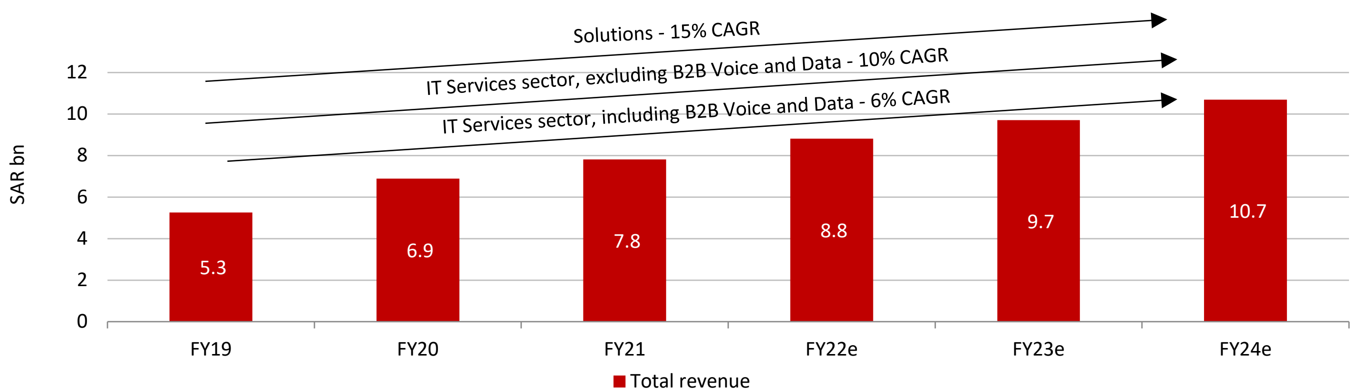
The company looks set to maintain its track record of industry-beating revenue growth…

Solutions has leveraged well its advantages highlighted in the points above, and registered strong top-line growth during the last 4-5 years, including the pandemic years.

The company's revenue clocked a 25% CAGR during FY18-FY21, outshining the 8% CAGR growth of the total ICT services market during that period. Solutions segregate its offerings under three verticals:

- **Core ICT Services:** This is the largest revenue segment of the company, although its share of the total revenue has come down over the years (~54% of total revenue in FY21 vs. ~68% of total revenue in FY17). It includes system integration services and communication & internet services. System integration involves the integration of networks, infrastructure and applications, and the related advisory and consulting services. Under the communication & internet services, the company provides high-quality connectivity services through the internet and satellite to the businesses. We expect this segment to retain its major share in the company's total revenue during our forecast period, though the contribution is likely to gradually ebb. The segment is expected to clock a lower revenue CAGR of 7-8% during FY21-26 (vs. ~20% during FY17-21), albeit on a higher base.
- **IT managed and operational services:** Under managed services, the company provides end-to-end management of business networks and systems of the customers. The operational services involve Business Process Outsourcing (BPO) services on behalf of its clients in the domain of customer care, HR, and other similar activities. The segment's share of the total revenue has hovered between 20% and 25% historically, and we expect this trend to continue in the future.
- **Digital services:** This line of business focuses on the latest technologies and services such as data center and cloud services, encompassing infrastructure as a service ("IaaS"), platform as a service ("PaaS"), and software as a service ("SaaS"). It also includes cybersecurity integration services, and other digital services like the Internet of Things (IoT), digital solutions to collect and analyze data from machines/devices, etc. This segment's share of the total revenue grew from 7.5% in FY17 to nearly 21% in FY21, as it clocked ~65% CAGR revenue growth during FY17-21. We expect the technologies covered under this vertical will continue to witness high demand and application amid the growing digitization. Accordingly, this segment is estimated to keep expanding at double-digit rates, between 15% and 20%. Thus, its share in total revenue is forecasted to increase by another 6-7 percentage points by the end of FY26.

Fig. 22: Solutions expected to maintain an above-average revenue growth rate



Source: Company Reports, U Capital Research

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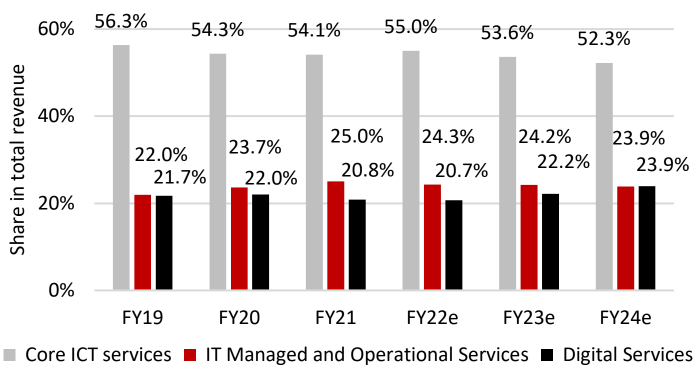
The growth rate achieved by Solutions has been across the board. Along with registering rapid growth, the market share of each business segment in its business vertical has also increased, which indicates the company's holistic growth approach. Since 2007, the company has worked on different strategies. From 2007 to 2014, which was termed Horizon One, the objective was to develop a solid foundation upon which to build a business. Horizon Two (2014-2019) was dedicated to giving the business rapid traction, which is visible in the revenue trend of the past few years.

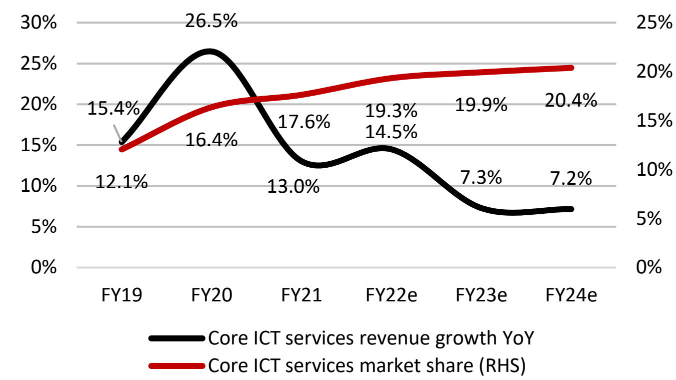
Now under its Horizon Three (2020-2025), Solutions aim to achieve stable growth along with improved profitability. For FY22, Solutions has given guidance of mid-to-high single-digit revenue growth. However, considering 1Q 2022 financials, the company's market standing, industry growth prospects, and the fact that it has easily beaten its guidance in the past, we opine the management's expectation to be on the conservative side, and accordingly, we expect it to clock a top-line growth in the low-to-mid double-digits. Accordingly, over the medium term, we estimate the company to clock an 11% total revenue CAGR during FY21-25, slightly higher than the 8% CAGR at which the Kingdom's overall ICT services market (including IT services and B2B voice & data) is expected to expand during this period.

