

November 8, 2023 12:01 AM GMT

Solutions by STC | EEMEA

Expensive structural growth.
Downgrade to Underweight

WHAT'S CHANGED

Solutions by STC (7202.SE)	From	To
Rating	Equal-weight	Underweight
Price Target	SAR 305.00	SAR 268.00

We turn more cautious, seeing valuation as rich in the context of more normalised single-digit organic growth and elevated profitability, which we think will act as a tough comp in 2024.

Key Takeaways

- Core Solutions growth was 6% over 9M23. We model 8-10% group organic growth across FY24-26; we think consensus at double-digit growth is too high
- We do not model stronger FY23 gross margins (MS 25.6%) as a sustainable level
- We now incorporate 1%/sales of impairments into our adj. EBIT margin forecasts
- Net net, our adj. EBIT forecasts rise 3% in FY23, fall 1-3% FY24-26. Combined with higher 9% WACC, our price target falls to SAR 268, implying 17% downside
- 24.5x FY25e adj. P/E is expensive vs. 9-10% FY26/27e organic adj. EPS growth

Vision 2030 remains a strong tech spend driver, but we think growth is structurally normalising and FY23 margins will prove a peak:

We view the Saudi IT services structural growth opportunity as intact, but three factors drive us to be more cautious: 1) Core Solutions growth has shown signs of having normalised lower towards market rates; while we think the market assumes continued double-digit organic growth over the mid-term, this is not our base case; 2) project mix and contract delivery have aided very strong YTD gross margin performance. We see margins at a high ebb, and as likely to normalise materially lower from here; 3) with a higher rate of receivables/contract asset impairments YTD, and on average >1% p.a. in recent years, we adjust our valuation framework and now look at adjusted operating profitability post an assumed c. 1% p.a. average level of impairments.

Valuation rich in the context of Solutions' profile: Solutions screens expensively versus most developed market IT services vendors. Investors continue to price the stock for earnings beats, as Solutions has delivered since IPO. Moving into 2024, we see fewer upside risks to consensus; we are 7/13% lower than consensus EBIT across FY24/25. Several factors also keep us cautious on valuation: 1) a material minority of Solutions' gross profit base is likely in business that we consider more akin to telco activities (and deserving a lower multiple); 2) high revenue share with concentration around parent company STC; 3) Solutions' high reliance on a single geography (KSA); and 4) limited granular disclosure around business sub-segments. Key risks to our Underweight are around potential for continued large contract wins in a dynamic KSA market, and for gross margins to remain higher for longer.

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Solutions by STC (7202.SE, SOLUTION AB)

EEMEA - Technology | Saudi Arabia

Stock Rating	Underweight
Industry View	No Rating
Price target	SAR 268.00
Shr price, close (Nov 7, 2023)	SAR 322.00
52-Week Range	SAR 385.00- 216.80
Mkt cap, curr (mn)	SAR 38,640
Net debt (12/23e) (mn)*	SAR (2,678)
EV, curr (mn)*	SAR 36,121

* = GAAP or approximated based on GAAP

Fiscal Year Ending	12/22	12/23e	12/24e	12/25e
Sales / Revenue (SAR mn)**	8,805	11,037	12,289	13,361
EBITDA (SAR mn)**	1,301	1,929	1,882	2,019
EBIT (SAR mn)**	1,074	1,649	1,601	1,717
ModelWare EPS (SAR)	8.32	12.40	12.18	13.17
Prior EPS (SAR)**	8.97	11.99	12.32	13.54
EPS (SAR)§	8.85	10.72	12.76	14.29
P/E**	29.2	26.0	26.4	24.5
EV/revenue*	3.0	3.3	2.9	2.9
EV/EBITDA**	20.5	18.9	19.0	19.2
EV/EBIT**	24.8	22.1	22.3	22.5
Div yld (%)	2.1	1.7	1.9	2.0
FCF yld ratio (%)**	6.8	3.3	3.6	3.8
Net debt (SAR mn)*	(2,548)	(2,678)	(3,417)	(4,182)

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

** = Based on consensus methodology

§ = Consensus data is provided by Refinitiv Estimates

* = GAAP or approximated based on GAAP

e = Morgan Stanley Research estimates

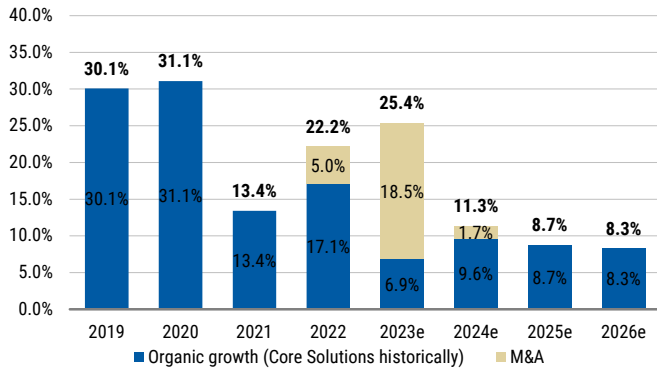
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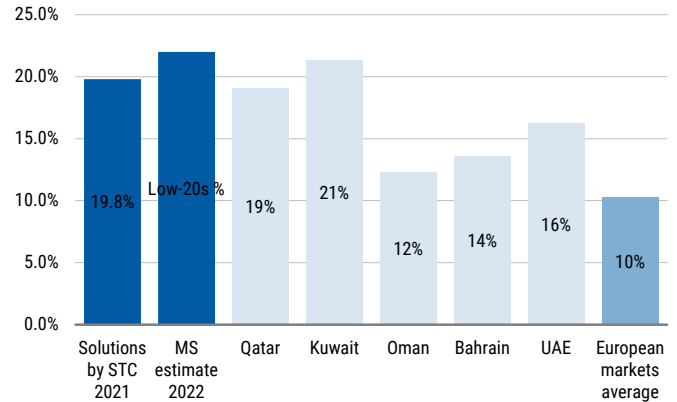
Key exhibits/narrative

Exhibit 1: Core Solutions growth has been normalising, and we expect organic growth to moderate to high s.d. %



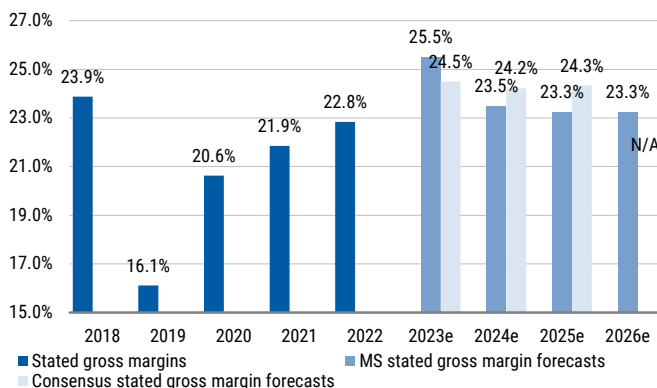
Source: Company data, Morgan Stanley Research estimates

Exhibit 2: Reflecting Solutions' already high market share in Saudi Arabia compared to what we see elsewhere



Source: IDC data, Gartner data (for market shares across broad spectrum of European markets), Morgan Stanley Research estimate for 2022

Exhibit 3: FY23 profitability is at a high ebb, and we think will form a tough profit comp into 2024



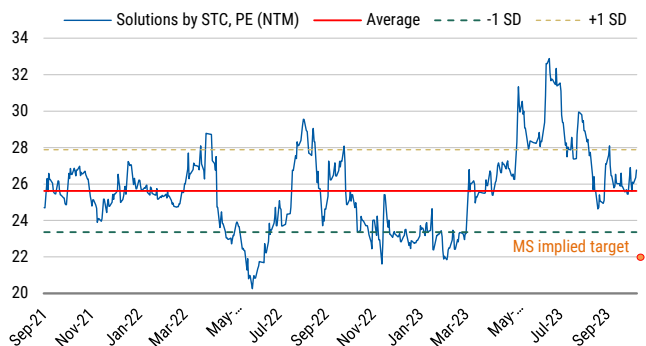
Source: Company data, Morgan Stanley Research estimates

Exhibit 4: Reflecting our lower top line and margins, our FY24/25 EBIT forecasts are 7/13% below consensus

	MS			Consensus			Delta		
SARm	FY23	FY24	FY25	FY23	FY24	FY25	FY23	FY24	FY25
Revenue	11,037	12,289	13,361	10,873	12,365	13,808	2%	-1%	-3%
% Δ y/y	25.4%	11.3%	8.7%	23.5%	13.7%	11.7%			
Stated gross profit	2,821	2,888	3,106	2,664	2,995	3,361	6%	-4%	-8%
% of sales	25.6%	23.5%	23.3%	24.5%	24.2%	24.3%			
Stated EBIT	1,512	1,577	1,693	1,451	1,696	1,935	4%	-7%	-13%
% of sales	13.7%	12.8%	12.7%	13.3%	13.7%	14.0%			
Stated EBITDA	1,816	1,882	2,019	1,725	2,010	2,285	5%	-6%	-12%
% of sales	16.5%	15.3%	15.1%	15.9%	16.3%	16.5%			
Stated net income	1,328	1,440	1,559	1,200	1,497	1,709	11%	-4%	-9%
Stated diluted EPS	11.06	12.00	12.99	10.60	12.68	14.53	4%	-5%	-11%

Source: Refinitiv consensus, Morgan Stanley Research estimates

Exhibit 5: Solutions NTM consensus P/E - our target price implies c. 22x/20x FY24/25 adj. P/E



Source: Factset data, Morgan Stanley Research

Exhibit 6: Key risks to our Underweight thesis

- Large contract wins, particularly with government sector customers around Vision 2030, and the drive towards digitalisation of the Saudi Arabian economy
- Gross margins (particularly on project business) have been notably strong in 2Q/3Q23. Upside risk would be if these prove more sustainable than we expect
- Solutions demonstrates that M&A is value accretive, and continues to execute on consolidating a fragmented MEA IT Services landscape

Source: Morgan Stanley Research

3 reasons we turn more cautious

1) We model a single-digit organic revenue growth profile, as organic growth performance normalises

Consensus expects continued double-digit organic growth at Solutions - we think this is too high: At the time of IPO in 2021, Solutions was delivering extremely strong growth, significantly above market levels. This - in our view - was driven by significant large-scale contract wins. On Solutions' own view, it defined the 2014-2019 period as "Horizon II", which was a period of "Rapid Growth". In contrast, it set out "Horizon III" as covering the 2020-2025 period, and characterised it as a period of "Stable Growth with Strong Profitability". However, consensus still expects Solutions to be delivering double-digit growth in both FY24 and FY25. We acknowledge that FY24 will still see top-line benefits from acquisition contribution from Contact Center Company (CCC), but 11.7% growth in FY25, to us, looks 3pps too high. We believe Solutions is now operating in a lower organic growth corridor of 8-10% across FY24-26.

