August 2024

Elm Co.

Investment Update

Record high bottom line reached in Q2-24 in support by growth in Digital Business and Business Processed Outsourcing segments; SAR 4.2bn project backlog, and products' growth to drive our future estimates

Elm reached its record-high results during Q2-24, with its bottom line reaching SAR 486.2mn (up 30.4% Y/Y and 41.0% Q/Q), and a top line reported at SAR 1,767.0mn (up 25.9% Y/Y and 7.8% Q/Q). Its Digital Business (DB) and Business Process Outsourcing (BPO) segments supported the top line at Y/Y growths of 23.8%, and 34.6%, respectively. GP margins fell 260bps Y/Y to 40.0% in H1-24 as a result of increased BPO contribution and revenue mix from the DB segment. Management revised their top line growth guidance from 16%-18% to 22%-24% for FY24 amid a growth of 27% Y/Y recorded during H1-24. Growth is expected to be driven by DB products and projects as well as the BPO segment, as the firm also sits on a project pipeline of SAR 4.2bn across all its segments. The firm's strategic focus on the competitive B2B landscape going forward, along with increased BPO business, is expected to pressurize margins in the short term to reach 39.6% in FY25 (from FY23's 39.9%, and H1-24's 40.0%) before improving gradually. In return, we forecast an FY23-FY28E revenue CAGR of 19.6%, and a net income CAGR of 22.9% for the same period, while recognizing upsides to those estimates from potential acquisitions to support the firm's strategy to inorganically, or organically, grow into 6 new sectors, as well as the THIQA acquisition which is expected to have an announcement on this year. We revise our TP to SAR 923.0 per share, at a "Neutral" recommendation.

Elm records its highest bottom line of SAR 486.2mn during Q2-24, while reaching its highest quarterly revenue recorded: Q2-24 marked Elm's highest quarterly bottom line recorded at SAR 486.2mn (up 30.4% Y/Y and 41.0% Q/Q), in support by its highest top line recorded at SAR 1,767.0mn (up 25.9% Y/Y and 7.8% Q/Q). Top line was driven by a 23.8% Y/Y growth in the DB segment, which constitutes 71.2% of H1-24 revenues; followed by a 34.6% growth in the BPO segment, which gained more share of Elm's revenue from 23.6% of revenues in H1-23 to 26.9% in H1-24 as a result of Elm finalizing projects and reaching project milestones for others in the segment. Professional services (PS) declined 2.9% Y/Y while it remains a modest contributor to Elm's performance at 1.9% of H1-24 revenues. GP margins edged lower in H1-24 by c. 260bps to reach 40.0% from 42.6% in H1-23 as a result of higher BPO contribution, and the contribution mix within the DB segment's products. While SG&A increased by 26.3% Y/Y, in part due to more hiring for the DB and BPO segments, OPEX-to-revenue for the quarter fell 70bps Y/Y and 250bps Q/Q in support by an expected credit loss reversal. Further supporting the bottom line was a positive revaluation of financial assets at SAR 19.1mn, as well as other income by SAR 19.6mn from money market funds and other cash accounts.

Revenue growth guidance revised to 22.0%-24.0% for FY24 as H1-24 records an ahead-of-schedule growth of 27.0% Y/Y; B2B focus expected to pressure GP margins in short term: With revenue growth ahead of schedule post BPO project completions and milestones reached, management foresees the remaining growth for FY24 to come from DB products and projects as well as the BPO segment. Furthermore, a 10 year agreement signed in H1-24 with The Ministry of Interior and SDAIA systemizes the firm's terms and conditions with the MOI and SDAIA; previously, the contractual phase of finalizing business with the MOI and SDAIA took time to iron out, yet this umbrella agreement seeks to streamline development and kick off products, services, and add-ons quicker. 42% of the company's FY23 revenue falls within this agreement. The ease of doing business, the project backlog of c. SAR 4.2bn (SAR 2.9bn in BPO, SAR 1bn, 300mn in PS), initiatives on value added services for its top 6 products, and the firm's role in the Kingdom's digital and economic transformation drive our revenue forecasts to a FY23-28E CAGR of 19.6%. We do see, however, that the increased focus on the competitive B2B segment, and the normalization of the BPO margins towards a guided range of 20%-24% as well as the expansions into that segment to slightly pressurize GP margins in the short term to reach 39.6% in FY25E from 39.9% in FY23 (40.0% in H1-24). We expect that the firm's digitalization focus to be able to enhance margins in the longer term, where we expect GP margins to improve gradually reach an FY26-28E average of 41.0%. Our estimates punctuate at an FY23-28 net income CAGR of 22.9%, in support of OPEX optimization and income from cash holdings.