Fig. 23: Core ICT services' share in total revenue is receding



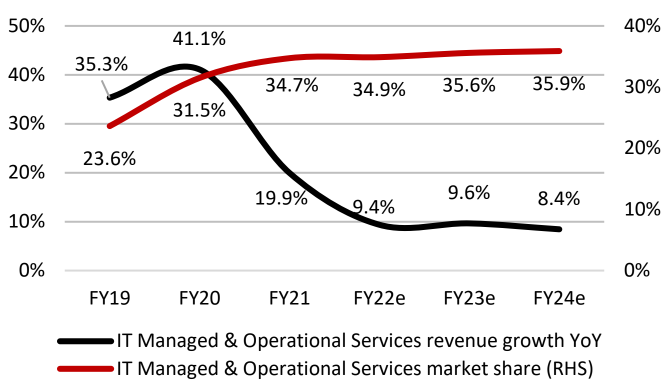
Source: Company Reports, U Capital Research

Fig. 24: Core ICT services' revenue growth and market share



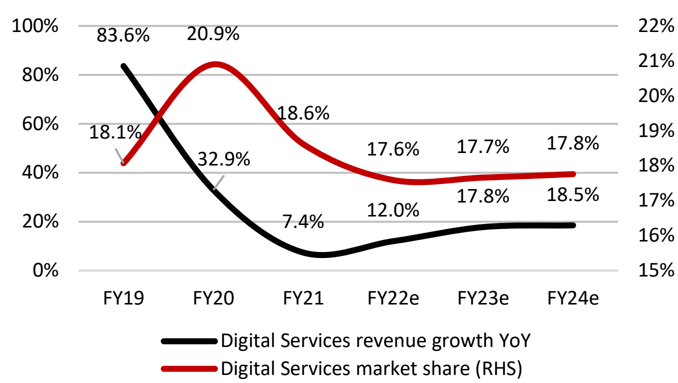
Source: Company Reports, U Capital Research

Fig. 25: IT Managed services' revenue growth and market share



Source: Company Reports, U Capital Research

Fig. 26: Digital services' revenue growth and market share



Source: Company Reports, U Capital Research

...accompanied by an improvement in profitability

As pointed out above, under the current strategy, Solutions will strive for its business growth to be accompanied by an improvement in its profitability. To achieve this, the company seeks to expand into new but related business lines, offering high-margin products. In addition, optimization of costs to enhance operational efficiency is also on the cards. We opine that the company has already initiated steps to achieve this, which helped it in reversing a declining trend in its margins during FY17-FY19. With the above-discussed steps bearing fruit, we expect expansion in Solutions' margins to sustain going forward.

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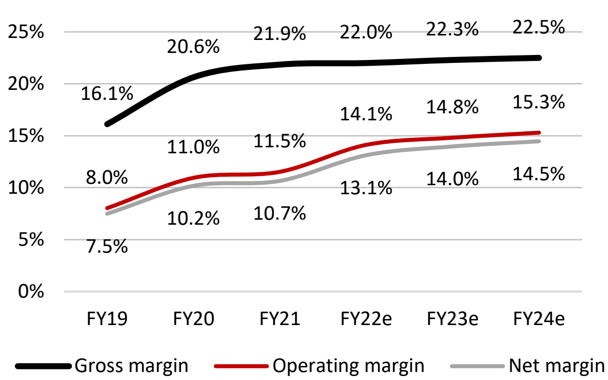
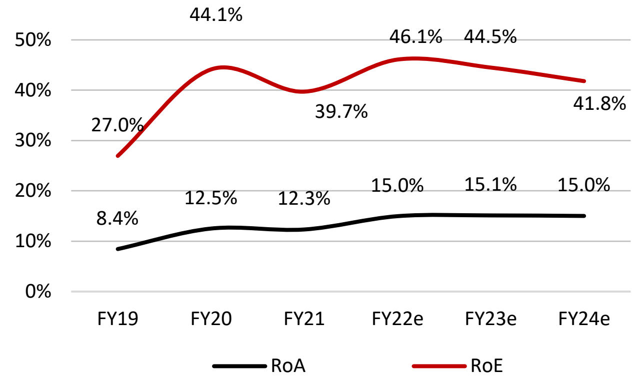
Fig. 27: Profitability expansion to continue…



Source: Company Reports, U Capital Research

Fig. 28: …boosting return to shareholders

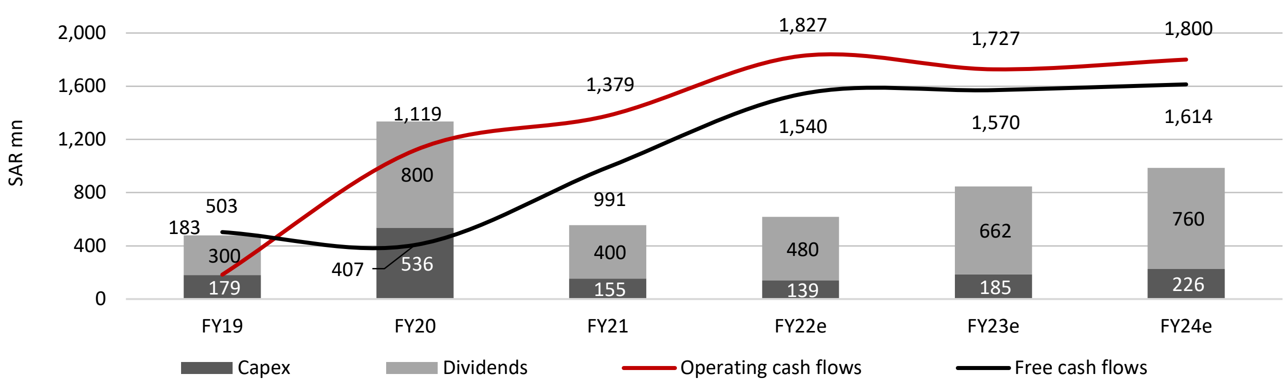


Source: Company Reports, U Capital Research

Strong balance sheet, coupled with low capex requirements to ensure sustained dividend payouts

Solutions is a zero debt company, and in the backdrop of relatively low capex requirements on average, the company has enjoyed healthy cash flows as well as liquidity. Solutions' receivables days had increased from 4 months in FY17 to slightly over 5 months in FY19, which we feel is due to the high volume of its business coming from the government and GREs. However, the company has worked to reduce its receivables days to nearly 4.5 months in FY21 and we expect it to bring down further to around 4 months going forward. Given our forecast of top-line growth and profitability improvement, we expect the company to comfortably meet its business funding needs, both for day-to-day operations as well as capex requirements for organic and inorganic growth. We expect Solutions would still be left with ample liquidity to maintain its dividend payouts. The company has increased its DPS in FY21 to SAR 4.0 per share from SAR 3.3 per share in FY20, resulting in a dividend payout of ~58 (57% in FY20).