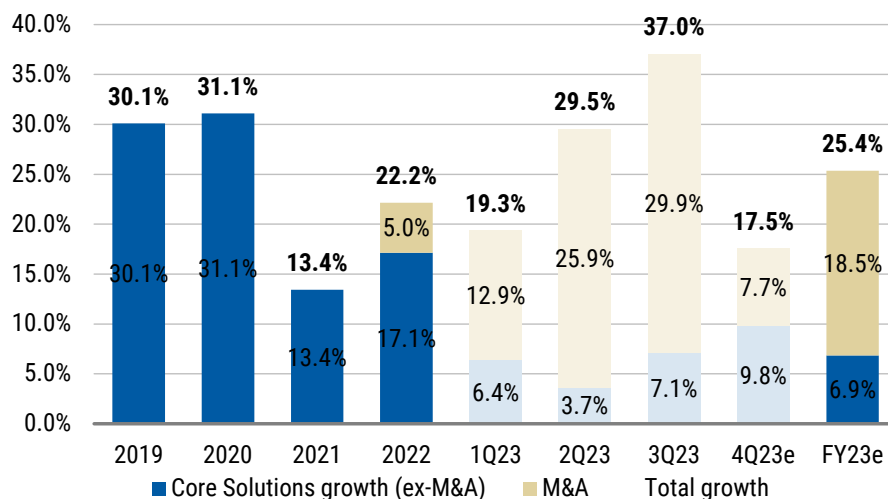
Exhibit 7: MS vs. Refinitiv consensus - revenue and revenue growth

SARm	MS			SARm	Consensus			Delta		
	FY23	FY24	FY25		FY23	FY24	FY25	FY23	FY24	FY25
Revenue	11,037	12,289	13,361	Revenue	10,873	12,365	13,808	2%	-1%	-3%
% Δ y/y	25.4%	11.3%	8.7%	% Δ y/y	23.5%	13.7%	11.7%			

NB: MS FY24 organic growth 9.6%. Source: Refinitiv, Morgan Stanley Research estimates

Beneath the surface, core Solutions growth has been normalising lower, while M&A contribution has increased: In 2019/20, Solutions delivered north of 30% growth, and this was entirely organic. Growth decelerated to c. 13% in 2021, and moderately increased to 17.1% in 2022. 2022 benefited from first time acquisition contribution of Giza Systems, which meant growth at the group level was c. 22%. While growth across 9M23 has actually accelerated (to 37% from 19% in 1Q), this has been driven mainly by M&A (continued contribution from Giza Systems, and new contribution from CCC). In contrast, Core Solutions growth has run at low levels - c. 6% in 1Q, c. 4% in 2Q, and c. 7% in 3Q. 9M23 core Solutions growth was c. 6%. Admittedly, 9M22 base comps were tough, but we think it is clear that Solutions' organic growth has now declined into a 'more normal' organic growth corridor.

We note that Solutions management indicates that core Solutions growth (i.e. organic) would still be running in the double-digit % levels had Solutions not acquired Giza and CCC: Management indicates that this is because there has been some work re-allocation between the core Solutions entity and some of the acquired entities. Nevertheless, as we discuss later in this section, this does not alter our base case expectation that lower 8-10% organic growth rates through the mid-term are a sensible baseline to forecast. We do expect a moderate acceleration to c. 10% organic growth in 4-Q (partly on base comp effects), but with Giza Systems contribution dropping out, we expect total growth to decelerate to c. 17.5%. For FY23, we forecast organic total growth of c. 6.9%.

Exhibit 8: Revenue growth decomposition between core Solutions and M&A

Source: Company data, Morgan Stanley Research estimates

Results versus MS estimates - fewer top-line beats, more profit beats: Regardless of attribution of organic growth by entity, we see the more normalised revenue performance reflected in the nature of Solutions' results versus our expectations. Between 2Q22 and 1Q23, Solutions was typically delivering high-single-digit % revenue beats, as well as beats on EBITDA and net income. However, in both 2Q and 3Q, revenues have fractionally missed our expectations. Admittedly, performance down the P&L has more than compensated on both occasions.

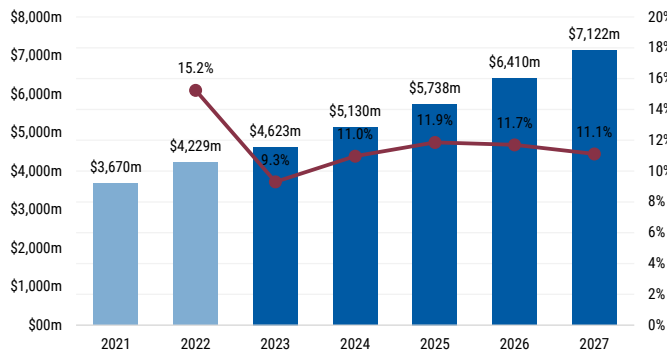
Exhibit 9: Magnitude of revenue, EBITDA and net income beats/(misses) vs. MS expectations

vs. MS estimate	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23
Revenue beat/(miss)	9.4%	10.5%	N/A	9.0%	-0.3%	-0.8%
EBITDA beat/(miss)	18.9%*	22.5%	5.0%	15.6%	12.1%	17.2%
Net income beat/(miss)	20.3%	34.7%	-10.0%	9.7%	9.1%	16.5%

*EBIT-level, 4Q22 N/A given revenue restatements, Source: Morgan Stanley Research estimates

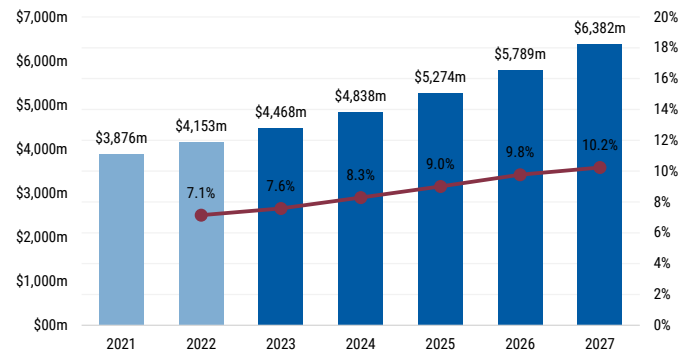
We believe an expectation of organic growth sustained in the double-digit range is too high... Firstly, we would point to market growth expectations from the likes of Gartner and IDC. Gartner forecasts growth to run at c. 11-12% p.a. between 2024 and 2027. In contrast, IDC forecasts growth to run at 8-10% p.a. over the same horizon. We note that - in our view - IDC market share data for Saudi Arabia appears more complete, given the list of vendors provided, when compared to Gartner. IDC data is also quoted by Solutions directly. Nevertheless, the general view appears to be that expected market growth rates are between 9-11% p.a. on average across the period. However, we would point out that these are purely IT Services market growth rates. While Solutions ceased providing disclosure around this a couple of years back, a material proportion of Solutions' business is in Communications & Internet (C&I) activities, which is more indexed towards 1-2% normal market growth rates, in our view. We would roughly estimate that C&I accounts for ~20% of group revenues (give or take several % points). If 80% of the group grows at 10% (the top end of IDC's projections, but below Gartner's), and 20% grows at 2%, this would blend out at a c. 8.4% group organic growth rate.

Exhibit 10: Gartner Saudi IT Services market forecasts (Ex-aaS)



Source: Gartner data, Morgan Stanley Research

Exhibit 11: IDC Saudi IT Services market forecasts

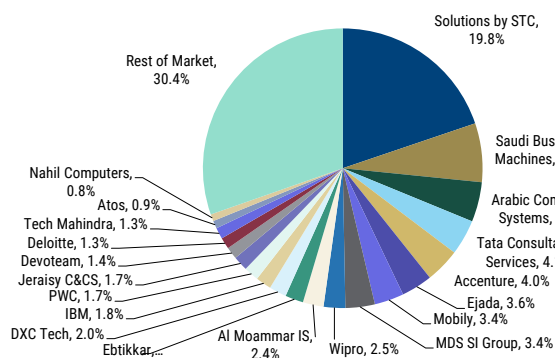


Source: IDC data, Morgan Stanley Research

... particularly given Solutions' high KSA IT Services market share and competitive dynamics: According to IDC data from 2021, Solutions by STC had a c. 19.8% share of the KSA IT Services market. We expect this to have increased to a low-20s % share on a pro forma 2022 basis, given c. 17% organic growth was clearly above market growth levels and given the acquisition of Giza Systems. While we expect Solutions to be able to sustain these high rates of share, we believe it is likely to be incrementally more difficult to increase its share. This is already at the higher end of the range of levels we see across other IT services markets, both in the broader Middle East region and across more mature Europe/Americas IT services markets. While Saudi Arabia is clearly a very attractive market, with growth drivers backed by Vision 2030, we ultimately think this will lead to continued investment into the market from other Western IT Services vendors.

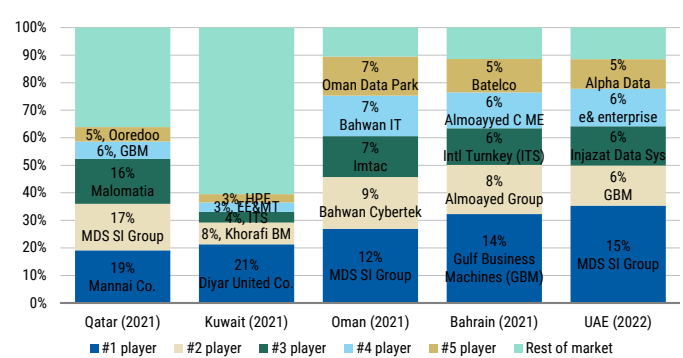
Today, much of the market is still dominated by local vendors (Solutions, SBM, Arabic Computer Systems). Nevertheless, global players such as Tata Consultancy Services, Accenture, and Wipro already have a presence in the region. Solutions does have clear competitive advantages against these vendors due to its incumbent brand presence, customer relationships, labour base, and high labour base Saudisation rate. Even so, IT services markets are competitive and international players may look to acquisitions to continue to build up their presence in the region.

