

# Sirma Group Holding

**Buy**

Transfer of coverage

Price: BGN 0.71

Price target: BGN 1.52

## Healthy leverage position, amidst slowdown in IT

Due to a change in analyst responsibilities, we transfer coverage of Sirma Group Holding (Sirma), with a BUY rating and a 12M price target (PT) of BGN 1.52/share, or 114% upside. Sirma sold its highly regarded Ontotext in the middle of this year and the sale should generate significant cash proceeds of BGN 39m, or c.90% of its market cap, on our estimates. We believe the proceeds are likely to be used for special dividends over 2022-23E and, together with its new policy of a 50% payout ratio, investors should enjoy healthy dividends (mid-high single digit yields) in the coming 3Y. With net cash/EBITDAs of around 2.0x, the deleveraged position and its huge cash pile should allow the company to continue with its M&A pipeline (like Sciant, ReSolution, TBI), bolstering its organic growth, which we estimate in mid-high single digits throughout 2023-24E (our forecasts are adjusted for the disposal). The company is trading at severe discounts to its larger peers on earnings valuations, with 2023-24E P/E and EV/EBITDA discounts of 45% and 43%, respectively.

**Major cash inflow from recent disposal.** A consortium of investors bought Sirma's Ontotext, a highly regarded and top player in semantic technology and the IT knowledge domains. Due to intense competition in the US, the group decided to partner with VCs, by selling a majority stake (76.2%). The company's equity was valued at BGN 80m, we estimate, after a share capital increase in the target. Sirma should receive cash proceeds of BGN 39m this year due to the sale, or c.90% of its market cap.

**Large cash pile should make dividends part of the equity story.** With a net cash position of BGN 21m by end-2022E and net cash/EBITDA above 2.0x, looking forward, investors could expect an improved dividend policy, in our view: 50% payout from the annual consolidated net profit. We pencil in a special BGN 0.04 DPS (a 5.4% yield) in 2023E due to the sale of Ontotext, in line with the proposed articles during the AGM on 24 June. Cumulatively, Sirma should pay out BGN 9.7m in dividends over 2022-24E, on our estimates (3-11% yields).

**Recessionary threats have not affected Sirma materially so far, but IT spending is expected to slow down in 2023E, according to Gartner.** Surveys indicate that CEOs intend to weather any recessionary budget cutbacks in IT, with Gartner and IDC forecasting mid-high single-digit growth in IT spending over 2023E, in line with our outlook. The fast-developing segments, like IaaS and cloud-based enterprise IT products/services, continue to be essential for its international clients, fuelling solid growth in the foreseeable future.

**Positive streak of M&A activity this year, but this may decelerate.** There has been no indication yet that transactions have slowed down, and prices remain elevated, according to the company. However, management believes that 4Q could see some loss in appetite and, with the market cooling, Sirma could take advantage of favourable M&A opportunities, benefiting from lower valuations.

**Valuation.** Currently, on our numbers, Sirma trades at 2023-24E P/Es of 6.1-5.6x, EV/EBITDAs of 3.4-2.9x and EV/sales of 0.5x, which are at average 45%, 43% and 18% discounts vs. its peers, respectively.

**Risks:** cutbacks in IT budgets; slower GDP growth; IT talent crunch, rising costs for third-party services. **Triggers:** special dividends.

### Expected events

3Q22 results	29 November 2022
4Q23 results	March 2023
1Q23 results	May 2023

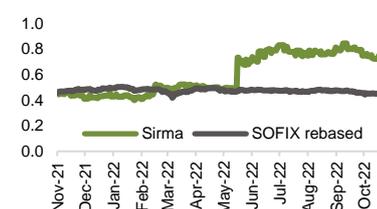
### Key data

Market Cap	EUR 22m
Free float	54%
3M ADTV	EUR 6.8k
Shares outstanding	59m
Major Shareholders	
	Geori Parvanov Marinov (8.9%)
	Tsvetan Borisov Alexiev (8.4%)
	Chavdar Velizarov Dimitrov (8.0%)
Bloomberg Code	SGH BU
SOFIX Index	582

### Price performance

52-w range	BGN 0.41-0.83
52-w performance	55%
Relative performance	55%

Sirma 12M share price performance



	Revenues	EBITDA	EBIT	NI	EPS	DPS	P/E	EV/EBITDA	Div.	ND/EBITDA
	BGNm	BGNm	BGNm	BGNm	BGN	BGN	x	x	yield	x
2020	59.4	11.2	5.9	3.7	0.06	0.00	8.7x	5.8x	0.0%	1.5x
2021	63.8	11.7	6.3	4.5	0.08	0.00	6.5x	5.9x	0.0%	1.8x
2022E	68.8	10.3	7.1	4.8	0.08	0.02	8.8x	4.0x	3.3%	-2.1x
2023E	72.9	11.8	8.4	6.9	0.12	0.08	6.1x	3.4x	11.4%	-2.1x
2024E	76.6	12.7	9.2	7.6	0.13	0.06	5.6x	2.9x	8.2%	-2.3x

