

Target Price: SAR17.8/share
Current Price: SAR16.2/share
Upside: +10%
Rating: Overweight

Saudi Azm for Communication and Information Technology Company (Azm)

TP revise to SAR17.8 on strong backlog/margin expansion

- FY24-25 revenue is likely to increase by ~20% y/y, primarily driven by strong backlog and new contract wins.
- Gross margins to expand gradually to ~23% over FY24-27e, aided by a change in revenue mix towards higher margins businesses.
- We raise our target price to ~SAR17.8/share based on an average of 30x P/E and DCF methods. We revise our rating to Overweight, with an upside of ~10%.

Sizeable backlog provides healthy top-line visibility: Azm's backlog stood at SAR329mn at the end of FY23. Since then, the company has secured multiple contracts worth ~SAR140mn, including: i) contracts with SASO (20% of FY22 revenue; 36 months duration) ii) SAR17mn contract with ETEC (17 months duration), iii) SAR18.5mn contract with the Ministry of Industry (12 months), iv) SAR15.2mn contract with the SDB (12 months) and v) contract award with the Small and Medium Enterprises General Authority (5% of FY23 revenues). As per our understanding, the backlog has increased to SAR351mn by FY9M24, with a potential to grow further, as Azm builds up a track record to bid for larger projects in a sole capacity. Considering the backlog realization period and new contract wins, we expect the top line to grow by ~20% y/y in FY24e (June-ended; in line with the guidance). Overall, on a conservative basis, we expect revenue to rise at a CAGR of 16% over FY23-28e.

Margins likely to expand given a strategic shift towards high margins business: The group's average gross margin for the period FY20-23 was ~21%. We expect it to gradually expand to ~23% over FY24-27e (24% in 1HFY24), mainly due to i) its focus on high margin businesses such as platforms, products and IT services, and ii) lower outsourcing revenues (generating a single digit margin only). This, along with the improvement in operating efficiencies, and higher equity income from its investment, would result in a 19% CAGR earnings growth over 2023-28e, with FY24 earnings likely increasing by 24% y/y (in-line with the guidance).

Figure 1: Key financial metrics

SARmn	FY22a	FY23a	FY24e	FY25e	FY26e
Revenue	152.6	190.4	229.3	274.3	321.5
Revenue growth	12.9%	24.8%	20.4%	19.6%	17.2%
Gross Profit	30.8	38.5	50.4	62.4	73.8
Gross Profit margin	20.2%	20.2%	22.0%	22.8%	23.0%
EBITDA	15.6	19.5	29.1	37.6	45.5
Op. income	14.5	17.3	27.7	35.8	43.4
Net profit*	19.1	23.1	28.5	35.1	42.3
Net profit margin	12.5%	12.6%	12.9%	13.3%	13.7%
EPS (SAR)	0.3	0.4	0.5	0.6	0.7
P/E	50.9x	42.2x	34.1x	27.7x	23.0x

Source: Company data, GIB Capital. June-ended. * Attributable to equity share holders

Stock data

NOMU Ticker	9534
Mkt cap (SARmn)	973
Trd. Val 3m (SARmn)	0.9
Free float	58.0%
QFI holding	2.4%

Source: Bloomberg

Prices indexed to 100



Source: Bloomberg

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Potential upside catalysts:

- **New product/platform launches:** Based on our discussion with the company, Azm plans to launch a new product company in the mortgage space. This may provide a significant boost to the company's earnings, although as of now it is still in the planning stage.
- **Inorganic growth strategy:** The company also plans to acquire a couple of companies with strong business moats and high profitability, which may further bolster its earnings potential.

Given the uncertainty surrounding the company's organic and inorganic expansion strategies, we have not factored these into our forecasts. Once more details emerge and these plans materialize, we will incorporate them into our projections, which may lead to a revision in our estimates and TP.

TASI transition: The planned transition to the main market, which has been approved by the board in April 2024, is expected to act as a positive catalyst for the stock. The stock was up by more than ~12% post the board's approval but later came down due to overall market-related weakness.