Exhibit 12: Saudi Arabia IT services market shares (2021)



Source: IDC data, Morgan Stanley Research

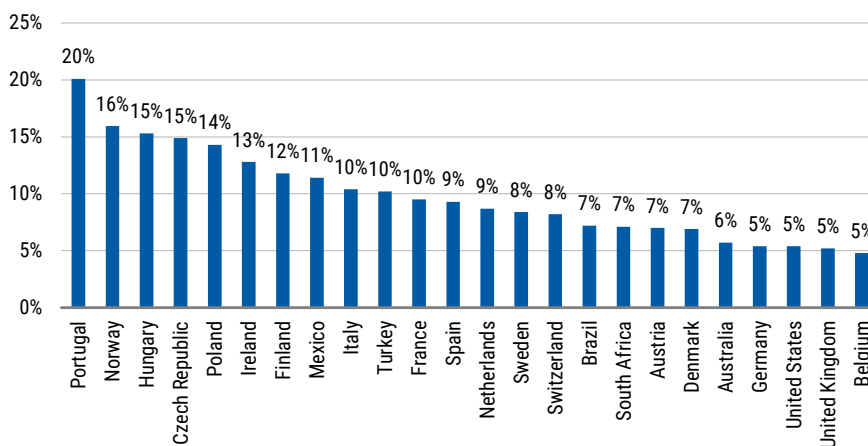
Exhibit 13: Other Middle East country market shares



Source: IDC data, Morgan Stanley Research

We note that it is difficult to precisely square Solutions' 2021 reported revenues versus that used by IDC in its market share data, but note that IDC appears to indicate that its data has been validated by the company (noted by an absence of an * and its associated comment: *"*Vendor revenues were estimated; IDC did not receive revenue guidance from vendors marked with *."*) We believe some of this delta in revenue base used potentially relates to revenue pools not captured by IDC's IT market definition (e.g. non-IT revenues like C&I, some non-IT outsourcing revenues), pass-through revenues, and revenue on hardware and software brought into contracts.

Exhibit 14: IT Services ex-aaS - #1 vendor market shares by geography



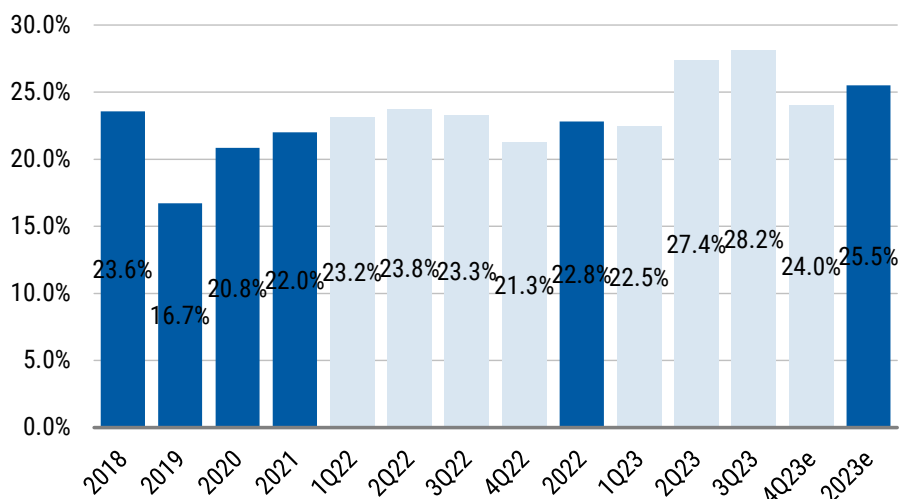
Source: Gartner data, Morgan Stanley Research

2) Profitability running at a high ebb and likely presents tough base comparables into 2024

Solutions has seen strong gross margin improvement year-to-date: While top-line beats have moderated, Solutions' performance has been aided by strong profitability performance. In particular, gross margins (on an ex-impairments, provisions basis) in 2Q23 and 3Q23 were clearly above historical levels, at 27.4% and 28.2% respectively. As a result, we are now forecasting 2023 gross margins to run at c. 25.5% (on a similar ex-impairments/provisions basis), up 270bps y/y vs. 22.8% in 2022. Driving this gross margin improvement, Solutions has called out a slate of higher-margin projects y/y, some cost optimisation initiatives, and efficient delivery on certain projects. On a stated basis, we forecast a 25.6% FY23 gross margin.

Fundamentally, a significant share of the business (Systems Integration) remains in more project-based business, while gross margin levels in IT Managed & Operational Services (ITMOS) and Digital Services remains unclear (after disclosure on this was discontinued in 2020). The positive angle on this would be if ITMOS or Digital Services have materially improved their gross margins (which were only 15% and 3% respectively in 2020), as these would be more sustainable. However, at this stage, we lack that visibility and our base assumption would be that this is more likely to be driven by changes in Core ICT gross profit margins (as ITMOS typically has longer contract lengths and therefore is less likely to jump materially in the space of 1 or 2 quarters).

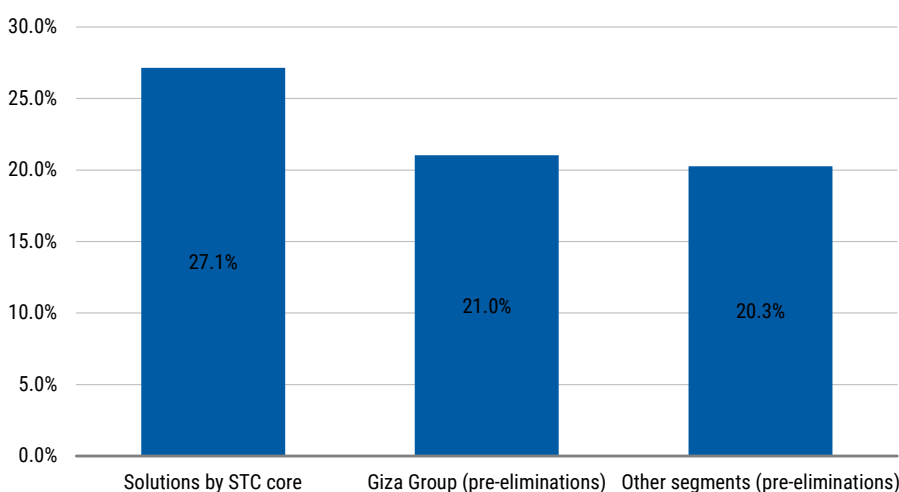
Exhibit 15: Gross profit margins ex-impairments and provisions



Source: Company data, Morgan Stanley Research estimates

Acquisitions have thus far been gross margin dilutive: Looking into Solutions' disclosure, the gross margin improvement cannot be attributed to M&A activity driving a structural improvement, not least because of the relative size of those acquisitions. In Solutions' disclosure, the core business in 9M23 generated a c. 27% gross margin, versus Giza Group at c. 21%, and 'other segments' at 20.3%. We note the below is on a pre intracompany eliminations basis, and thus the gross margins attributable are likely to be an overestimation.

Exhibit 16: Gross margin comparison 9M23 between segments



Source: Company data, Morgan Stanley Research

Ultimately, we think strong 2023 profit margin performance will form a tough comp into 2024: Our assumption is that current gross margin levels are not sustainable. We continue to forecast gross margins to run closer to 23% on a forward view. We forecast c. 200bps of gross margin compression in 2024 (over 2023). However, we would point out that ~23% gross margins would look entirely reasonable in the context of Solutions' margins from 2018 through to 2022. In addition, we note that margins in this business can

be volatile; note the margin swings seen between 2018 to 2020 in [Exhibit 15](#). While consensus is yet to process the 3Q23 result (and is likely going to need to revise up its FY23 gross margin forecasts significantly), it expects gross margins to continue to improve towards 24% by FY25. In addition, consensus expects stated EBIT margins to rise towards 14% by FY25, with corresponding EBITDA margins around 16.5%.

Exhibit 17: MS vs. consensus estimates

SARm	MS			SARm	Consensus			Delta		
	FY23	FY24	FY25		FY23	FY24	FY25	FY23	FY24	FY25
Revenue	11,037	12,289	13,361	Revenue	10,873	12,365	13,808	2%	-1%	-3%
% Δ y/y	25.4%	11.3%	8.7%	% Δ y/y	23.5%	13.7%	11.7%			
Stated gross profit	2,821	2,888	3,106	Stated gross profit	2,664	2,995	3,361	6%	-4%	-8%
% of sales	25.6%	23.5%	23.3%	% of sales	24.5%	24.2%	24.3%			
Stated EBIT	1,512	1,577	1,693	Stated EBIT	1,451	1,696	1,935	4%	-7%	-13%
% of sales	13.7%	12.8%	12.7%	% of sales	13.3%	13.7%	14.0%			
Stated EBITDA	1,816	1,882	2,019	Stated EBITDA	1,725	2,010	2,285	5%	-6%	-12%
% of sales	16.5%	15.3%	15.1%	% of sales	15.9%	16.3%	16.5%			
Stated net income	1,328	1,440	1,559	Stated net income	1,200	1,497	1,709	11%	-4%	-9%
Stated diluted EPS	11.06	12.00	12.99	Stated diluted EPS	10.60	12.68	14.53	4%	-5%	-11%

Source: Refinitiv consensus, Morgan Stanley Research estimates

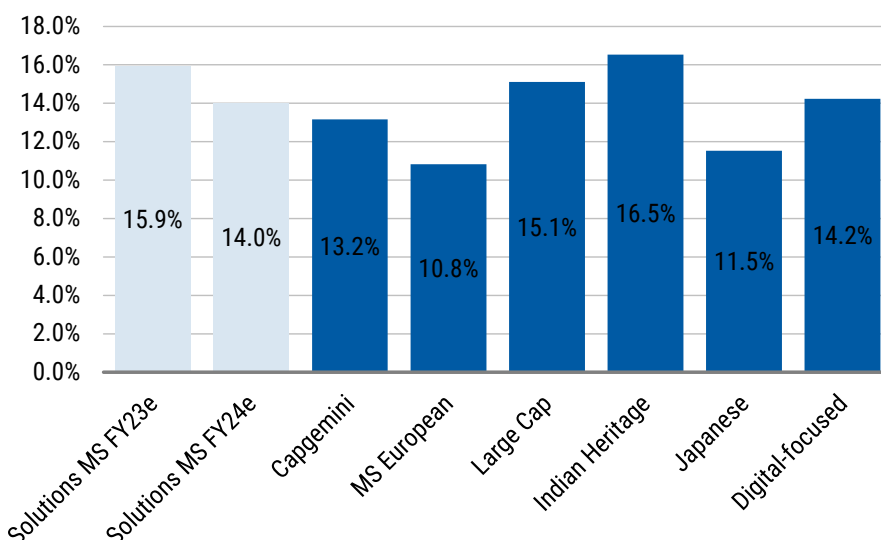
Our expectation is that ~ 13% adj. EBIT margins is the 'right' corridor for Solutions:

With our forecast stack, we are 7/13% below consensus EBIT across FY24/25, largely driven by our lower gross margin forecasts. We note that consensus at 16.5% EBITDA margins by FY25 would be a material increase on how Solutions has historically guided to EBITDA margins - both FY22 and FY23 guidance was for 13-15% EBITDA margins. We acknowledge that Solutions delivered a 15.8% EBITDA margin in FY22 (i.e. well above the upper end of its 13-15% guidance), but we think it is telling that 13-15% was again guided for in 2023, as this can be influenced by project mix and project delivery. As it stands, we expect Solutions once again to comfortably beat guidance (we model 16.5% EBITDA margins in FY23). Nevertheless, IT services business models have some degree of lumpiness around margins, and we would not merely extrapolate y/y improvements into perpetuity from these levels.

