GiB CAPITAL جي آي بي كابيتال

Target Price: SAR680/share
Current Price: SAR711/share
Upside: -4% (+Div. Yield: 1%)
Rating: Neutral

Elm Company (Elm)

Compelling growth coupled with margin expansion

- Robust 2Q23 results, mainly aided by strong digital business segment performance, coupled with the margin expansion
- Robust digital business, aided by new contract wins and expanding the existing services, should ensure the strong profitability going forward
- Post upgrading our estimates (w/o Thiqah's acquisition), we raise our TP to SAR680 based on 30x 2024EPS but revise our rating to Neutral on Elm

Long-term growth story remains intact: Elm continues to remain at the forefront of several Vision 2030 digital transformation initiatives by the KSA government. We continue to expect a step-up increase in high margin digital business (+70% of total revenues) as the company not only develops new platforms but also continues to expand existing digital platforms (such as Nusuk, Absher, Fasah, Tamm, Muqeem, etc.) by adding value-added services, helping in further monetization. Furthermore, we expect BPO segment to witness sustained growth as the management actively enters newer contracts in different sectors with healthy margins. Overall, we expect Elm's topline and net income to grow at a CAGR of 19% and 25%, respectively between 2022-26e (24% and 26% in 2018-22).

Thiqah's acquisition- a key upside catalyst: In June 2023, Elm announced that it has started initial talks with Thiqah to acquire 100% shares owned by PIF in the latter. The deal, if successful, would potentially make Elm the largest player in the government services digitization space in KSA. This will also likely enable Elm's entry into new technologies such as AI and give access to a new clientele. Given the limited overlap between Thiqah's and Elm's product propositions, we expect the acquisition to expand product portfolio, unlock synergies and complement Elm's higher-margin digital products business. However, given the uncertainty, we have not factored in this acquisition in our forecasts. However, once the deal is completed and we get more details, we will incorporate it into our forecasts, which may lead to a revision in our valuation.

Valuation and risks: Better growth and margin profile than local peers justify a higher PE multiple though we keep it at 30x lower than some local peers. Key downside risks include increased competition, slower than expected pace of digitalization, higher wage inflation, and loss of data arrangement with NIC.

*Figure 1: Key financial metrics**

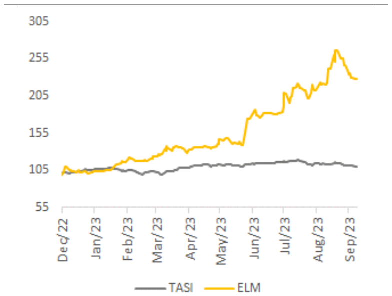
SARmn	2022a	2023e	2024e	2025e
Revenue	4,606	5,752	6,997	8,247
Revenue growth	*20%*	*25%*	*22%*	*18%*
Gross Profit	1,886	2,429	2,971	3,504
Gross Profit margin	*41%*	*42%*	*42%*	*42%*
Op. income	972	1,398	1,744	2,075
Op. Profit margin	*21%*	*24%*	*25%*	*25%*
Net profit	930	1,381	1,681	1,987
Net profit margin	*20%*	*24%*	*24%*	*24%*
EPS (SAR)	11.6	17.3	21.0	24.8
DPS (SAR)	4.9	6.9	10.5	12.4
P/E	61.1x	41.2x	33.8x	28.6x

*Source: Company, GIB Capital. * We have not incorporated the Thiqah acquisition*

Stock data	
TASI ticker	7203
Mcap (SARmn)	58,208
Trd. Val (3m) (SARmn)	140.7
Free float	33.0%
QFI holding	13.1%
TASI FF weight	0.99%

Source: Bloomberg

Prices indexed to 100



Source: Bloomberg

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2023 guidance revised upwards: Post reporting strong 1H23 results, Elm has upgraded its 2023e guidance with revised top-line growth of 21-23% vs 14-16% earlier, and EBIT margin of 22-24% vs 19-21%. However, given its past record and 1H23 performance, we expect the company to beat its guidance for 2023e, driven by higher contribution of digital business.

Figure 2: Strong 2022 and 2023 guidance

	2022 guidance	*2022a*	*2023 Previous guidance*	*2023 Updated guidance*	*2023 GIBCe**
Revenue growth	10-12%	20%	14-16%	21-23%	25%
EBIT margin	18-21%	21%	19-21%	22-24%	24%
CFO as % net inc.	100%	181%	80-90%	80-90%	102%

*Source: Company data, GIB Capital. * We have not incorporated the Thiqah acquisitio*

Robust 2Q23 results: The 2Q23 revenues rose by 35% y/y to ~SAR1,404mn due to a 43% y/y increase in digital business revenue and a ~23% rise in BPO revenue, offsetting a 15% drop in professional services revenues. The cost of revenue grew at a slower pace than the top-line growth, up by 28% y/y, leading to gross profit growth of ~46% y/y, with gross margin expansion of ~3.2pps to 42.9% in 2Q23. This, along with controlled Opex, pushed the operating margin by ~6.5pps to 26.9%. Overall, the net income nearly doubled with a net margin of 26.6% (+7.8pps).

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