Fig. 29: Solid cash flows to easily accommodate capex and dividends



Source: Company Reports, U Capital Research

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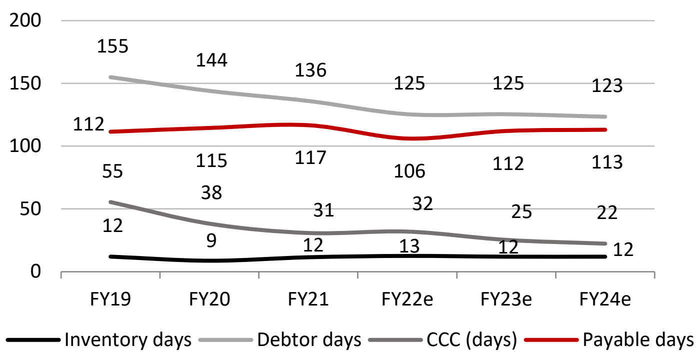
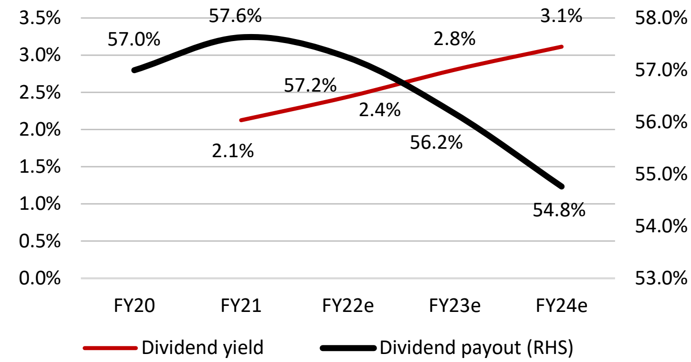
Fig. 30: Receivables days gradually reducing



Source: Company Reports, U Capital Research

Fig. 31: Consistent dividend payments likely



Source: Company Reports, U Capital Research

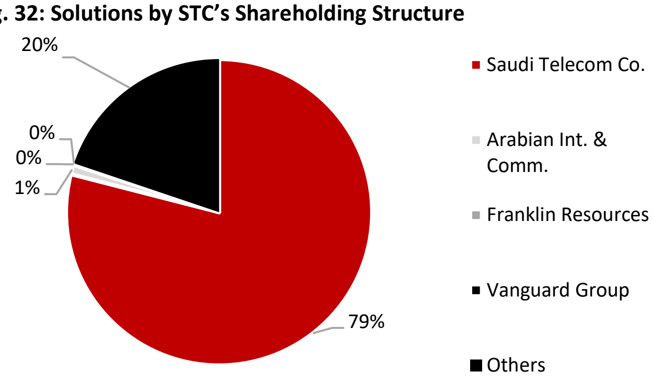
Assign Hold rating

Solutions' stock price has appreciated ~20% year-to-date till 12 May 2022 and is nearly 50% since the close of its first trading day on 29 September 2021. In our view, the current valuation levels indicate that most of the near-term positives are already priced in and therefore, we assign a **HOLD** rating on the stock with a target price of SAR 233.5, implying an upside of 3.3%.

About Solutions by STC

The company was incorporated under the name of "Arabian Internet and Communication Services Company" in 2003 and got listed on Tadawul in 2021. "Solutions by STC" is its commercial name and the telecom major Saudi Telecom Company (STC) is the largest shareholder in the company, holding a 79% stake currently. Solutions by STC is a leading player in the Kingdom's IT sector and offers a range of products and services covering system integration, cloud services, cybersecurity, managed networks, and connectivity solutions, among others. The company caters to both the public and private sector clients, with more than 50% of revenue being generated from the government and government-related entities (as of FY21). In terms of geography, the company generates almost all of its business from the Kingdom. Solutions' has five offices in Saudi Arabia, two in Riyadh including the headquarters, and one each in Jubail, Khobar, and Jeddah. As of FY21, the company has more than 1,500 professionals working for it.

Fig. 32: Solutions by STC's Shareholding Structure



Source: Bloomberg, 17 April 2022

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Key financials

In SAR mn, except stated otherwise	FY19	FY20	FY21	FY22e	FY23e	FY24e
Income Statement						
Revenue	5,257	6,891	7,816	8,807	9,691	10,658
Cost of sales	(4,410)	(5,469)	(6,108)	(6,870)	(7,530)	(8,260)
Gross profit	**847**	**1,422**	**1,708**	**1,938**	**2,161**	**2,398**
General and administration expenses	(350)	(460)	(462)	(454)	(478)	(502)
Selling and distribution expenses	(158)	(159)	(196)	(217)	(236)	(258)
(Impairment)/reversal of impairment of accounts receivable	9	(46)	(151)	(35)	(36)	(34)
Operating profit	**422**	**755**	**901**	**1,244**	**1,435**	**1,631**
Interest expenses on lease liabilities	-	-	-	-	-	-
Finance income/(costs), net	13	(1)	3	12	21	28
Profit before zakat	**435**	**754**	**904**	**1,256**	**1,457**	**1,659**
Zakat expense	(41)	(52)	(71)	(100)	(103)	(117)
Profit attributable to shareholders of the company	**394**	**702**	**833**	**1,156**	**1,354**	**1,542**
Balance Sheet						
Cash and cash equivalents	414	993	1,608	2,644	3,441	4,197
Trade and other receivables	2,635	2,804	3,021	3,034	3,331	3,605
Contract assets	1,166	1,505	1,256	1,561	1,804	1,954
Right of use assets	77	72	55	51	48	45
Property and equipment	167	594	551	408	342	349
Total assets	**4,877**	**6,335**	**7,173**	**8,266**	**9,636**	**10,894**
Contract liabilities	452	336	354	426	630	693
Lease liabilities	54	48	31	28	26	25
Trade and other payables	1,458	1,974	1,931	2,062	2,312	2,559
Total liabilities	**3,621**	**4,411**	**4,902**	**5,520**	**6,300**	**6,861**
Share capital	100	1,200	1,200	1,200	1,200	1,200
Retained earnings	1,079	610	960	1,339	1,878	2,576
Equity Attributable to Shareholders	**1,257**	**1,924**	**2,271**	**2,746**	**3,340**	**4,037**
Cash Flow Statement						
Net cash generated from operating activities	183	1,119	1,379	1,827	1,727	1,800
Net cash generated from investing activities	151	(536)	(155)	(139)	(185)	(226)
Net cash (used in) provided by financing activities	(813)	(4)	(610)	(655)	(741)	(818)
Cash and cash equivalents at the end of the period	**414**	**993**	**1,608**	**2,640**	**3,441**	**4,197**
Key Ratios						
Gross margin (%)	16.1%	20.6%	21.9%	22.0%	22.3%	22.5%
EBITDA margin (%)	9.8%	12.5%	14.2%	17.0%	17.1%	17.1%
Operating margin (%)	8.0%	11.0%	11.5%	14.1%	14.8%	15.3%
Net margin (%)	7.5%	10.2%	10.7%	13.1%	14.0%	14.5%
ROA	8.4%	12.5%	12.3%	15.0%	15.1%	15.0%
ROE	27.0%	44.1%	39.7%	46.1%	44.5%	41.8%
Current Ratio (x)	1.3x	1.4x	1.4x	1.5x	1.5x	1.6x
Capex/Sales	3.4%	7.8%	2.0%	1.6%	1.9%	2.1%
Debt-Equity Ratio	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x
EPS	3.3	5.8	6.9	9.6	11.3	12.8
BVPS	125.7	16.0	18.9	22.9	27.8	33.6
DPS	80.0	3.3	4.0	5.5	6.3	7.0
Dividend Payout Ratio	203.1%	57.0%	57.6%	57.2%	56.2%	54.8%
Dividend Yield (%)	NA	NA	2.1%	2.4%	2.8%	3.1%
P/E (x)	0.0x	0.0x	27.1x	23.5x	20.0x	17.6x
P/BV (x)	0.0x	0.0x	9.9x	9.9x	8.1x	6.7x
EV/EBITDA (x)	0.0x	0.0x	19.1x	16.6x	14.5x	12.8x
Price as at period end*	-	-	188.2	226.0	226.0	226.0