Our view here is supported by looking at adj. EBIT margins with a broader perspective:

On a pre-impairments basis, we forecast Solutions to deliver a c. 15.9% adj. EBIT margin in FY23, and a more normalised 14% margin in FY24. On a post-normalised impairments basis, we forecast a margin of 13% on adjusted EBIT. We illustrate this against different groups of vendors in the exhibit below. Notably, these margin levels are above that of European IT services bellwether Capgemini, and clearly above broader European peers. 14% for FY24 is only modestly below pure-play digital IT services vendors (which typically run with materially higher 40% gross margins). It is comfortably below large cap IT services vendors and Indian Heritage vendors, but we note these two groups typically have very high employee offshore ratios or have their employees primarily situated in low-cost countries (e.g. India). With Solutions' highly onshored labour base, we would not see pre-impairment margins of c. 15.9% (for FY23) as long-term sustainable levels.

Exhibit 18: Solutions by STC adj. EBIT margins vs. other global IT services vendors (2023)

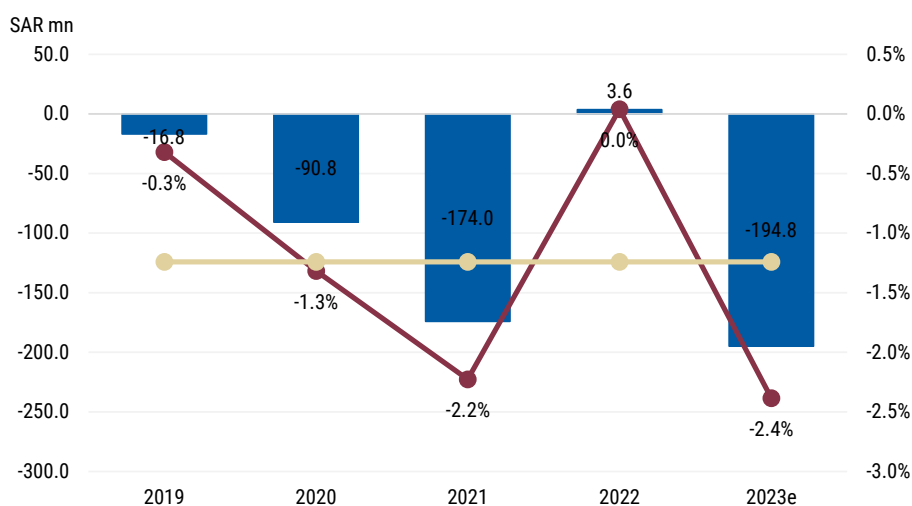


Source: Morgan Stanley Research estimates, Refinitiv data for non-covered companies in stock groups

3) We shift to modelling an ongoing level of impairments within our key adj. EBIT margin forecasts.

Higher level of impairments seen in 9M23: While Solutions has delivered very strong profitability year-to-date, we note that impairments in the cost structure have ticked up. These impairments have been centred around accounts receivables and contract assets, and YTD have totalled > SAR 200m. In comparison, FY22 saw broadly nil accounts receivables and contract asset impairments.

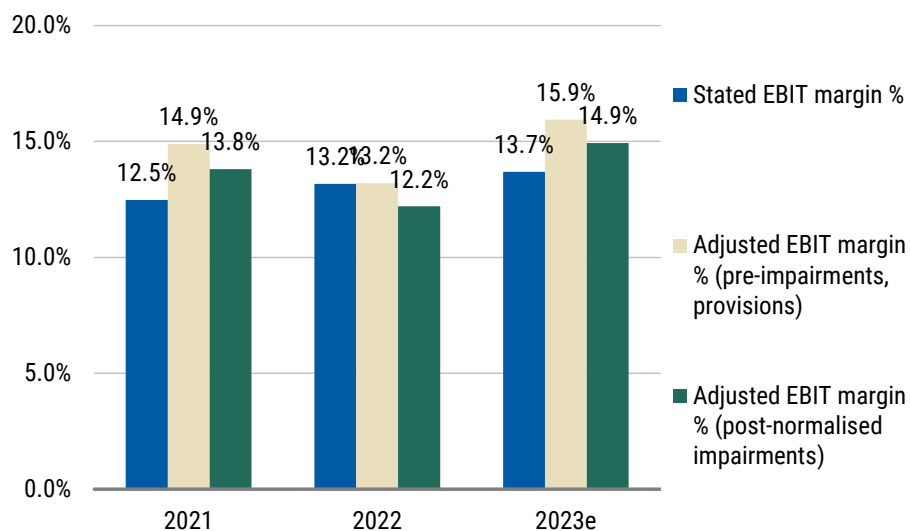
Exhibit 19: Impairment/provision movements, and as a % of sales



Source: Company data, Morgan Stanley Research estimates

We shift to modelling Solutions' profitability on a normalised impairments basis: Given the data we now have going back several years, we note that Solutions is - on average - running at >1% of sales per annum in impairment or provision charges. In 9M23 to date, that level is much closer to 2%. Previously, we looked at valuing Solutions on an adjusted EBIT basis, which was prior to these charges. However, with days sales outstanding clearly at the upper end of our broad IT services coverage, and the nature of Solutions' receivables profile, we believe it is now prudent to model these on an ongoing basis at c. 1% of sales. This mechanically reduces our adjusted EBIT margin forecasts by 1pp over our previous methodology. Note that our adjusted EBIT margin methodology also excludes our estimate of purchase price allocation amortisation when compared to stated EBIT.

Exhibit 20: EBIT margin methodology comparisons



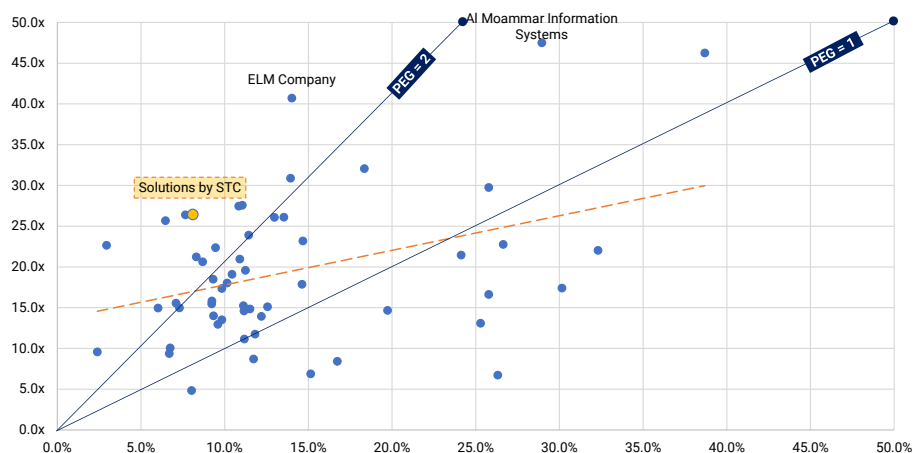
Source: Company data (for stated EBIT margin), Morgan Stanley Research estimates

24.5x FY25 adj. P/E is a valuation too far to bridge

Solutions trades on a premium IT Services multiple

>2x run-rate PEG screens highly versus global IT services peers: At SAR 322, Solutions trades on c. 26.4x/24.5x FY24/25 adj. P/E (post normalised impairments), on our updated forecasts. For context, our 26.4x FY24 adj. P/E compares to our forecast FY24-27 adj. diluted EPS CAGR of c. 9%, which is fully organic. We acknowledge that these forecasts will likely be increased through M&A given Solutions' stated intentions and the significant capacity provided by Solutions' balance sheet (MS SAR 2.7bn by end of 2023, pre-Devoteam Middle East stake purchase). However, we lack conviction at this stage around Solutions' track record of value enhancement through M&A given the acquisitions of Giza Systems and CCC have been relatively recent. We illustrate broad IT Services valuation levels in the exhibit below, to show comparative valuation levels. Solutions screens towards the upper end of the peer set. We note that ELM Company also screens as relatively highly-rated through this lens, though we note that ELM has a higher degree of software-enabled services in its mix (through its Digital Products unit).

Exhibit 21: CY24 adj. P/E vs. CY25 adj. EPS growth: Solutions valuation vs. global core IT services



Source: Refinitiv consensus (for non-covered companies), Morgan Stanley Research estimates (for covered companies), Refinitiv consensus, ex-outliers, CY24 adj. EPS growth used where CY25 not available, stated EPS used where adjusted EPS forecasts not available (e.g. ELM, AI Moammar)

Comparing versus Capgemini and Netcompany: While we do not necessarily see a clear comp for Solutions by STC in Europe, we think it is worth investors being aware of the levels at which other IT services in developed markets are trading. Starting with the European IT services bellwether, Capgemini. For reference, Solutions trades on c. 24.5x FY25 adj. P/E, on our forecasts. We forecast Capgemini to be a structural ~6% organic top-line growth company, with a sustainable ~7-9% organic adjusted EPS growth rate. The company is highly diversified by geography and business activity, and trades on our forecasts at c. 13.8x FY25 adj. P/E (post-SBC and recurrent restructuring). We forecast Netcompany to be a structural ~8-10% organic top-line growth company, with mid-20s% organic growth on adjusted EPS. Netcompany's revenues are highly skewed towards its Danish business unit, and it has a high proportion of public sector in its revenue mix. On our forecasts, Netcompany trades on c. 13.5x FY25 adj. P/E, or 17.7x on FCF. We would

note, however, that valuation should not be a simple 1:1 on near-term revenue and EPS growth rates, as - given significantly lower IT spend in Saudi Arabia - we would expect long-term growth potential at Solutions to be higher than that of both Capgemini and Netcompany.

