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Solutions by STC | Europe

2Q23 flash results: Profit beats despite revenue miss, 4% org. growth

STOCK RATING	INDUSTRY VIEW	PRICE TARGET
Equal-weight	No Rating	SAR 295.00

Despite a strong profit performance once again (12/9% EBITDA beat vs. MS/consensus, 9/6% on net income), revenue performance was in-line with MS and c. 3% below consensus. Solutions has disclosed that - in 1H23 - the organic business grew a modest c. 5% y/y (c. 4% for 2Q). Given the recent strong stock performance (now up to 30x MS 2024 adj. P/E) and given top-line growth is very important for the equity story at this valuation, we think the lack of a top-line beat and the disclosed rate of organic growth will outweigh the profit beat on the headline results. While the stock is down c. 4% in Sunday trading, we expect continued underperformance on Monday the market digests the details.

Core ICT momentum solid, gross profit significantly beats: Within the revenue mix, Core ICT grew 29% y/y, above our 25% estimate, offset by 41% growth in IT Managed and Operational Services (MS 49%). Digital Services at 16% growth was broadly in-line with MS (15%). In 2Q, government revenues were +5%, STC revenues were +47%, and private sector was +80%. Headline gross profit was a significant 22/18% beat vs. MS/consensus, and was a 27% gross margin. This may partly be mix on acquisition, but it nevertheless suggests strong core business performance. We look to the full results to see if there are any one-offs in this number. Cost growth (and company commentary of an increased bad debt provision) limited the net income beat to 9/6% vs. MS/consensus.

FCF weaker: FCF in 2Q was SAR -355m; while we await the full cash flow statement, we suspect this will relate to working capital movements in the quarter.

As usual, we look forward to the full results in due course to understand underlying performance in the quarter (i.e. excluding movements in provisions, impairments etc). We also look for any updates to guidance. We will update our forecasts at that point. On our current forecasts and at SAR 350, Solutions trades on c. 30x FY24 adj. P/E.

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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 295.00
Shr price, close (Jul 30, 2023)	SAR 350.00
52-Week Range	SAR 385.00- 216.80
Mkt cap, curr (mn)	SAR 42,000
Net debt (12/23e) (mn)*	SAR (2,511)
EV, curr (mn)*	SAR 39,481

* = GAAP or approximated based on GAAP

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Exhibit 1: 2Q23 results versus MS estimates and consensus

SAR m	Actual	2Q23		% Δ vs	
		MSe	Consensus	MSe	Cons
Core ICT Services	1,377	1,340			
y/y growth (%)	29%	25%			
IT Managed and Operational Services	825	869			
y/y growth (%)	41%	49%			
Digital Services	499	500			
y/y growth (%)	16%	15%			
Total revenue	2,701	2,709	2,788	-0.3%	-3.1%
y/y growth (%)	30%	30%	34%		
Gross profit	732	598	620	22.4%	18.1%
% margin	27.1%	22.1%	23.0%		
Stated EBITDA	456	407	419	12.1%	8.8%
% margin	16.9%	15.1%	15.5%		
Stated net income	340	311	321	9.1%	5.9%
Free cash flow	-355	265			

Source: Company data, Company compiled consensus, Morgan Stanley Research estimates (e)

Valuation Methodology and Risks

Solutions by STC (7202.SE)

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

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

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(as of June 30, 2023)

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Stock Rating Category	Coverage Universe		Investment Banking Clients (IBC)			Other Material Investment Services Clients (MISC)	
	Count	% of Total	Count	% of Total IBC	% of Rating Category	Count	% of Total Other MISC
Overweight/Buy	1353	37%	280	44%	21%	607	39%
Equal-weight/Hold	1658	46%	293	46%	18%	716	46%
Not-Rated/Hold	2	0%	0	0%	0%	0	0%
Underweight/Sell	610	17%	68	11%	11%	224	14%
Total	3,623		641			1547	

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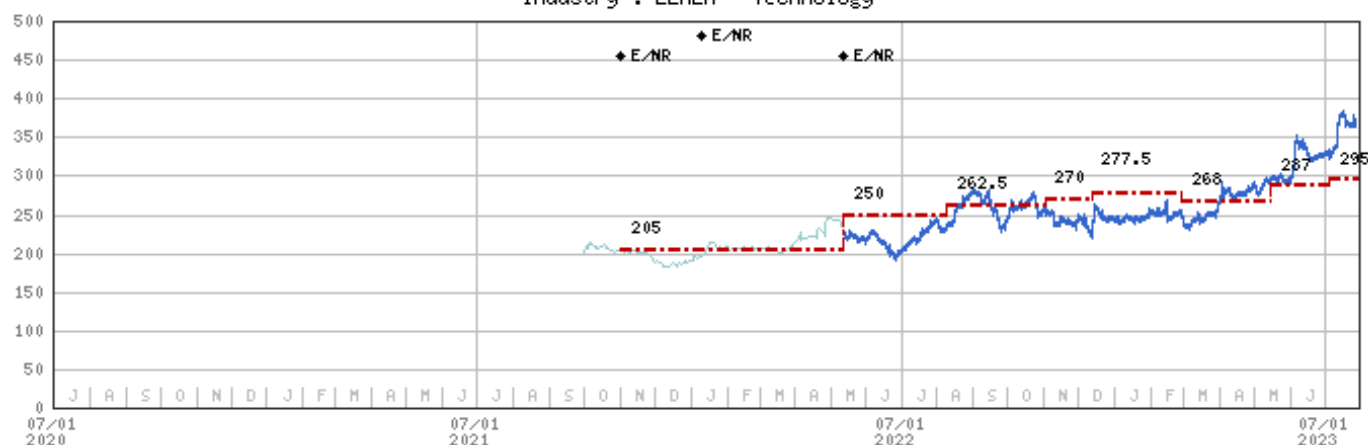
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Stock Price, Price Target and Rating History (See Rating Definitions)

Solutions by STC (7202.SE) - As of 7/29/23 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

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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COMPANY (TICKER)	RATING (AS OF)	PRICE* (07/30/2023)
George W Webb Solutions by STC (7202.SE)	E (05/12/2022)	SAR 350.00

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* Historical prices are not split adjusted.