Recommendation	**Neutral**
Target Price (SAR)	**923.0**
Upside / (Downside)*	**-2.8%**

Source: Tadawul *prices as of 13th of August 2024

Key Financials

in SAR mn, (unless specified)	FY22	FY23	FY24E	FY25E
Revenues	4,606	5,898	7,218	8,726
Growth %	20.3%	28.1%	22.4%	20.9%
Net Income	930.2	1,347.1	1,721.3	1,999.08
Growth %	64.1%	44.8%	27.8%	16.1%
EPS	11.63	16.84	21.52	24.99
DPS	4.85	7.00	9.70	11.25

Source: Company reports, Aljazira Capital

Key Ratios

	FY22	FY23	FY24E	FY25E
Gross Margin	40.9%	39.9%	40.0%	39.6%
OP Margin	21.1%	22.9%	23.4%	23.5%
Net Margin	20.2%	22.8%	23.8%	22.9%
EBITDA Margin	23.7%	25.4%	25.9%	25.6%
RoE	30.5%	33.7%	34.1%	32.4%
P/E (x)	NA	48.4	44.2	38.0
P/B (x)	NA	16.3	15.1	12.3
EV/EBITDA (x)	NA	43.3	39.3	32.7
Dividend Yield	NA	0.9%	1.0%	1.2%

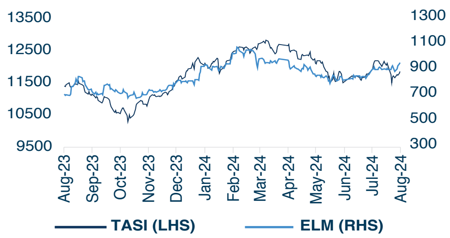
Source: Company reports, Aljazira Capital

Key Market Data

Market Cap(bn)	76.0
YTD%	16.6%
52-week (High)/(Low)	672 / 1,125
Share Outstanding (mn)	80.0

Source: Company reports, Aljazira Capital

Price Performance



Source: Tadawul, Aljazira Capital

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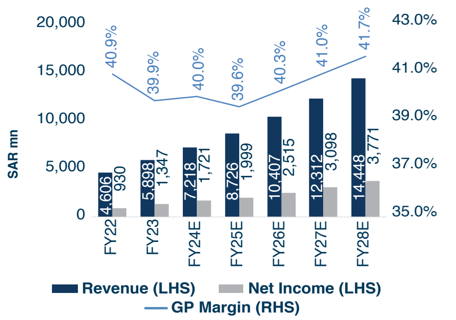
M&A strategy, including THIQA, as well as potentials for larger success of non-top six products provides upsides to the stock's revenue: Management's M&A focus looks to support its initiative to vertically diversify into six B2B sectors including Logistics, Tourism, and Fintech while gradually prioritizing among these sectors. Furthermore, more upsides are present from the long awaited THIQA acquisition, which management expect to announce on in FY24. Among the upsides from M&A, revenue enhancement could be found in further success of non-top 6 DB products (which make up 19.0 % of H1-24 DB revenues) or the creation of new wide-use products in the future. Furthermore, key government contract awardations ahead of 2030 initiatives is another source of upsides to the stock's estimated revenues.

Financial strength could support further major acquisitions without detrimental strain on financials; Solid balance sheet supporting net income from finance income: With no debt on its balance sheet, Elm carries a cash and murabaha holding of SAR 3.22bn, in addition to a SAR 735mn in public money market funds. With cash and cash-equivalents including money market funds making up c. 43% of its assets, Elm is able to comfortably pursue an acquisition via internal resources, or a mix of internal resources and debt, to reduce its cost of capital. Furthermore, its value of its VC holdings grew c. 54% in H1-24 from FY23's end, as Elm maintains a portfolio of VC investments in line with its digital focused business model with potential of wide-use applications across several sectors. While the portfolio only contributes modestly to the bottom line, a potential growth in any of the firms in its portfolio grants Elm the upside risk of their holdings' success. Furthermore, its cashflow from operation currently sits at 120% from positive net working capital movement. Despite a decrease in its payable days (77 days by H1-24 from FY23's 90 days) management expects that to revert in H2-24, potentially further supporting its cashflow generation. Income from murabaha deposits and money market funds reached c. 1.22 EPS in H1-24 (growing 42% Y/Y). We expect its cash and cash account holdings to remain a major component of its business model in times of excess cash and high interest rates, and further supporting its dividend payouts which we expect to be maintained at 45% in FY24-FY25E, paying out a DPS of SAR 9.7 and SAR 11.25 respectively.