Price target lowered to SAR 268 (from SAR 305), downgrade to Underweight: Our lowered DCF-based price target is driven by 2 main factors. Firstly, we have revised our profit margin forecast methodology, which is now post a normalised level of impairments running through the P&L and DCF framework. We model this as 1% per annum (in effect, reducing our adjusted EBIT margin forecast by this amount). Secondly, and aligned closer to our broader IT services coverage in Europe, we increase our applied WACC from 8.5% to 9% (most of our core IT services coverage WACCs are between 8.5% to 9% and we note Solutions' Saudi Arabia country presence vs. developed markets for most of our coverage, and modestly higher Saudi Arabia equity risk premium levels). Our price target implies 17% downside and is c. 20x FY25e adj. P/E. While our price target still implies a material premium versus European IT services vendors, we note the scope for higher longer-term growth (beyond the next few years) at Solutions given the relatively low level of digitalisation seen across the MEA region.

In our view, to justify current valuation levels, investors need to be confident in Solutions sustaining at least low-teens % organic growth through the mid-term (vs. MS at 8-10%). This is not implausible, but we would see this more as a bull case outcome. In our bull case, we also bake in higher margins as sustainable, which underpins our SAR 382 bull case valuation (implying c.20% upside).

We see a number of factors investors should bear in mind around Solutions' valuation

In our note from August [Time for a valuation pause](#), we highlighted how, after strong YTD share price performance, we saw valuation levels as sufficiently capturing the investment opportunity. Solutions' share price is broadly at the same levels as at the time of that note. We highlight 4 factors below that we think investors should consider around Solutions' valuation (including in the context of other IT services companies).

Communications & Internet exposure more akin to Telco activity (and multiple)

Within Solutions' Core ICT segment are two sub-divisions of activity: 1) System Integration; and 2) Communications & Internet. Until 1H21, Solutions provided revenue and growth disclosure around these line items. System integration is a core IT services competency that the majority of IT services vendors will have, whereas C&I is atypical. Within C&I, Solutions will be helping organisations to secure business internet and satellite services, after wholesale purchasing communication capacity from telecommunication providers. Services offered include Dedicated Internet Access (DIA), data and VSAT services, and enterprise mobility management (EMM).

In our view, with the exception of EMM, Solutions' activity here is more telco-like and middle-man in nature, and should attract more of a telco provider valuation multiple, rather than that of a premium-growth IT services company. The B2B voice & data market in Saudi Arabia is a relatively mature and low-growth market - at the time of IPO, data

shared on this indicated very low single-digit % growth per annum. As at 1H21, C&I was c. 22% of group revenues, and we suspect it was a materially higher share of gross profit (given Core ICT was running at a much higher gross margin than the rest of the group). Even if we assume System Integration and C&I had the same gross margin, C&I would have been contributing c. 30% of group gross profit.

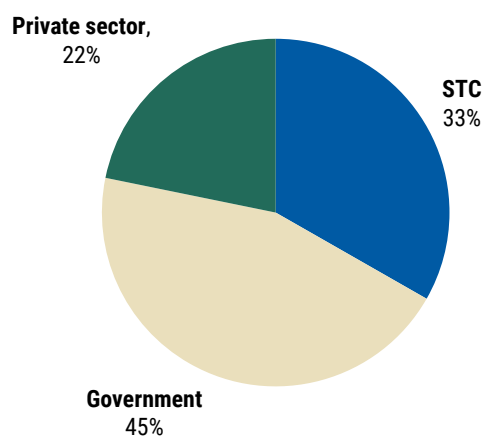
Exhibit 22: Historical segmental disclosure provided by Solutions

	FY18	FY19	FY20	1H21	FY23E
% share of revenues					
Core ICT	63.5%	56.3%	54.3%	53.3%	53.4%
o/w. System Integration	42.7%	39.7%	33.6%	31.2%	
o/w. Comms & Internet	20.7%	16.6%	20.7%	22.2%	
IT Managed & Operational Services	21.1%	22.0%	23.6%	24.9%	30.1%
o/w. Outsourcing Services	17.1%	17.2%	17.8%	18.0%	
o/w. Managed Services	4.0%	4.8%	5.8%	7.0%	
Digital Services	15.4%	21.7%	22.0%	21.7%	16.5%
o/w. Cloud Services	6.7%	9.1%	9.8%	12.4%	
o/w. Cyber Security	7.6%	8.2%	8.4%	5.7%	
o/w. Digital Services	1.1%	4.5%	3.8%	3.7%	
Gross margins					
Core ICT Services	33.3%	21.2%	30.0%		
IT Managed & Operational Services	9.4%	13.6%	15.4%		
Digital Services	4.8%	5.4%	3.2%		

Source: Company data, Morgan Stanley Research estimates

Customer mix dynamics

Exhibit 23: 9M23/YTD revenue by customer source



Source: Company data, Morgan Stanley Research

Although private sector revenue has been growing strongly in 2023 YTD (partly aided by acquisitions), Solutions remains heavily skewed towards STC and government revenues. On the government side, we are comfortable that this is actually relatively diversified, given a multitude of public sector ministries are supplied. However, a third of revenues are into parent company Saudi Telecom, which is unsurprising given Solutions is effectively the in-house IT division of STC. In addition, STC is still a 79% shareholder of Solutions' equity. Aside from customer concentration risk (i.e. STC's spending patterns will influence Solutions' growth rates), we do think there is a potential long-term risk around this. In Europe, when Novo Nordisk spun out NNIT, over time it led to a change in strategy around

Novo Nordisk's IT procurement, to include a broader array of third-party vendors. This led to a structural drag on NNIT's revenues generated from Novo Nordisk and became a material headwind to the equity story. To be clear, we do not see this as a likely scenario for Solutions in the near to medium term as we have no clear indication that STC is looking to change its IT procurement practices, but we would not rule this out over the longer term as a possibility if strategy shifts.

Predominantly single-country exposure

While much of our IT services coverage plays across multiple geographies, Solutions remains predominantly reliant on Saudi Arabia. On disclosure provided in Solutions' 2022 annual report, on a run-rate basis, Solutions generated c. 90% of revenues from Saudi Arabia, with the residual revenues generated from across the rest of the Gulf Cooperation Council (GCC) and West, East, and Central Africa regions.

Granularity of disclosure

We believe investors would benefit from increased disclosure from Solutions, particularly around some of the areas that were pared back in 2021 (sub-segment performance, segmental gross margins), as well as around order backlogs or some forward-looking work metric. We consider Solutions to have a broad array of types of work in its mix (reflecting its one-stop-shop market position) but, given these have different contract dynamics, it makes trend interpretation somewhat difficult. For example, in IT services there is typically a clear link between revenue generation and employee headcount. Typical IT services companies on this metric may screen between say €50k and €125k/employee per year, as illustrated in the exhibit below. However, for Solutions by STC (using FTE headcount), this number is comfortably in excess of €1m. We think this partly reflects Solutions' less labour-intensive revenue streams (e.g. Communications & Internet), some degree of reseller revenue in the mix, as well as particular contract structure types for the region (e.g. delivering hardware/software with professional services). Nevertheless, drawing a link (therefore) between headcount growth and revenue growth is made more challenging. More granular headcount disclosure (e.g. by segment, attrition rates) on a regular basis would also be helpful, in our view.

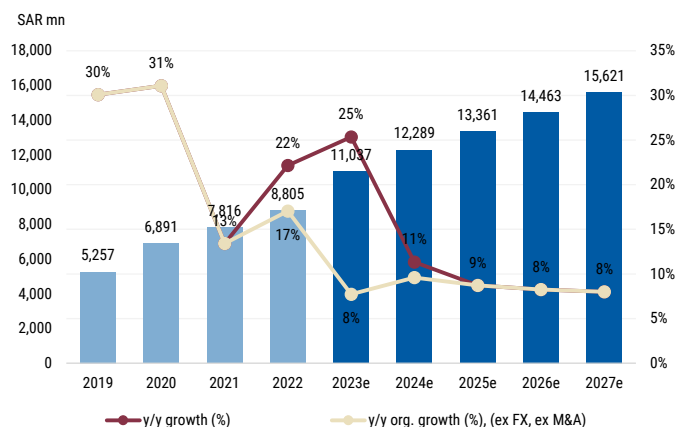
Exhibit 24: Revenue per employee comparison

Company	Company headquarters	Refinitiv ticker	2022 revenue per employee
Perficient	United States	PRFT.O	€125k
Tietoenvy	Finland	TIETO.HE	€120k
IBM (Consulting division)	United States	IBM.N	€113k
Sopra Steria	France	SOPR.PA	€103k
Atos	France	ATOS.PA	€102k
Netcompany	Denmark	NETC.DC	€98k
DXC Technology	United States	DXC.N	€94k
Accenture	United States	ACN.N	€80k
EPAM	United States	EPAM.N	€77k
Endava	United Kingdom	DAVA.N	€72k
Globant	Luxembourg	GLOB.N	€62k
Capterini	France	CAPP.PA	€61k
Indra (Minsait)	Spain	IDR.MC	€54k
Cognizant	United States	CTSH.O	€52k
Solutions by STC (EUR)	Saudi Arabia	7202.SE	€1,297k

Source: Company data, Morgan Stanley Research estimates

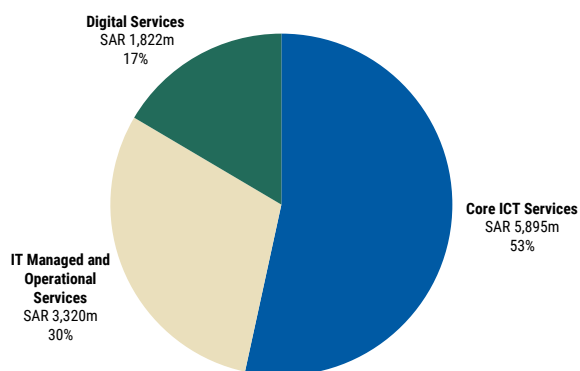
Other exhibits

Exhibit 25: Revenue growth vs. organic growth over time



Source: Company data, Morgan Stanley Research estimates

Exhibit 26: Revenue mix by division (MS FY23)



Source: Morgan Stanley Research estimates

Forecast changes: While Solutions has increased its FY23 guidance to 19-22% with the 3Q results, we suspect this remains conservative. As a result, we leave our FY23 forecast broadly unchanged at c. 25%. Updated FY23 EBITDA margin guidance is 13-15%, though we also see this as conservative, and our forecast is 16.5%. Changing our adj. EBIT margin methodology to be post normalised impairments, our adj. EPS forecasts decline 1/3/2% for FY24/25/26, while our adj. EBIT margin for FY23 is increased 3% on the back of higher YTD profitability. Within our DCF-derived price target change, we update for our short-term forecast revisions, we bake in our updated logic around adjusted EBIT margins, and apply a higher 9% WACC (to align with our broader coverage and reflecting market discount rates - we note ERPs for Saudi Arabia are modestly above those seen in Western Europe, for example).