Recap of 1H24: Saudi Azm's 1H24 earnings remained largely in line with our estimates; however, revenue fell short of our expectations. Azm's 1H24 revenue came in at SAR107mn, up 4.4% y/y but below our estimates by about 11%. This growth was mainly driven by their enterprise and proprietary technology businesses. While revenue fell short, profits met our expectations due to higher-than-anticipated margins. Gross margins were around 24% in 1H24, exceeding our forecast of 22%. This improvement is due to a shift in their revenue mix, with a greater portion coming from their higher-margin segments. Additionally, growth in other income also contributed to a better-than-expected net margin of around 13%, compared to our estimate of 11%.

Valuation and Risks: We use an equal mix of DCF and P/E-based valuation methods for valuing the company. For relative valuation, we use a 30x multiple (25x earlier) on an average of FY24-25e EPS and arrive at a 1Y forward TP of SAR17.5/share. This adjustment reflects the re-rating of Azm's local and global peers (Figure 2). For DCF, using a WACC of 10%, we arrive at a 1Y forward TP of SAR18.1/share. Combining both approaches, we derive a blended average TP of SAR17.8/share (rounded off), indicating an Overweight rating with ~10% upside potential.

Being a technology-driven company, the major risk is failure to keep up with technological changes in the sector. Lack of diversity in clientele, ability to maintain talent, execution risks leading to inability to bid for future projects, increase in competition, unfavorable changes in regulations are some of the other risks.