Source: Company Reports, U Capital Research *Current market price is used for forecast periods

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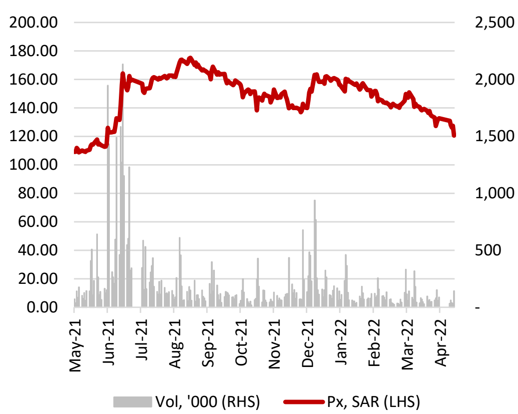
Al Moammar Information

Target Price: SAR 158.5/share
Upside: 31.4%

Recommendation	**Buy**
Bloomberg Ticker	MIS AB
Current Market Price (SAR)	120.60
52wk High / Low (SAR)	178.600/108.200
12m Average Vol. (000)	204.2
Mkt. Cap. (USD/SAR Mn)	7,839/3,015
Shares Outstanding (mn)	25.0
Free Float (%)	52%
3m Avg Daily Turnover (SAR'000)	13,083.0
6m Avg Daily Turnover (SAR'000)	20,266.5
P/E'22e (x)	18.9
P/B'22e (x)	7.2
Dividend Yield '22e (%)	2.4%
Price Performance:	
1 month (%)	(13.5)
3 month (%)	(23.0)
12 month (%)	11.5

Source: Bloomberg, valued as of 12 May 2022

Price-Volume Performance



Source: Bloomberg

- **The first Saudi company in the IT sector to be listed on Tadawul has a sizeable number of government and semi-government clients**
- **Inked several contracts, launched new initiatives recently focusing on new and upcoming technologies like artificial intelligence, big data, etc.**
- **MIS is implementing a data centers project which is expected to boost the earnings and profitability; a likely decline in impairments should also impact margins positively**
- **Management commits to maintain dividend payout at a minimum of 45% till FY23**

We initiate coverage on **Al Moammar Information Systems (MIS)** and assign a **Buy** rating with a target price of SAR 158.5 per share, offering an upside of 31.4%. Currently, the stock trades at a P/E of 18.9x, based on our FY22 estimates. MIS is undertaking a project to build some new data centers in the Kingdom by mid-2023, which is expected to be a major near-term catalyst for earnings growth. Moreover, revenue is also likely to rebound, tracking the general ICT industry trend, and the government's increased focus on progressing towards a digital economy. Initiatives and deals that were undertaken over the last one and a half year has the potential to boost the earnings capability of MIS over the near-to-medium term, in our view, while also lending diversification benefits to the business.

Investment Thesis

Valuation and risks: Our target price is based on blended valuation methodologies – (i) Discounted Cash Flow (DCF) and (ii) Relative Valuation (using P/E multiple). Key downside risks to our valuation include i) below-expected performance of the business units ii) an anticipated improvement in the receivable impairment not materializing, iii) less-than-estimated expansion in margins, iv) higher than forecasted leverage levels, and/or the associated debt costs. Key upside risks to our valuation include i) better-than-estimated revenue growth, especially in the data center segment ii) better-than-expected improvement in margins, and iii) lower-than-estimated leverage levels and/or debt servicing costs.

Recovery on the cards: MIS has products and solutions across the domains of the IT sector i) Top-line expected to return to growth after weakening for two years, backed by several new projects & initiatives undertaken, ii) SAR 2.5bn cumulative value of WIP contracts currently, highest in the company's history, iii) New data centers project to give a fillip to earnings growth, iv) gross margins expected to improve, aided by an improvement in revenue and diversification of revenue streams, v) operating and net margin under pressure last year but set to recover with improvement in gross margins and likely decrease in impairments, vi) leverage position higher than peers at present, but a forecasted pickup in earnings should aid in better debt management vii) sustained dividend payouts; minimum dividend payout policy of 45% till FY23

Year	FY19	FY20	FY21	FY22e	FY23e	FY24e
Revenues (SAR mn)	997.5	674.8	638.8	715.8	793.0	883.7
Net income (SAR mn)	76.0	81.3	56.5	159.1	159.1	134.0
Gross margin	16.4%	25.7%	26.1%	36.5%	34.2%	28.3%
Net profit margin	7.6%	12.0%	8.8%	22.2%	20.1%	15.2%
RoE	33.7%	28.1%	17.2%	42.2%	34.5%	25.4%
FCF (SAR/share)	0.3	(2.7)	(0.3)	7.2	7.2	7.0
DPS (SAR/share)	2.0	2.1	2.0	2.9	3.1	3.3
Dividend Yield	7.0%	2.7%	1.7%	2.4%	2.6%	2.7%
P/E (x)	9.3x	23.7x	67.0x	18.9x	19.0x	22.5x
P/BV (x)	1.8x	4.7x	11.3x	7.2x	6.0x	5.4x