Exhibit 27: Forecast changes (Old vs. new)

SARm	New forecasts				SARm	Old forecasts				Changes			
	FY23	FY24	FY25	FY26		FY23	FY24	FY25	FY26	FY23	FY24	FY25	FY26
Revenue	11,037	12,289	13,361	14,463	Revenue	11,074	12,338	13,436	14,555	0%	0%	-1%	-1%
% Δ y/y	25.4%	11.3%	8.6%	8.7%	% Δ y/y	25.8%	11.4%	8.6%	8.9%				
% org. Δ y/y (PF)	7.7%	9.6%	8.6%	8.7%	% org. Δ y/y (PF)	8.9%	9.8%	8.6%	8.9%				
Stated EBIT	1,512	1,577	1,693	1,849	Stated EBIT	1,445	1,598	1,746	1,897	5%	-1%	-3%	-3%
% of sales	13.7%	12.8%	12.7%	12.8%	% of sales	13.1%	13.0%	13.0%	13.0%				
Adj. EBIT	1,649	1,601	1,717	1,873	Adj. EBIT	1,599	1,622	1,770	1,921	3%	-1%	-3%	-3%
% of sales	14.9%	13.0%	12.9%	13.0%	% of sales	14.4%	13.2%	13.2%	13.2%				
Stated dil EPS	11.06	12.00	12.99	14.30	Stated dil EPS	10.64	12.14	13.37	14.64	4%	-1%	-3%	-2%
Adj. dil EPS	12.40	12.18	13.17	14.48	Adj. dil EPS	11.99	12.32	13.54	14.82	3%	-1%	-3%	-2%

Source: NB: PF = pro-forma method. Source: Morgan Stanley Research estimates

Risk Reward – Solutions by STC (7202.SE)

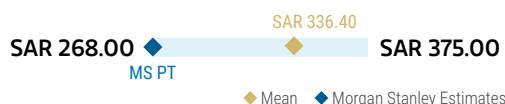
Structural growth, but at a high valuation given normalised growth rates

PRICE TARGET SAR 268.00

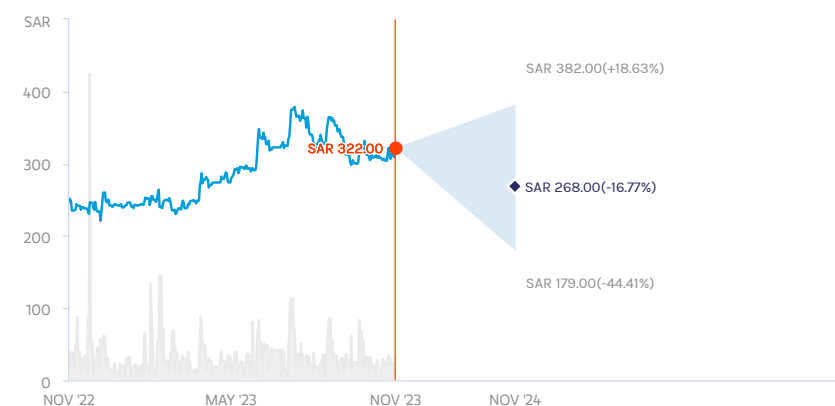
We value Solutions by STC with a 10-year DCF, using a WACC of 9%, and a 2.5% terminal growth rate.

Consensus Price Target Distribution

Source: Refinitiv, Morgan Stanley Research



RISK REWARD CHART



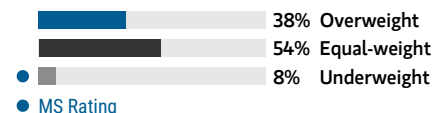
Source: Refinitiv, Morgan Stanley Research

Source: Refinitiv, Morgan Stanley Research

UNDERWEIGHT THESIS

- Strongly positioned to help support KSA Vision 2030 by enabling technology adoption in the public and private sectors across Saudi Arabia.
- We forecast Solutions to grow revenues organically at a c. 9% CAGR FY23-26. In the context of ICT services, this represents a relatively high rate of growth, reflecting KSA's earlier positioning on the IT adoption maturity curve.
- We consider project mix and gross margins to be at a relatively high ebb. We expect margins to normalise lower into 2024, and to be sustained within a 12.5-13% range (on an adj. EBIT basis).
- We see the current valuation multiple of c. 24x FY25 adj. P/E as expensive in the context of high-single-digit % forward adj. EPS growth.

Consensus Rating Distribution



Source: Refinitiv, Morgan Stanley Research

Risk Reward Themes

Secular Growth: *Positive*

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

BULL CASE

SAR 382.00

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. 16% total growth in FY24 and c. 14% in FY25 (vs. 9% in our base case). Operating leverage drives adj. EBIT margins higher and Solutions sustains >13% margins through the mid-term, and reaches ~15% in terminal state. The FY24-27 revenue growth CAGR is c. 12%, c. 6.5% FY27-33. Our bull case equates to c. 25x FY25 adj. P/E, or c. 2.8x EV/Sales.

BASE CASE

SAR 268.00

Growth in-line with the market, margins normalise

After c. 17% org. growth in FY22, Solutions continues to deliver strong growth. We forecast c. 7% org. for FY23 (25% total growth), c. 10% for FY24. EBITDA margins compress vs. FY23 levels, reflecting M&A impacts and project mix. Stated EBITDA margins ease from 16.5% in FY23 to ~15%, as gross margins normalise. The FY28-34 revenue growth CAGR is c. 5.5%. Adj. EBIT (post normalised impairments) margins improve gradually to ~13% in terminal state. Our base case equates to c. 20x FY25 adj. P/E.

BEAR CASE

SAR 179.00

Increased competition drives below-market growth

Beyond FY23, Solutions' top-line growth moderates below the wider market, driven by increased competition. We model total growth of 8%/7%/6% for FY24/25/26. 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 limited. The FY24-27 revenue CAGR is c. 6%, c. 3% FY27-33. Our bear case represents c. 15x FY25 adj. P/E, or c. 1.3x EV/Sales.

Risk Reward – Solutions by STC (7202.SE)

KEY EARNINGS INPUTS

Drivers	2022	2023e	2024e	2025e
Group y/y revenue growth (%)	22.2	25.4	11.3	8.7
Group adj. EBIT margin (%)	12.2	14.9	13.0	12.8
Group stated EBITDA margin (%)	15.8	16.5	15.3	15.1

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
- 4Q23 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
- Bolt-on M&A
- Gross margin sustained at high levels

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

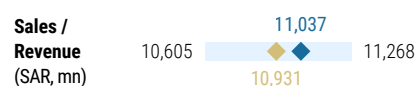
OWNERSHIP POSITIONING

Inst. Owners, % Active	51.4%	<div style="width: 51.4%;"></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

Financial forecasts

Exhibit 29: Revenue drivers

Profit & Loss	FY	FY	FY	FY	FY	FY	FY	FY	FY	FY
YE 31st Dec - SARm	2018	2019	2020	2021	2022	2023E	2024E	2025E	2026E	2027E
Core ICT Services	2,566	2,960	3,744	4,231	1,324	5,895	6,220	6,546	6,887	7,231
y/y growth (%)		15.4%	26.5%	13.0%	-68.7%	345.3%	5.5%	5.3%	5.2%	5.0%
y/y cc growth (%)		15.4%	26.5%	13.0%	51.3%	24.0%	5.5%	5.3%	5.2%	5.0%
y/y org. growth (%), (ex FX, ex M&A)		15.4%	26.5%	13.0%	51.3%	7.7%	5.5%	5.3%	5.2%	5.0%
o/w. System Integration	1,727	2,085	2,316							
y/y growth (%)		20.7%	11.1%							
o/w. Communication and Internet	838	875	1,428							
y/y growth (%)		4.4%	63.2%							
IT Managed and Operational Services	854	1,155	1,630	1,955	529	3,320	3,937	4,331	4,721	5,134
y/y growth (%)		35.3%	41.1%	20.0%	-72.9%	527.3%	18.6%	10.0%	9.0%	8.7%
y/y cc growth (%)		35.3%	41.1%	20.0%	13.6%	42.9%	18.6%	10.0%	9.0%	8.7%
y/y org. growth (%), (ex FX, ex M&A)		35.3%	41.1%	20.0%	13.6%	9.2%	12.7%	10.0%	9.0%	8.7%
o/w. Outsourcing Services	690	903	1,229							
y/y growth (%)		30.8%	36.1%							
o/w. Managed Services	163	252	401							
y/y growth (%)		54.4%	59.1%							
Digital Services	622	1,142	1,518	1,629	390	1,822	2,132	2,483	2,856	3,256
y/y growth (%)		83.6%	32.9%	7.3%	-76.1%	367.6%	17.0%	16.5%	15.0%	14.0%
y/y cc growth (%)		83.6%	32.9%	7.3%	2.3%	7.2%	17.0%	16.5%	15.0%	14.0%
y/y org. growth (%), (ex FX, ex M&A)		83.6%	32.9%	7.3%	2.3%	5.3%	17.0%	16.5%	15.0%	14.0%
o/w. Cloud Services	270	478	677							
y/y growth (%)		77.0%	41.7%							
o/w. Cyber Security	308	430	578							
y/y growth (%)		39.6%	34.5%							
o/w. Digital Services	44	234	262							
y/y growth (%)		433.0%	12.1%							
Total revenues	4,041	5,257	6,891	7,816	8,805	11,037	12,289	13,361	14,463	15,621
y/y growth (%)		30.1%	31.1%	13.4%	22.2%	25.4%	11.3%	8.7%	8.3%	8.0%
y/y cc growth (%)		30.1%	31.1%	13.4%	22.2%	25.7%	11.3%	8.7%	8.3%	8.0%
y/y org. growth (%), (ex FX, ex M&A)		30.1%	31.1%	13.4%	17.0%	7.7%	9.6%	8.7%	8.3%	8.0%
y/y org. growth (%), (ex M&A, ex-out not PF)		30.1%	31.1%	13.4%	17.1%	6.9%	9.6%	8.7%	8.3%	8.0%