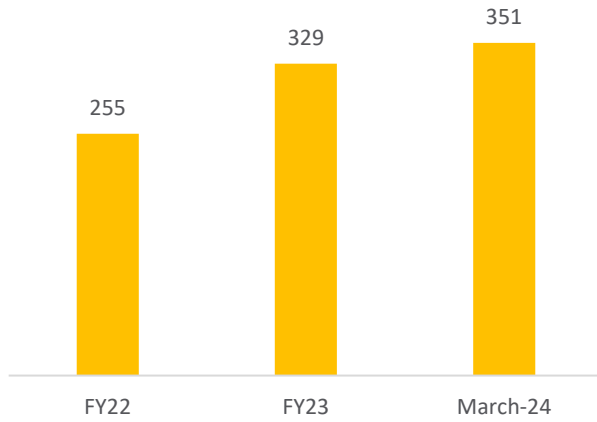
Figure 2: Peer comps

Company name	Country	Mkt Cap (US\$mn)	P/E Ratio (TTM)	Est P/E Current Yr	P/E - FY2	EV/T12M EBITDA	Est. EV/ EBITDA - 1FY	Est. EV/EBITD A - 2FY	Dividend Yield - FY1	P/B
Local										
Elm Co	KSA	17,482	46.2x	40.2x	34.7x	40.3x	34.4x	29.3x	1%	15.7x
Arabian Internet	KSA	8,818	26.4x	22.8x	20.0x	18.3x	17.0x	15.1x	2%	9.3x
Saudi Azm	KSA	259	37.7x	34.1x	27.9x	41.8x	31.3x	24.3x	N.A.	11.8x
Al Moammar Infor	KSA	1,168	107.8x	N.A.	N.A.	109.5x	N.A.	N.A.	N.A.	12.2x
Perfect Presenta	KSA	1,206	34.1x	24.9x	21.5x	26.0x	22.2x	18.6x	1%	11.0x
Average			50.4x	30.5x	26.0x	47.2x	24.5x	21.0x	1%	12.0x
Median			37.7x	29.5x	24.7x	40.3x	22.2x	18.6x	1%	11.8x
Product companies										
Sap Se	Germany	233,576	79.6x	38.7x	28.8x	25.8x	25.2x	18.4x	1%	5.0x
Intuit Inc	US	167,734	55.2x	35.7x	31.3x	36.2x	25.8x	22.5x	1%	8.9x
Salesforce Inc	US	262,073	51.6x	27.6x	24.3x	23.8x	17.2x	15.7x	1%	4.4x
Workday Inc-A	US	57,154	38.2x	31.7x	27.6x	86.8x	22.3x	19.1x	0%	5.6x
Veeva Systems-A	US	32,775	63.1x	33.1x	29.8x	60.3x	26.4x	22.9x	0%	7.1x
Sage Group	UK	13,504	40.3x	29.4x	25.8x	24.2x	19.8x	17.7x	2%	10.4x
Open Text Corp	Canada	8,128	26.0x	7.1x	8.4x	8.0x	7.9x	8.9x	3%	2.0x
Autodesk Inc	US	45,018	49.3x	26.2x	23.2x	34.4x	21.9x	19.3x	0%	24.3x
Adobe Inc	US	214,337	37.8x	26.5x	23.5x	26.5x	21.5x	18.9x	0%	14.0x
Synopsys Inc	US	90,082	62.1x	45.3x	39.5x	28.7x	36.5x	33.9x	N.A.	12.6x
Dassault Systeme	France	55,030	46.2x	28.9x	26.4x	26.4x	21.6x	19.6x	1%	6.2x
Cadence Design	US	80,609	86.0x	50.0x	42.5x	62.3x	40.8x	33.6x	0%	22.6x
Ansys Inc	US	28,641	63.2x	34.9x	31.3x	39.1x	27.0x	24.2x	0%	5.3x
Ptc Inc	US	21,501	74.1x	36.4x	30.6x	35.8x	28.0x	25.5x	0%	7.3x
Constellation So	Canada	58,285	83.1x	37.5x	30.8x	25.0x	21.5x	17.9x	N.A.	25.2x
Average			57.1x	32.6x	28.3x	36.2x	24.2x	21.2x	1%	10.7x
Median			55.2x	33.1x	28.8x	28.7x	22.3x	19.3x	0%	7.3x
IT companies										
Wipro Ltd	India	28,267	21.6x	19.5x	17.7x	12.6x	11.8x	10.8x	2%	3.1x
Hcl Tech Ltd	India	44,036	23.7x	21.7x	19.4x	14.5x	13.3x	12.1x	4%	5.5x
Mindtree Ltd	India	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Cognizant Tech-A	US	33,243	14.7x	14.5x	13.5x	9.2x	9.2x	8.7x	2%	2.5x
Tata Consultancy	India	165,043	30.2x	26.8x	24.2x	20.9x	18.9x	17.1x	3%	14.9x
Wns Holdings Ltd	India	2,351	15.1x	11.6x	10.3x	9.5x	7.3x	6.6x	0%	3.1x
Genpact Ltd	US	5,983	9.6x	11.0x	10.1x	9.3x	8.8x	8.1x	2%	2.6x
Exlservice Holdi	US	4,911	28.1x	18.8x	16.5x	16.6x	13.1x	11.7x	0%	6.1x
Mphasis Ltd	India	5,359	28.7x	26.0x	22.5x	18.0x	16.4x	14.5x	2%	5.1x
Infosys Ltd	India	72,246	22.9x	22.9x	20.4x	16.0x	15.1x	13.7x	3%	6.8x
Tech Mahindra Lt	India	15,078	48.3x	26.6x	19.6x	25.2x	17.1x	13.2x	3%	4.7x
Average			24.3x	19.9x	17.4x	15.2x	13.1x	11.7x	2%	5.4x
Median			23.3x	20.6x	18.5x	15.2x	13.2x	11.9x	2%	4.9x
Overall										
Average			45.0x	27.9x	24.2x	31.0x	20.3x	17.8x	1%	9.2x
Median			39.3x	26.8x	24.2x	25.5x	20.6x	17.8x	1%	6.9x

Source: Bloomberg, GIB Capital

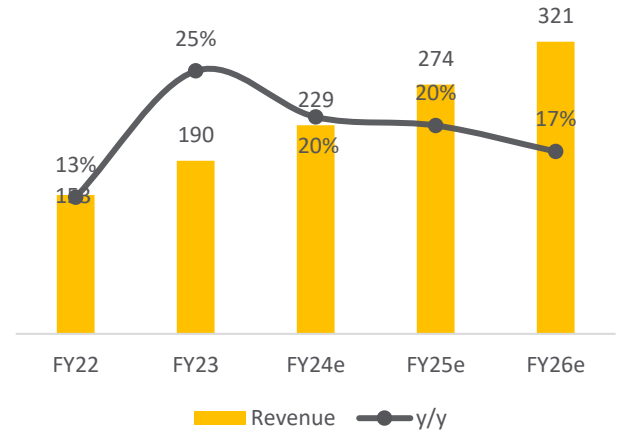
Financial analysis in charts

Figure 3: Backlog trend (SARmn)