Source: Company Reports, U Capital Research **P/E and P/B from 2022 onwards calculated on price of 12/05/2022*

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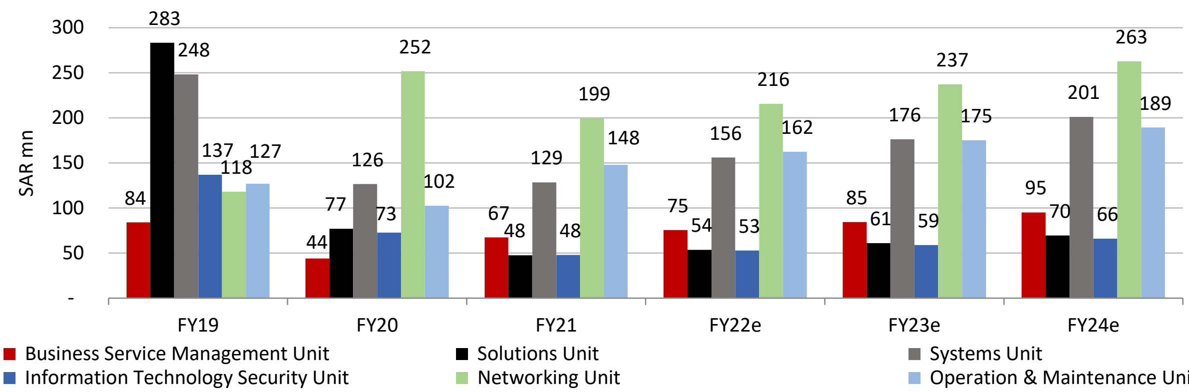
The existing business units are expected to gain traction amid an improving business environment

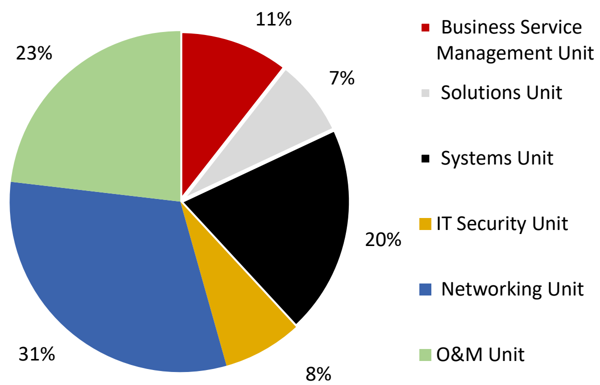
The company carries out a gamut of ICT solutions and services through six business units, namely, Business Service Management Unit, Solutions Unit, Systems Unit, Information Security Unit, Networking Unit, and Operations & Maintenance (O&M) Unit. Of these, Networking Unit had the largest revenue share in FY21 total revenue (31.2%), followed by O&M Unit (23.1%), and Systems Unit (20.1%). According to the management, the total value of new projects of the company during 1Q 2022 reached ~SAR 1.5bn, including SAR 1.2bn data centers project, while the cumulative value of work-in-progress contracts and business amounted to SAR 2.5bn, which is the highest in the company's history. The order book position should swell further with the company adding more contracts during the remaining quarters of the year. This provides good revenue visibility in our view, even if the company manages to book only a part of its outstanding contract in revenue, and accordingly, we estimate MIS' top-line to rebound in FY22, after remaining under pressure during the last two years.

Fig. 33: Among the existing units, Networking Unit has remained the largest revenue provider



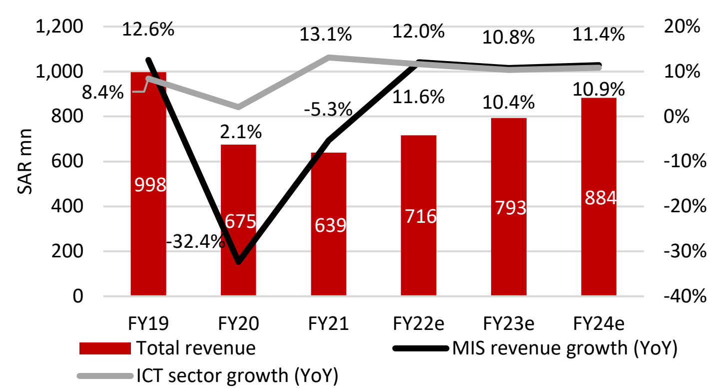
Source: Company Reports, U Capital Research

Fig. 34: Revenue share of different business units in FY21



Source: Company Reports, U Capital Research

Fig. 35: Revenue expected to grow in tandem with the industry



Source: Company Reports, Solutions' IPO Prospectus, U Capital Research

Spearheaded by the government's push toward a digital economy, the ICT sector is forecasted to clock a double-digit growth rate over the next few years. Accordingly, the company also expects its business volume to grow over the coming years, and to ensure this, it plans to launch new initiatives, products as well as services as per market needs. In this regard, it is to be noted that the company has signed several agreements since the start of FY21, which enables it to participate and capitalize on the existing and new opportunities in the IT domain like cloud services, artificial intelligence, Internet of Things (IoT), data centers, etc. Apart from the data centers' deal with SFC and Abunayyan Holding, some of the other noteworthy contracts signed during the last 12-15 months are:

- Participated as a founding member with a consortium of commercial entities to establish a sharia-compliant digital bank in the Kingdom having a share capital of SAR 1.5bn, with the MIS contributing SAR 25mn towards its capital
- A strategic deal with BMC Software Inc. to provide cloud information technology management services to Saudi government agencies and large and medium companies by using the Helix software

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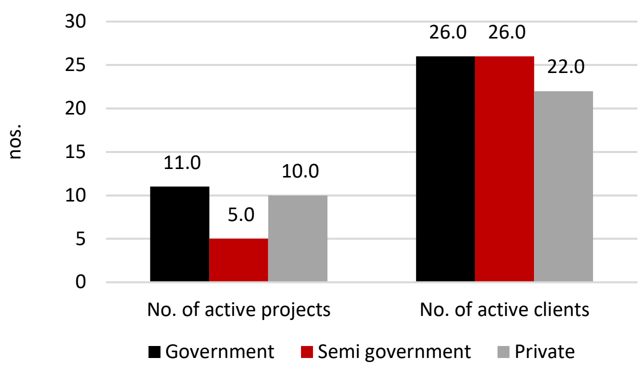
- Launched an investment fund as per an MoU with Al Rajhi Capital with an initial size of SAR 1bn to fund the digital & technological infrastructure and medical equipment projects
- MIS Forward (100% subsidiary) inked a binding agreement with a European fintech company to develop and implement various innovative applications for MIS, such as i) 'The Venture Studio' to support creative and emerging ideas, ii) "Buy Now, Pay Later" application, expected to be launched during 1H 2022, iii) an e-commerce platform and application, expected to be launched during 1H 2022, and iv) "Open Banking" platforms, expected to be launched during 2H 2022
- Launched in December 2021 applications and solutions of DataRobot through MIS cloud services to fulfill the artificial intelligence, machine learning, and data science needs of government agencies, and large and medium corporate
- In March 2022, Edarat Communications & Information Technology Company (50% owned by MIS) obtained a higher level classification license to provide cloud computing services which allows it to deal with secret and top-secret government data