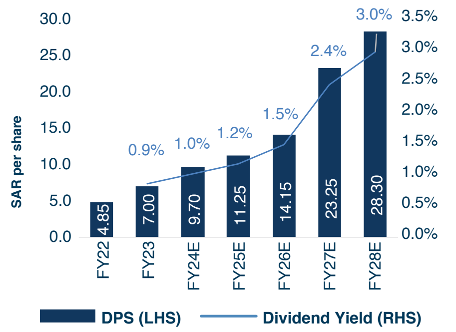
AJC View and Valuation: Elm hypersensitivity to KSA's economy is set to directly benefit from the digital and economic initiatives underway in Saudi Arabia; as it will benefit from government services activities, immigration, and tourism driven by pilgrimage, sports, and events such as Expo 2023. Furthermore, a pickup in financial services, trade, and other facets of the economic machine, as GDP is expected to grow 1.7% in FY24 and expanding to 4.7% the year after, will directly affect the demand over Elm's DB segment. In the near term, however, the strategic focus on the BPO segment and B2B business is expected to come at the cost of pressurizing GP margins, as compared to the less cost intensive DB segment. Management guides for normal gross margins for the segment of between 20%-24%, lower than the FY22-23 BPO average of 28%, though that could change depending on project mixes. We therefore forecast an FY23-28E revenue CAGR of 19.6%, while GP margins to dip slightly by 40bps from H1-24 levels to reach 39.6% by FY25E on the back of competition in B2B segments and BPO margins. Our estimates punctuate at a net income CAGR of 22.9%. Upsides to the stock's valuations exist from 1) Maintained GP margins via GP margin friendly projects and revenue mixes 2) Major value-adding acquisitions, including THIQA, 3) Higher than expected major contract awardations servicing government initiatives and 4) More contribution from the PS segment amid new initiatives to take the segment global. Downsides to the stocks valuations stem from 1) Lower than expected margins from revenue mix and 2) Slowdown from government demand. We value the stock at a blended 50% DCF (WACC = 10.4%, and terminal rate = 3.5%) and 50% PE valuation (38x over FY25E estimates) to arrive at a TP of **SAR 923 per share** and a "**Neutral**" recommendation.