Source: Company data, Morgan Stanley Research estimates (E)

Exhibit 30: Income statement

Profit & Loss	FY	FY	FY	FY	FY	FY	FY	FY	FY	FY
YE 31st Dec - SARm	2018	2019	2020	2021	2022	2023E	2024E	2025E	2026E	2027E
Total revenues	4,041	5,257	6,891	7,816	8,805	11,037	12,289	13,361	14,463	15,621
<i>y/y growth (%)</i>		30.1%	31.1%	13.4%	22.2%	25.4%	11.3%	8.7%	8.3%	8.0%
<i>y/y cc growth (%)</i>		30.1%	31.1%	13.4%	22.2%	25.7%	11.3%	8.7%	8.3%	8.0%
<i>y/y org. growth (%)</i> , (ex FX, ex M&A)		30.1%	31.1%	13.4%	17.0%	7.7%	9.6%	8.7%	8.3%	8.0%
<i>y/y org. growth (%)</i> , (ex M&A, ex-out not PF)		30.1%	31.1%	13.4%	17.1%	6.9%	9.6%	8.7%	8.3%	8.0%
Cost of sales	(3,076)	(4,410)	(5,469)	(6,108)	(6,794)	(8,216)	(9,401)	(10,254)	(11,101)	(11,989)
Stated gross profit	965	847	1,422	1,708	2,011	2,821	2,888	3,106	3,363	3,632
<i>as % of sales</i>	23.9%	16.1%	20.6%	21.9%	22.8%	25.6%	23.5%	23.3%	23.3%	23.3%
Adj. selling and distribution expenses	(113)	(158)	(159)	(196)	(246)	(317)	(353)	(387)	(419)	(453)
<i>y/y growth</i>		39.4%	1.0%	23.1%	25.8%	28.5%	11.6%	9.7%	8.3%	8.0%
<i>as % of sales</i>	-2.8%	-3.0%	-2.3%	-2.5%	-2.8%	-2.9%	-2.9%	-2.9%	-2.9%	-2.9%
Adj. general and administration expenses	(273)	(357)	(429)	(450)	(600)	(739)	(811)	(868)	(926)	(1,000)
<i>y/y growth</i>		31.0%	20.3%	4.8%	33.3%	23.2%	9.7%	7.1%	6.6%	8.0%
<i>as % of sales</i>	-6.7%	-6.8%	-6.2%	-5.8%	-6.8%	-6.7%	-6.6%	-6.5%	-6.4%	-6.4%
Other income/(losses)	6	74	(2)	2	(28)	(48)	--	--	--	--
Amortisation of acquired intangibles	--	--	--	--	(6)	(24)	(24)	(24)	(24)	(24)
Net impairments/provisions in COGS	13	(32)	(14)	(11)	3	6	--	--	--	--
Net impairments/provisions below COGS	(7)	15	(77)	(163)	1	(230)	(123)	(134)	(145)	(156)
Total impairments	6	(17)	(91)	(174)	4	(223)	(123)	(134)	(145)	(156)
Total impairments % of sales	0.1%	-0.3%	-1.3%	-2.2%	0.0%	-2.0%	-1.0%	-1.0%	-1.0%	-1.0%
Normalised impairments assumption % sales	-1.0%	-1.0%	-1.0%	-1.0%	-1.0%	-1.0%	-1.0%	-1.0%	-1.0%	-1.0%
Stated EBIT	572	348	757	899	1,160	1,512	1,577	1,693	1,849	1,999
<i>as % of sales</i>	14.2%	6.6%	11.0%	11.5%	13.2%	13.7%	12.8%	12.7%	12.8%	12.8%
Adjusted EBIT (pre-impairments)	567	365	848	1,073	1,162	1,759	1,723	1,850	2,018	2,179
<i>as % of sales</i>	14.0%	6.9%	12.3%	13.7%	13.2%	15.9%	14.0%	13.9%	14.0%	14.0%
Adjusted EBIT (post-normalised impairments)	526	312	779	995	1,074	1,649	1,601	1,717	1,873	2,023
<i>as % of sales</i>	13.0%	5.9%	11.3%	12.7%	12.2%	14.9%	13.0%	12.9%	13.0%	13.0%
D&A	43	92	105	208	232	304	305	326	355	381
<i>as % of sales</i>	1.1%	1.8%	1.5%	2.7%	2.6%	2.8%	2.5%	2.4%	2.5%	2.4%
o/w. normal depreciation (MSe)	30	54	55	155	172	195	197	200	202	219
<i>as % of sales</i>	0.7%	1.0%	0.8%	2.0%	2.0%	1.8%	1.6%	1.5%	1.4%	1.4%
o/w. lease depreciation	--	17	19	17	18	47	33	35	38	41
o/w. amortisation	13	21	31	35	36	39	52	67	90	98
<i>as % of sales</i>	0.3%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.5%	0.6%	0.6%
o/w. ppa of intangibles	--	--	--	--	6	24	24	24	24	24
Stated EBITDA	614	440	862	1,107	1,392	1,816	1,882	2,019	2,204	2,380
<i>as % of sales</i>	15.2%	8.4%	12.5%	14.2%	15.8%	16.5%	15.3%	15.1%	15.2%	15.2%
Adjusted EBITDA (post-NI)	569	404	884	1,203	1,301	1,929	1,882	2,019	2,204	2,380
<i>as % of sales</i>	14.1%	7.7%	12.8%	15.4%	14.8%	17.5%	15.3%	15.1%	15.2%	15.2%
Net finance income/(expense)	30	13	(1)	3	38	59	52	69	92	115
Stated PBT	608	435	754	904	1,171	1,523	1,628	1,762	1,941	2,114
Adj. PBT (post-NI)	557	325	778	998	1,113	1,708	1,652	1,786	1,965	2,138
Stated tax (Zakat)	(52)	(41)	(52)	(71)	(118)	(194)	(187)	(203)	(223)	(243)
<i>Tax rate % of stated PBT</i>	-8.5%	-9.4%	-6.9%	-7.9%	-10.1%	-13.7%	-11.5%	-11.5%	-11.5%	-11.5%
Adjusted tax (Zakat)	(47)	(31)	(54)	(80)	(114)	(218)	(190)	(205)	(226)	(246)
<i>Tax rate % of adj. PBT</i>	-8.5%	-9.4%	-6.9%	-8.1%	-10.3%	-13.7%	-11.5%	-11.5%	-11.5%	-11.5%
NCIs	--	--	--	--	(1)	(1)	(1)	(1)	(1)	(1)
Stated net income	556	394	702	833	1,053	1,328	1,440	1,559	1,716	1,870
Adj. net income (post-NI)	509	294	724	917	998	1,488	1,461	1,580	1,738	1,891
Average diluted SII	120	120	120	120	120	120	120	120	120	120
Stated diluted EPS	4.64	3.28	5.85	6.94	8.77	11.06	12.00	12.99	14.30	15.58
Adj. diluted EPS (post-NI)	4.24	2.45	6.04	7.65	8.32	12.40	12.18	13.17	14.48	15.76
Dividend announced	--	--	--	475	595	654	714	773	833	892
Dividend per share	--	--	--	4.00	5.00	5.50	6.00	6.50	7.00	7.50
<i>% stated net income</i>	0%	0%	0%	57%	57%	49%	50%	50%	49%	48%
<i>% paid up share capital</i>	0%	0%	0%	40%	50%	55%	59%	64%	69%	74%

Pre-40% acquisition of Devoteam Middle East pending deal closure and disclosure of financials

Source: Company data, Morgan Stanley Research estimates (€)

Exhibit 31: Balance sheet

Balance Sheet	FY	FY	FY	FY	FY	FY	FY	FY	FY	FY
YE 31st Dec - SARm	2018	2019	2020	2021	2022	2023E	2024E	2025E	2026E	2027E
Accounts receivable	1,829	2,635	2,804	3,021	4,345	5,014	5,019	5,634	6,099	6,650
As % annualised sales	45%	50%	41%	39%	49%	45%	41%	42%	42%	43%
Receivables days	165 days	155 days	144 days	136 days	153 days	155 days	149 days	146 days	148 days	149 days
Prepayments and other assets	301	157	157	288	195	287	312	339	367	397
As % annualised sales	7%	3%	2%	4%	2%	3%	3%	3%	3%	3%
Contract assets	868	1,166	1,505	1,256	1,277	1,604	2,173	2,362	2,645	2,857
As % annualised sales	21%	22%	22%	16%	14%	15%	18%	18%	18%	18%
Other current assets	140	151	112	274	322	241	250	272	294	317
As % annualised sales	3%	3%	2%	4%	4%	2%	2%	2%	2%	2%
Total current assets	3,138	4,109	4,578	4,839	6,138	7,146	7,754	8,607	9,406	10,222
Accounts payable	1,236	1,458	1,974	1,931	2,573	3,209	3,434	3,665	3,894	4,166
As % annualised sales	-31%	-28%	-29%	-25%	-29%	-29%	-28%	-27%	-27%	-27%
Deferred revenue	988	1,427	1,705	2,277	3,266	3,209	3,309	3,598	3,821	4,047
As % annualised sales	-24%	-27%	-25%	-29%	-37%	-29%	-27%	-27%	-26%	-26%
Contract liabilities	336	452	336	354	488	514	581	642	706	775
As % annualised sales	-8%	-9%	-5%	-5%	-6%	-5%	-5%	-5%	-5%	-5%
Other current liabilities	99	40	53	72	136	138	125	136	147	159
As % annualised sales	-2%	-1%	-1%	-1%	-2%	-1%	-1%	-1%	-1%	-1%
Total current liabilities	2,659	3,377	4,068	4,634	6,462	7,069	7,448	8,040	8,568	9,147
Net working capital	480	732	509	204	(323)	77	306	566	837	1,074
As % annualised sales	12%	14%	7%	3%	-4%	1%	2%	4%	6%	7%
LT equity investments	0	--	--	--	--	125	125	125	125	125
Intangible assets	64	104	91	98	373	635	635	635	635	635
Tangible assets	102	167	594	551	473	374	314	255	189	120
Other non-current assets	23	84	79	78	53	69	69	69	69	69
Total non-current assets	189	354	764	726	899	1,203	1,143	1,084	1,018	949
Cash & equivalents	892	414	993	1,608	544	2,719	3,458	4,223	5,081	6,063
ST investments	230	--	--	--	2,701	650	650	650	650	650
ST debt	--	--	--	--	194	192	192	192	192	192
LT debt	--	--	--	--	502	499	499	499	499	499
Net cash/(debt)	1,123	414	993	1,608	2,548	2,678	3,417	4,182	5,040	6,022
End of service indemnities	126	189	295	237	261	422	457	484	500	502
Lease liabilities	--	54	48	31	16	19	19	19	19	19
Other non-current liabilities	--	--	--	--	24	--	--	--	--	--
Share capital	100	100	1,200	1,200	1,200	1,200	1,200	1,200	1,200	1,200
Retained earnings	1,515	1,079	610	960	1,432	2,194	3,102	4,080	5,168	6,361
Other equity	50	78	113	111	162	96	59	20	(22)	(68)
NCI	--	--	--	--	29	27	28	29	30	31
Total equity	1,665	1,257	1,924	2,271	2,823	3,516	4,389	5,329	6,376	7,524
Total assets	4,450	4,877	6,335	7,173	10,282	11,718	13,004	14,564	16,154	17,883
Total liabilities and equity	4,450	4,877	6,335	7,173	10,282	11,718	13,004	14,564	16,154	17,883