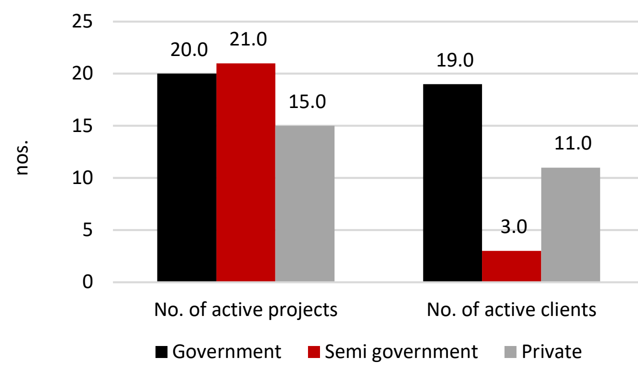
In addition, the company established a 100% subsidiary in January 2021, named EMS, specializing in the field of healthcare services and manufacturing and selling medical equipment and products. Consequently, MIS secured several healthcare-related contracts, such as a SAR 186mn contract for the operation and medical maintenance of King Saud Medical City, a SAR 39mn contract for the operation and maintenance of the digital infrastructure of 48 hospitals in the Central Region of Saudi Arabia, SAR 58mn contract for the operation and maintenance of the digital infrastructure of 72 hospitals in the Eastern Region and Northern Region, and SAR 79mn contract for the maintenance of medical devices and equipment for Al-Noor Specialized Hospital in Makkah.

Fig. 36: MIS Critical Infrastructure Business Line



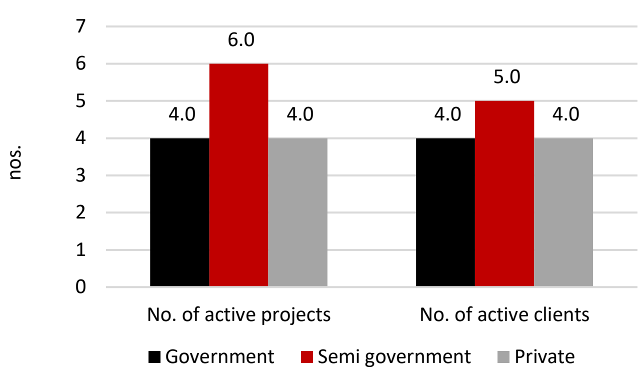
Source: Company Reports, U Capital Research

Fig. 37: MIS Cloud Computing And Consulting Business Line



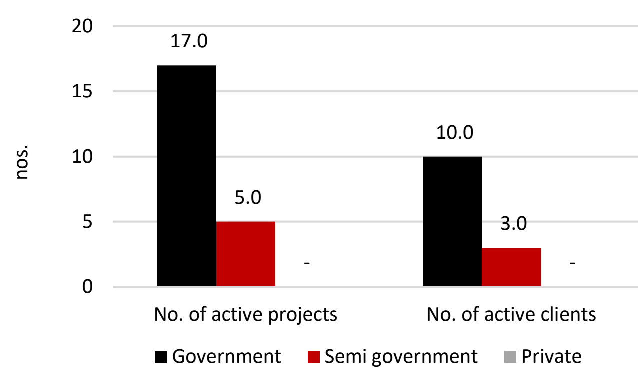
Source: Company Reports, U Capital Research

Fig. 38: MIS Digital Solutions Business Line



Source: Company Reports, U Capital Research

Fig. 39: MIS Operation And Maintenance Business Line



Source: Company Reports, U Capital Research

Thus, it can be said that the MIS has been building exposure in the right places and at a right time. Many of the recent agreements provide MIS with the wherewithal to participate and benefit from the multitude of existing as well as upcoming opportunities across the spectrum of the ICT sector. Moreover, operating in the various facets of the IT industry gives resilience and diversification benefits to the company.

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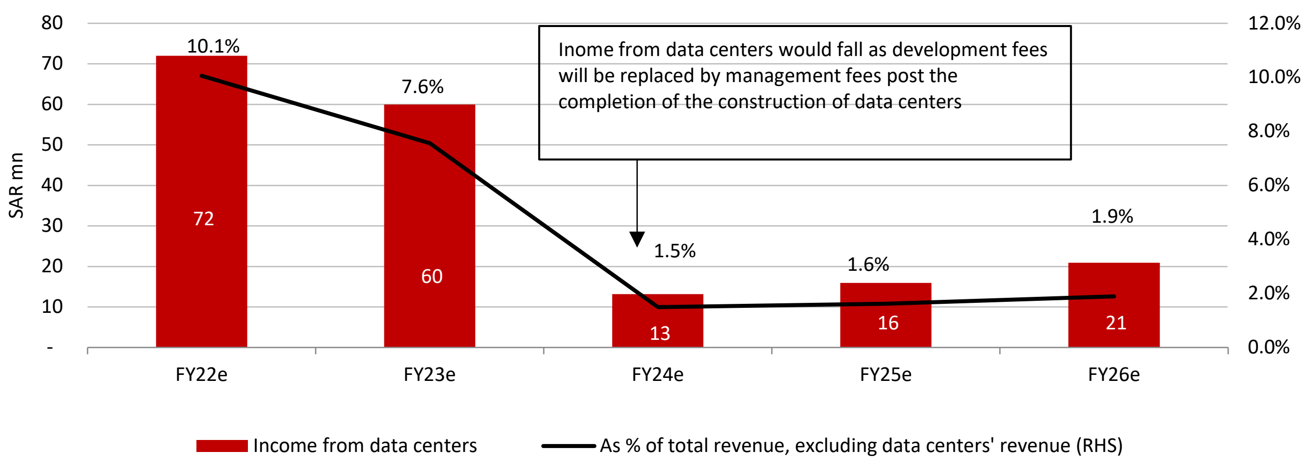
Data centers project to aid in business recovery…