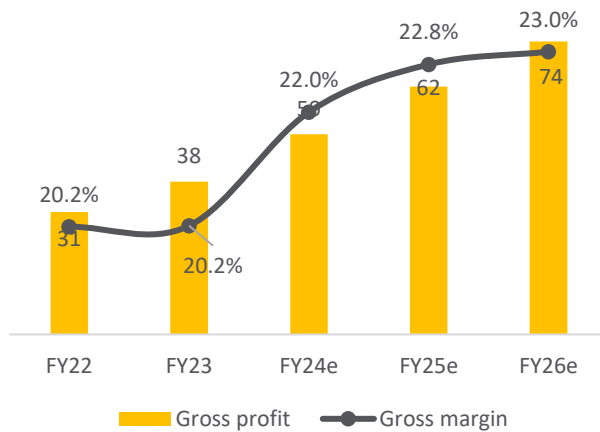
Source: Company data, GIB Capital

Figure 4: Revenue forecast (SARmn)



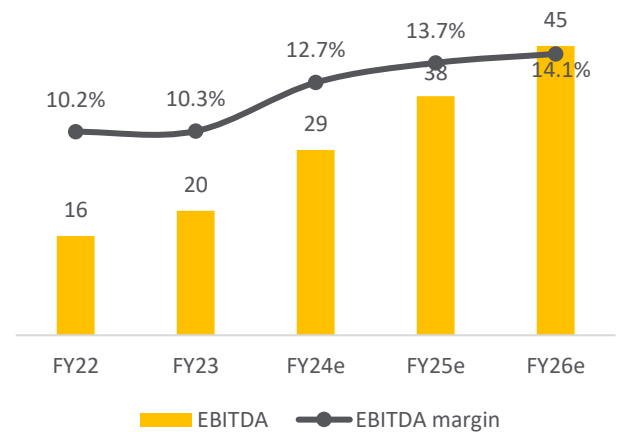
Source: Company data, GIB Capital

Figure 5: Gross profit and gross margin trend (SARmn)



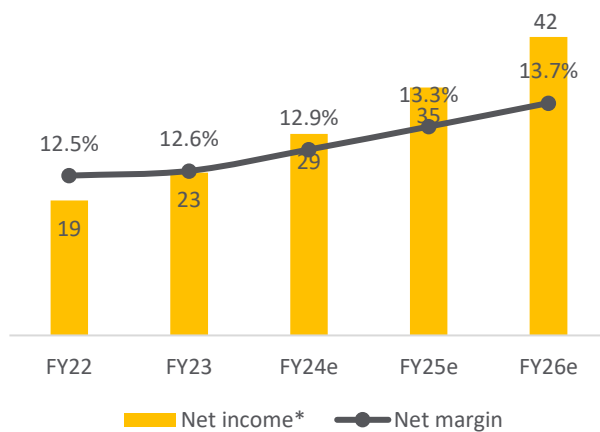
Source: Company data, GIB Capital

Figure 6: EBITDA and EBITDA margin trend (SARmn)



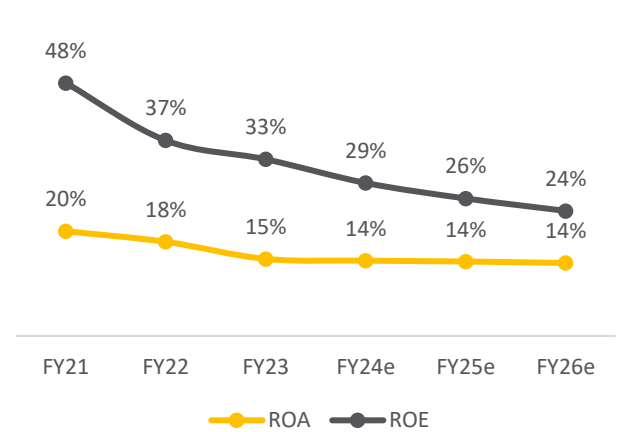
Source: Company data, GIB Capital

Figure 7: Net income* forecast (SARmn)



Source: Company data, GIB Capital* attributable to equity holders

Figure 8: ROA and ROE



Source: Company data, GIB Capital

Financials

Figure 9: Summarized basic financial statements (SARmn)