Fig 1. Growth in the short term to be supported by BPO and DB projects pipeline



Sources: AlJazira Capital, Company Financials

Fig 2. Dividend payout supported by solid cash-heavy balance sheet



Sources: AlJazira Capital, Company Financials

Key Financials

Amount in USD mn, unless otherwise specified	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E	FY27E	FY28E
Income statement									
Revenues	2,466	3,828	4,606	5,898	7,218	8,726	10,407	12,312	14,448
Y/Y	**17.3%**	**55.2%**	**20.3%**	**28.1%**	**22.4%**	**20.9%**	**19.3%**	**18.3%**	**17.4%**
Cost of Sales	(1,639)	(2,505)	(2,720)	(3,547)	(4,330)	(5,271)	(6,214)	(7,265)	(8,425)
Gross profit	**827**	**1,323**	**1,886**	**2,351.1**	**2,887.8**	**3,455**	**4,193**	**5,047**	**6,024**
Selling and distribution expenses	(87)	(197)	(235)	(277)	(333)	(398)	(464)	(537)	(619)
Expected credit losses	(35)	(90)	(149)	(92)	(82)	(110)	(121)	(131)	(139)
Depreciation and amortization	(112)	(116)	(120)	(150)	(181)	(182)	(180)	(178)	(176)
General and administrative expenses	(247)	(306)	(373)	(476)	(591)	(701)	(825)	(964)	(1,122)
Operating profit	**345**	**615**	**972**	**1,351**	**1,692**	**2,049**	**2,591**	**3,221**	**3,950**
Zakat	(66)	(82)	(93)	(126)	(151)	(178)	(224)	(276)	(336)
Net income	**296**	**567**	**930**	**1,347.1**	**1,721.3**	**1,999**	**2,515**	**3,098**	**3,771**
Y/Y	**-3.2%**	**91.4%**	**64.1%**	**44.8%**	**27.8%**	**16.1%**	**25.8%**	**23.2%**	**21.7%**
EPS (SAR)	**3.70**	**7.09**	**11.63**	**16.84**	**21.52**	**24.99**	**31.44**	**38.73**	**47.13**
DPS (SAR)	**0.00**	**3.00**	**4.85**	**7.00**	**9.70**	**11.25**	**14.15**	**23.25**	**28.30**
Balance sheet									
Assets									
Cash and cash equivalent	1,013	1,362	589	384	2,654	3,292	4,848	6,797	9,065
Accounts receivable	1,370	1,655	1,465	2,322	2,541	2,709	3,201	3,753	4,364
Other current assets	898	1,375	3,101	4,260	3,630	5,055	5,720	6,333	6,990
Property & Equipment	374	347	353	375	330	321	326	333	340
Intangible assets	83	165	180	175	122	73	30	(2)	(27)
Total Assets	**4,013**	**5,194**	**6,026**	**8,097**	**9,926**	**12,136**	**14,856**	**17,999**	**21,582**
Liabilities & owners' equity									
Total current liabilities	1,375	1,984	2,575	3,530	4,260	5,270	6,402	7,621	8,884
Total non-current liabilities	404	401	404	573	626	691	767	855	957
Paid -up capital	50	800	800	800	800	800	800	800	800
Statutory reserves	25	(27)	175	175	240	240	240	240	240
Other reserve	-	-	(24)	13	13	13	13	13	13
Retained earnings	1,709	1,955	2,404	3,302	4,282	5,417	6,929	8,766	10,982
Total owners' equity	2,234	2,810	3,047	3,995	5,040	6,175	7,687	9,524	11,740
Total equity & liabilities	**4,013**	**5,194**	**6,026**	**8,097**	**9,926**	**12,136**	**14,856**	**17,999**	**21,582**
Cashflow statement									
Operating activities	724	598	1,706	1,559	2,369	2,922	3,237	3,849	4,517
Investing activities	283	(175)	(1,731)	(1,231)	608	(1,390)	(653)	(618)	(678)
Financing activities	(98)	(75)	(748)	(532)	(708)	(894)	(1,027)	(1,281)	(1,571)
Change in cash	908	349	(774)	(204)	2,270	638	1,556	1,949	2,268
Ending cash balance	**1,013**	**1,362**	**589**	**384**	**2,654**	**3,292**	**4,848**	**6,797**	**9,065**
Key fundamental ratios									
Liquidity ratios									
Current ratio (x)	2.4	2.2	2.0	2.0	2.1	2.1	2.2	2.2	2.3
Profitability ratios									
GP Margin	33.5%	34.6%	40.9%	39.9%	40.0%	39.6%	40.3%	41.0%	41.7%
Operating Margins	14.0%	16.1%	21.1%	22.9%	23.4%	23.5%	24.9%	26.2%	27.3%
EBITDA Margin	18.5%	19.1%	23.7%	25.4%	25.9%	25.6%	26.6%	27.6%	28.6%
Net Margins	12.0%	14.8%	20.2%	22.8%	23.8%	22.9%	24.2%	25.2%	26.1%
Return on assets	7.4%	10.9%	15.4%	16.6%	17.3%	16.5%	16.9%	17.2%	17.5%
Return on equity	13.3%	20.2%	30.5%	33.7%	34.2%	32.4%	32.7%	32.5%	32.1%
Market/valuation ratios									
EV/sales (x)	NA	NA	NA	11.0x	10.2x	8.4x	6.9x	5.6x	4.6x
EV/EBITDA (x)	NA	NA	NA	43.3x	39.3x	32.7x	25.8x	20.4x	16.3x
EPS (SAR)	3.7	7.1	11.6	16.8	21.5	25.0	31.4	38.7	47.1
BVPS (SAR)	27.9	35.1	38.1	49.9	63.0	77.2	96.1	119.0	146.8
Market price (SAR)*	NA	NA	NA	815.0	950.0	950.0	950.0	950.0	950.0
Market-Cap (SAR mn)	NA	NA	NA	65,200	76,000	76,000	76,000	76,000	76,000
Dividend yield	NA	NA	NA	0.9%	1.0%	1.2%	1.5%	2.4%	3.0%
P/E ratio (x)	NA	NA	NA	48.4x	44.2x	38.0x	30.2x	24.5x	20.2x
P/BV ratio (x)	NA	NA	NA	16.3x	15.1x	12.3x	9.9x	8.0x	6.5x

Sources: AlJazira Capital, Company Financials

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AlJazira Capital, the investment arm of Bank AlJazira, is a Shariaa Compliant Saudi Closed Joint Stock company and operating under the regulatory supervision of the Capital Market Authority. AlJazira Capital is licensed to conduct securities business in all securities business as authorized by CMA, including dealing, managing, arranging, advisory, and custody. AlJazira Capital is the continuation of a long success story in the Saudi Tadawul market, having occupied the market leadership position for several years. With an objective to maintain its market leadership position, AlJazira Capital is expanding its brokerage capabilities to offer further value-added services, brokerage across MENA and International markets, as well as offering a full suite of securities business.

RATING TERMINOLOGY

1. Overweight: This rating implies that the stock is currently trading at a discount to its 12 months price target. Stocks rated "Overweight" will typically provide an upside potential of over 10% from the current price levels over next twelve months.
2. Underweight: This rating implies that the stock is currently trading at a premium to its 12 months price target. Stocks rated "Underweight" would typically decline by over 10% from the current price levels over next twelve months.
3. Neutral: The rating implies that the stock is trading in the proximate range of its 12 months price target. Stocks rated "Neutral" is expected to stagnate within +/- 10% range from the current price levels over next twelve months.
4. Suspension of rating or rating on hold (SR/RH): This basically implies suspension of a rating pending further analysis of a material change in the fundamentals of the company.

Disclaimer