MIS is among the key investment partners of the Saudi government's USD 18bn data centers strategy. The company had signed a Memorandum of Understanding (MOU) in June 2021 with Saudi Fransi Capital (SFC) to set up a private investment fund having an initial size of SAR 700mn, and scalable up to SAR 3.5bn, to develop, own, and operate data centers across Saudi Arabia. As part of this MoU, Sharia-compliant Saudi Data Centers Fund 1 was launched in October 2021 with a target size of SAR 1.5bn, and subsequently, a project to design, develop, and manage six data centers was announced at an estimated budget of SAR 1.2bn in the first phase. The cumulative initial capacity of the first data center project would be 24 megawatts (MW), which can be increased to 120 MW. MIS will receive a development fee equivalent to 10% of the project's cost. In addition, it will also be entitled to a 7% management fee applied to the revenue generated from the data centers (not modeled as of now for the lack of required information), as it has entered into an initial agreement to manage the data centers for 15 years. In our opinion, the company might earn additional income from this project apart from the development and management fee by itself becoming a contractor (either partially or fully) to set up the project. MIS had received a go-ahead from SFC to commence the project on 02 January 2022 and expects to complete the project by mid-2023, and has so far awarded civil, electromechanical, and technical contracts worth up to SAR 800mn in this regard.

Fig. 40: Data centers project to boost the earnings in FY22 and FY23



Source: Company Announcements, U Capital Research

We have assumed the company to get 60% of the expected income from the project (c. SAR 72mn) in FY22, which is nearly 11% of FY21 total revenue and around 10% of FY22e top-line, excluding the revenue from data centers. The remaining development fee is estimated to be received in FY23, followed by the data centers' management fee in subsequent years. Apart from this, the company has also entered into a partnership agreement with Abunayyan Holding to develop green data centers. While we have not accounted for the revenue that may accrue from this project, or the execution of phase II of the above-discussed data center project, given the lack of specific details, we contend they hold the potential to significantly augment the company's future revenue stream, once implemented.

…and along with a likely decrease in impairment provisions support margin enhancement

Despite pressure on the top line during the last two years, the company did well in containing its expenses, thereby improving the gross margin to 26.1% in FY21 from 25.7% in FY20. However, operating and net margins eroded in FY21 from FY20, partly owing to an 86.0% YoY jump in impairment expense on receivables and contract assets. Nevertheless, the company expects its receivables' collections to improve going forward which might result in a decrease in or reversal of some provisions, thereby positively impacting the operating and net income.

Moreover, income from the data centers project is also estimated to lead to a healthy expansion in the margins aided by the development, as well as the management fees. Hence, the resultant increase in the bottom line is expected to be directly proportional to the inflow of such income, which will enhance the profitability of the company as well as returns for the shareholders.

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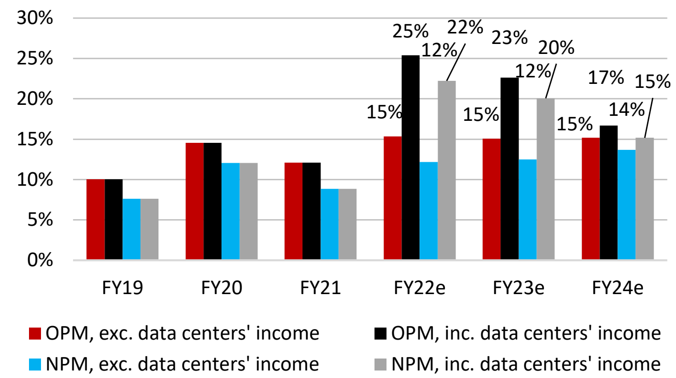
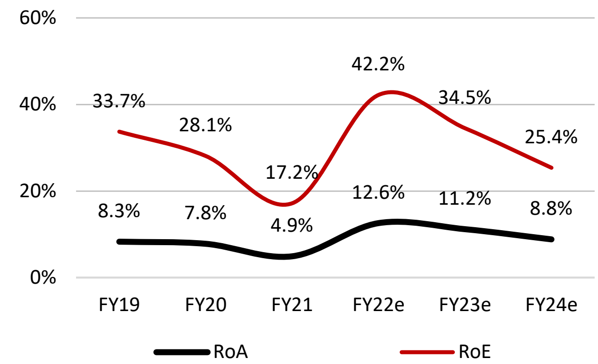
Fig. 41: Margins likely to expand significantly on data centers' income



Source: Company Reports, U Capital Research

Fig. 42: Return to shareholders also set to rise

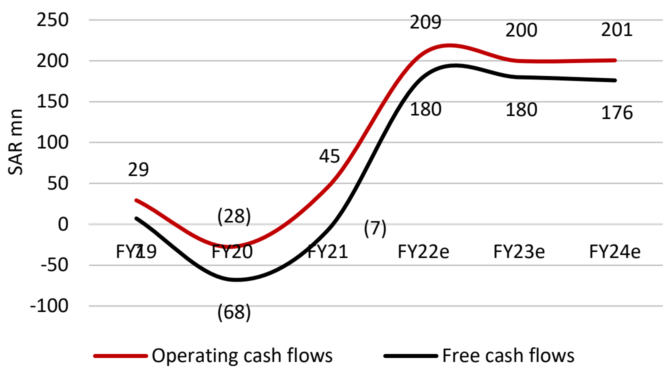


Source: Company Reports, U Capital Research

…leading to enhanced cash flows; ease in the leverage position

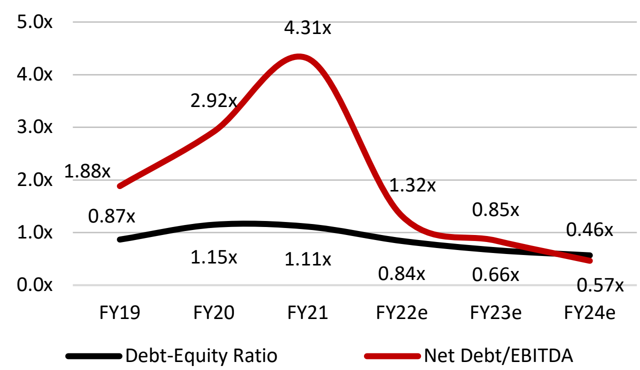
Given our expectation of an expansion in the company's profitability on the back of a recovery in top line and implementation of new projects, cash flows are also forecasted to be relatively better-off. Improved cash flows would equip the company to comfortably meet its capex requirements, which are expected to remain low at a historical average of ~2.0% of revenue, while also lowering its outstanding debt levels. Lower debt levels are desirable under the current situation as the economy is likely to witness a rising interest rate environment.