Income statement	FY22a	FY23a	FY24e	FY25e	FY26e
Revenue	152.6	190.4	229.3	274.3	321.5
y/y growth	12.9%	24.8%	20.4%	19.6%	17.2%
Cost of Services/Goods	(121.7)	(151.9)	(178.8)	(211.9)	(247.7)
Gross Profit	30.8	38.5	50.4	62.4	73.8
<i>Gross Margin</i>	20.2%	20.2%	22.0%	22.8%	23.0%
Selling and Marketing	(2.1)	(0.8)	(0.9)	(1.1)	(1.2)
General and Administrative	(14.2)	(20.3)	(21.8)	(25.5)	(29.3)
Operating Profit	14.5	17.3	27.7	35.8	43.4
<i>Operating margin</i>	9.5%	9.1%	12.1%	13.1%	13.5%
Finance Cost	(0.7)	(1.2)	(2.1)	(2.0)	(1.9)
Share of profit from investment in an associate	0.9	1.8	2.0	2.2	2.3
Other revenue	5.8	7.7	4.0	2.9	3.2
Profit Before Tax and Zakat	20.5	25.6	31.7	39.0	47.0
Tax and Zakat	(1.4)	(1.6)	(2.1)	(2.5)	(3.1)
Profit After Tax	19.1	24.0	29.6	36.4	43.9
Non-controlling interest	0.0	(0.9)	(1.1)	(1.3)	(1.6)
Profit available to equity holders	19.1	23.1	28.5	35.1	42.3
y/y growth	23.0%	20.8%	23.7%	23.0%	20.5%
<i>Net margin</i>	12.5%	12.1%	12.4%	12.8%	13.2%
EPS	0.3	0.4	0.5	0.6	0.7
DPS	0.0	0.0	0.0	0.0	0.0
<i>Dividend Payout</i>	0.0%	0.0%	0.0%	0.0%	0.0%

Balance Sheet	FY22a	FY23a	FY24e	FY25e	FY26e
Account Receivables	11.2	23.9	28.8	34.5	40.4
Other Current Assets	44.8	58.2	63.0	70.1	77.6
Cash and Equivalents	27.2	27.6	58.7	93.6	136.1
Total Current Assets	83.2	109.7	150.5	198.2	254.1
Total Non-Current Assets	24.4	49.2	50.4	51.7	53.2
Total Assets	107.6	158.9	200.9	250.0	307.3
Current Liabilities	40.1	70.6	85.4	98.0	111.5
Non-current Liabilities	15.7	18.9	16.6	16.6	16.6
Equity	51.8	69.3	98.9	135.4	179.3
Total Equity and Liabilities	107.6	158.9	200.9	250.0	307.3
BVPS	0.9	1.2	1.6	2.3	3.0

Cashflow	FY22a	FY23a	FY24e	FY25e	FY26e
Cashflow from Operations	32.2	30.6	34.8	38.0	46.1
Cashflow from Investing	(8.3)	(27.7)	(2.6)	(3.1)	(3.5)
Cashflow from Financing	(10.3)	(2.5)	(1.0)	0.0	0.0
Total Cashflows	13.6	0.4	31.1	34.9	42.5

Source: Company, GIB Capital. June-ended

Figure 10: Key ratios

Key ratios	FY22a	FY23a	FY24e	FY25e	FY26e
Profitability ratios					
RoA	17.8%	14.5%	14.2%	14.0%	13.8%
RoE	36.9%	33.3%	28.9%	25.9%	23.6%
Net margin	12.5%	12.1%	12.4%	12.8%	13.2%
Liquidity ratios					
Current Assets/ Current Liabilities	2.1	1.6	1.8	2.0	2.3
Receivable Days	27	46	46	46	46
Payable days	34	8	10	10	10
Cash conversion cycle	-7	38	36	36	36
Debt ratios					
Net Debt/EBITDA (w/ IFRS liab.)	-0.9x	-0.4x	-1.4x	-2.0x	-2.6x
Debt/Assets (w/ IFRS liab.)	0.1x	0.1x	0.1x	0.1x	0.1x
Net Debt/Equity (w/ IFRS liab.)	-0.2x	-0.1x	-0.4x	-0.6x	-0.7x
Valuation ratios					
P/E	50.9	42.2	34.1	27.7	23.0
P/B	18.8	14.0	9.8	7.2	5.4
EV/EBITDA	58.5	46.7	31.3	24.3	20.1
FCF yield	2.5%	2.4%	2.9%	3.3%	4.0%
Dividend yield	0.0%	0.0%	0.0%	0.0%	0.0%

Source: Company, GIB Capital. June-ended

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