Pre-40% acquisition of Devoteam Middle East pending deal closure and disclosure of financials

Source: Company data, Morgan Stanley Research estimates (€)

Exhibit 32: Cash flow statement

Cash Flow Statement	FY	FY	FY	FY	FY	FY	FY	FY	FY	FY
YE 31st Dec - SARm	2018	2019	2020	2021	2022	2023E	2024E	2025E	2026E	2027E
P&L PBT	608	435	754	904	1,171	1,523	1,628	1,762	1,941	2,114
D&A and impairments as a % of sales	43 1.1%	92 1.8%	109 1.6%	209 2.7%	232 2.6%	304 2.8%	305 2.5%	326 2.4%	355 2.5%	381 2.4%
Employee benefits expense	53	77	90	60	68	88	95	103	111	120
Other impairments/provisions	2	17	91	174	(4)	223	123	134	145	156
Other non-cash add-backs	--	(72)	--	(0)	--	17	(0)	(0)	(0)	(0)
Other operating cash flows	--	--	--	--	--	--	--	--	--	--
Net finance expense add-back	(30)	(13)	1	(3)	(38)	(59)	(52)	(69)	(92)	(115)
Change in receivables % of sales	(870) -21.5%	(805) -15.3%	(218) -3.2%	(368) -4.7%	(948) -10.8%	(713) -6.5%	(5) 0.0%	(615) -4.6%	(465) -3.2%	(552) -3.5%
Change in prepayments/other assets % of sales	(164) -4.1%	122 2.3%	1 0.0%	(143) -1.8%	192 2.2%	(30) -0.3%	(26) -0.2%	(27) -0.2%	(28) -0.2%	(29) -0.2%
Change in contract assets % of sales	(15) -0.4%	(290) -5.5%	(336) -4.9%	248 3.2%	97 1.1%	(144) -1.3%	(568) -4.6%	(190) -1.4%	(283) -2.0%	(212) -1.4%
Change in payables % of sales	429 10.6%	191 3.6%	492 7.1%	(36) -0.5%	422 4.8%	404 3.7%	225 1.8%	232 1.7%	229 1.6%	272 1.7%
Change in deferred revenue % of sales	507 12.6%	439 8.3%	278 4.0%	572 7.3%	863 9.8%	(101) -0.9%	100 0.8%	289 2.2%	223 1.5%	226 1.4%
Change in contract liabilities % of sales	(312) -7.7%	116 2.2%	(116) -1.7%	18 0.2%	57 0.6%	26 0.2%	67 0.5%	61 0.5%	64 0.4%	69 0.4%
Other working capital changes % of sales	(87) -2.2%	(26) -0.5%	30 0.4%	(185) -2.4%	66 0.7%	42 0.4%	(22) -0.2%	(11) -0.1%	(11) -0.1%	(12) -0.1%
Net change in WC as a % of sales	(512) -12.7%	(253) -4.8%	131 1.9%	107 1.4%	748 8.5%	(516) -4.7%	(229) -1.9%	(261) -2.0%	(271) -1.9%	(237) -1.5%
Net interest paid	31	16	2	3	21	76	52	69	92	115
Tax paid	(27)	(100)	(39)	(52)	(65)	(144)	(187)	(203)	(223)	(243)
End of service payments	(9)	(16)	(20)	(33)	(56)	(50)	(61)	(76)	(95)	(118)
Cash from operating activities	160	183	1,119	1,379	2,106	1,469	1,675	1,786	1,963	2,173
Net capital expenditure as a % of sales	(133) 3.3%	(179) 3.4%	(536) 7.8%	(155) 2.0%	(134) 1.5%	(145) 1.3%	(246) 2.0%	(267) 2.0%	(289) 2.0%	(312) 2.0%
Total capex as a % of sales	(133) 3.3%	(179) 3.4%	(536) 7.8%	(155) 2.0%	(134) 1.5%	(145) 1.3%	(246) 2.0%	(267) 2.0%	(289) 2.0%	(312) 2.0%
Share issue / (repurchase)	--	--	--	--	--	--	--	--	--	--
Cash dividends paid	(300)	(800)	--	(400)	(475)	(595)	(654)	(714)	(773)	(833)
Net disposals / (acquisitions)	--	100	--	--	(372)	(415)	--	--	--	--
Lease repayments	--	(13)	(4)	(29)	(22)	(34)	(36)	(39)	(42)	(46)
Other financing cash flows	--	--	--	(181)	--	--	--	--	--	--
Other investing cash flows	570	230	--	--	(2,701)	1,929	--	--	--	--
Issue of debt	--	--	--	--	554	(14)	--	--	--	--
Repayment of debt	--	--	--	--	--	--	--	--	--	--
Cash FX impact	--	--	--	--	(20)	(20)	--	--	--	--
FCFE as % of adj. EBIT y/y growth (%) as % of sales	27 5.1%	(9) -2.7%	579 74.4%	1,195 120.1%	1,950 181.5%	1,289 78.2%	1,392 87.0%	1,478 86.1%	1,630 87.0%	1,813 89.6%
	0.7%	-0.2%	8.4%	15.3%	22.1%	11.7%	11.3%	11.1%	11.3%	11.6%
FCFF as % of adj. EBIT y/y growth (%) as % of sales	4 0.8%	(12) -3.9%	594 76.3%	1,224 123.0%	1,984 184.7%	1,264 76.6%	1,400 87.5%	1,484 86.5%	1,633 87.2%	1,816 89.8%
	0.1%	-0.2%	8.6%	15.7%	22.5%	11.4%	11.4%	11.1%	11.3%	11.6%

Pre-40% acquisition of Devoteam Middle East pending deal closure and disclosure of financials

Source: Company data, Morgan Stanley Research estimates (E)

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](#)
6. View explanation of HERS methodology - [ESG_HERS_External_Link.pdf](#)

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(as of October 31, 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	1337	37%	270	43%	20%	594	39%
Equal-weight/Hold	1664	46%	299	47%	18%	700	46%
Not-Rated/Hold	3	0%	0	0%	0%	1	0%
Underweight/Sell	588	16%	61	10%	10%	220	15%
Total	3,592		630			1515	

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.

Analyst Stock Ratings

Overweight (O). The stock's total return is expected to exceed the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Equal-weight (E). The stock's total return is expected to be in line with the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Not-Rated (NR). Currently the analyst does not have adequate conviction about the stock's total return relative to the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Underweight (U). The stock's total return is expected to be below the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Unless otherwise specified, the time frame for price targets included in Morgan Stanley Research is 12 to 18 months.

Analyst Industry Views

Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

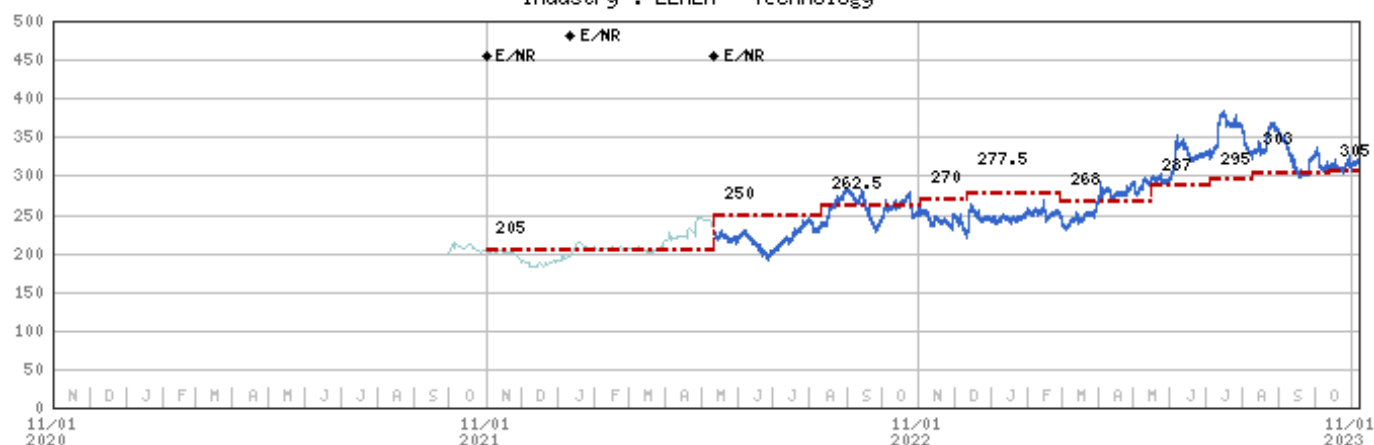
In-Line (I): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.

Cautious (C): The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.

Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index or MSCI Latin America Index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index or MSCI sub-regional index or MSCI AC Asia Pacific ex Japan Index.

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

Solutions by STC (7202.SE) - As of 11/6/23 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; 10/13/23 : 305

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)

Effective January 13, 2014, the stocks covered by Morgan Stanley Asia Pacific will be rated relative to the analyst's industry (or industry team's) coverage.

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INDUSTRY COVERAGE: EEMEA - Technology

COMPANY (TICKER)	RATING (AS OF)	PRICE* (11/07/2023)
George W Webb Solutions by STC (7202.SE)	U (11/08/2023)	SAR 322.00

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