Fig. 43: Cash flows are estimated to improve gradually



Source: Company Reports, U Capital Research

Fig. 44: D/E expected to come down aided by earnings growth



Source: Company Reports, U Capital Research

Assign a Buy rating on better income visibility

Based on the recent business development initiatives undertaken by the company, we reckon the company might enter a new, higher growth phase over the coming few years, which is expected to be complemented by enhanced profitability. Accordingly, we assign a **BUY** rating on the stock with a target price of SAR 158.5, implying an upside of 31.4%. The company has proposed a bonus share issue in January 2022 in the ratio of 1:5, to be approved by an EGM. This will increase the size of the capital to SAR 300mn from the current SAR 250mn. We will make the required changes in our estimates once the decision is implemented. While the bonus issue will not alter the market value of the firm, it will lead to a reduction in the current market price which could raise the attractiveness of the stock, particularly among retail investors. A consistent dividend payment (minimum 45% dividend payout policy till FY23) also bodes well for the investors.

About MIS

MIS was established in 1979 in Khobar. It is currently headquartered in Riyadh and has an Eastern Region office in Dammam, and a Western Province office in Jeddah. The primary activity of the company is to provide a wide variety of solutions and services in the Information Technology (IT) sector like network integration, information security, cybersecurity, software solutions, support, and maintenance activities, carried out through six strategic business units. MIS is also foraying in setting up and management of data

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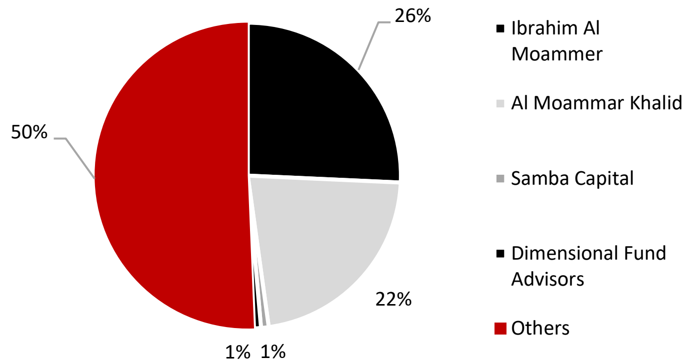
centers in the Kingdom. The company became the first Saudi public listed company in the IT sector after it got listed on the Saudi Stock Exchange (Tadawul) in 2019. As of 2021, MIS had around 200 employees as part of its central team and more than 700 personnel in the operation and maintenance team.

Fig. 45: MIS' Shareholding Structure



Source: Bloomberg, 17 April 2022

Key financials

In SAR mn, except stated otherwise	FY19	FY20	FY21	FY22e	FY23e	FY24e
Income Statement						
Revenue	998	675	639	716	793	884
Cost of sales	(834)	(502)	(472)	(526)	(581)	(647)
Gross profit	**164**	**173**	**167**	**262**	**272**	**250**
General and administration expenses	(44)	(55)	(61)	(67)	(74)	(83)
Selling and distribution expenses	(12)	(10)	(10)	(11)	(12)	(13)
(Impairment)/reversal of impairment of accounts receivable	(8)	(10)	(18)	(2)	(6)	(6)
Operating profit	**100**	**98**	**77**	**182**	**179**	**148**
Finance costs	(22)	(18)	(19)	(19)	(19)	(18)
Finance income	3	2	1	2	4	6
Profit before zakat	**83**	**89**	**65**	**171**	**171**	**144**
Zakat expense	(7)	(8)	(8)	(12)	(12)	(10)
Profit attributable to shareholders of the company	**76**	**81**	**56**	**159**	**159**	**134**
Balance Sheet						
Cash and cash equivalents	29	81	22	108	177	243
Trade and other receivables	351	516	388	432	478	533
Contract assets	428	375	568	650	612	573
Contract costs	104	139	90	90	90	90
Property and equipment	21	37	42	48	55	62
Total assets	**936**	**1,148**	**1,152**	**1,377**	**1,469**	**1,568**
Contract liabilities	93	139	123	100	110	122
Loans and borrowings	220	373	371	353	333	314
Trade and other payables	317	243	265	292	323	359
Total liabilities	**682**	**823**	**818**	**957**	**968**	**1,013**
Share capital	160	200	250	250	250	250
Retained earnings	72	108	71	142	207	247
Equity Attributable to Shareholders	**254**	**324**	**334**	**420**	**502**	**555**
Cash Flow Statement						
Net cash generated from operating activities	29	(28)	45	209	200	201
Net cash generated from investing activities	(11)	(18)	(38)	(13)	(14)	(16)
Net cash (used in) provided by financing activities	(95)	98	(67)	(110)	(116)	(119)
Cash and cash equivalents at the end of the period	**29**	**81**	**22**	**108**	**177**	**243**
Key Ratios						
Gross margin (%)	16.4%	25.7%	26.1%	36.5%	34.2%	28.3%
EBITDA margin (%)	10.2%	14.8%	12.7%	26.0%	23.3%	17.4%
Operating margin (%)	10.0%	14.6%	12.1%	25.4%	22.6%	16.7%
Net margin (%)	7.6%	12.0%	8.8%	22.2%	20.1%	15.2%
ROA	8.3%	7.8%	4.9%	12.6%	11.2%	8.8%
ROE	33.7%	28.1%	17.2%	42.2%	34.5%	25.4%
Current Ratio (x)	1.4x	1.4x	1.3x	1.6x	1.7x	1.7x
Capex/Sales	1.1%	2.7%	2.1%	1.8%	1.8%	1.8%
Debt-Equity Ratio	0.9x	1.1x	1.1x	0.8x	0.7x	0.6x
EPS	3.0	3.3	2.3	6.4	6.4	5.4
BVPS	15.9	16.2	13.3	16.8	20.1	22.2
DPS	2.0	2.1	2.0	2.9	3.1	3.3
Dividend Payout Ratio	42.1%	51.7%	88.5%	45.6%	48.7%	60.6%
Dividend Yield (%)	7.0%	2.7%	1.7%	2.4%	2.6%	2.7%
P/E (x)	9.3x	23.7x	67.0x	18.9x	19.0x	22.5x
P/BV (x)	1.8x	4.7x	11.3x	7.2x	6.0x	5.4x
EV/EBITDA (x)	9.0x	22.4x	50.8x	17.5x	17.1x	20.0x
Price as at period end*	28.4	77.0	151.4	120.6	120.6	120.6

Source: Company Reports, U Capital Research *Current market price is used for forecast periods

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Disclaimer

Recommendation

BUY	Greater than 20%
ACCUMULATE	Between +10% and +20%
HOLD	Between +10% and -10%
REDUCE	Between -10% and -20%
SELL	Lower than -20%

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