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## Closing Prices as of 31 October 2022

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# Company snapshot –BUY, 12M PT BGN 1.52/share

Sirma		SHARE PRICE PERFORMANCE		COMPANY DESCRIPTION									
<b>BUY</b>													
Bloomberg ticker	SGH BU			Sirma Group Holding is one of the largest ICT companies in the region, having operated for 29 years, and has been listed on the Bulgarian Stock Exchange since 2015. So far, the company has completed over 400 projects in 185 countries. In 1H22, the European market accounted for 60% of its revenues, North America's share stood at 22%, while the UK added 15%. Sirma's main scope of operations is developing software and rendering IT services for many sectors, including banks and industrial companies.									
Closing price (BGN/share)	0.71												
PT (BGN/share)	1.52												
Upside to PT	114%												
Shares outstanding (m)	59												
Market cap (EURm)	22												
Free float	54%												
Average daily turnover (EURk)	6.8												
52 Week performance	55%												
52 Week relative performance	55%												
52 Week Range (BGN)	0.41-0.83												
<b>RATIOS</b>													
<b>BGN'share</b>		<b>2020</b>	<b>2021</b>	<b>2022E</b>	<b>2023E</b>	<b>2024E</b>	<b>VALUATION RATIOS</b>		<b>2020</b>	<b>2021</b>	<b>2022E</b>	<b>2023E</b>	<b>2024E</b>
EFS		0.06	0.08	0.08	0.12	0.13	EV/EBITDA		5.8x	5.9x	4.0x	3.4x	2.9x
BVPS		1.53	1.59	1.45	1.49	1.56	EV/Sales		1.1x	1.1x	0.6x	0.5x	0.5x
DPS		0.00	0.00	0.02	0.08	0.06	P/E		8.7x	6.5x	8.8x	6.1x	5.6x
Dividend pay-out ratio		0%	0%	31%	100%	50%	Organic FCF		13.0%	-9.2%	11.6%	14.9%	16.8%
<b>FINANCIAL RATIOS</b>		<b>2020</b>	<b>2021</b>	<b>2022E</b>	<b>2023E</b>	<b>2024E</b>	FCF yield		10.4%	-23.2%	104.3%	14.9%	16.8%
EBITDA margin		18.9%	18.3%	14.9%	16.1%	16.6%	Dividend yield		0.0%	0.0%	3.3%	11.4%	8.2%
EBIT margin		9.9%	9.9%	10.3%	11.5%	12.0%	<b>FCF BREAKDOWN (BGNm)</b>		<b>2020</b>	<b>2021</b>	<b>2022E</b>	<b>2023E</b>	<b>2024E</b>
Net margin		8.1%	9.4%	9.3%	12.6%	13.1%	EBIT		5.9	6.3	7.1	8.4	9.2
Effective tax rate		7.7%	8.9%	10.0%	10.0%	10.0%	NOPAT		5.4	5.7	6.4	7.6	8.3
ROE		4.5%	5.3%	7.4%	10.4%	10.8%	Net investment		-2.1	-12.6	37.6	-1.3	-1.2
ROA		3.1%	3.6%	4.2%	5.8%	6.1%	FCF		3.3	-6.8	44.0	6.3	7.1
ROIC		3.0%	3.6%	3.9%	5.8%	6.0%	Organic FCF		4.2	-2.7	4.9	6.3	7.1
<b>COMPANY FINANCIALS</b>													
<b>INCOME STATEMENT, BGNm</b>		<b>2020</b>	<b>2021</b>	<b>2022E*</b>	<b>2023E</b>	<b>2024E</b>	<b>BALANCE SHEET, BGNm</b>		<b>2020</b>	<b>2021</b>	<b>2022E*</b>	<b>2023E</b>	<b>2024E</b>
Revenues		59.4	63.8	68.8	72.9	78.6	PPE		9	11	11	11	12
OPEX		53.5	57.5	58.5	61.1	63.8	Goodwill and Intangibles		81	118	48	48	48
EBITDA		11.2	11.7	10.3	11.8	12.7	Inv. in associated and Other		1	2	21	21	21
D&A		-5.4	-5.4	-3.2	-3.4	-3.5	Total non-current assets		90	130	80	80	80
Operating profit		5.9	6.3	7.1	8.4	9.2	Inventories		1	3	3	3	3
PBT		5.2	6.6	7.1	10.2	11.1	Trade accounts receivable		17	17	19	20	21
Income tax		-0.4	-0.6	-0.7	-1.0	-1.1	Cash and cash equivalents		13	11	49	52	57
Minorities		1.2	1.5	1.6	2.2	2.5	Others		33	3	3	3	3
Net profit		3.7	4.5	4.8	6.9	7.6	Total current assets		63	34	73	78	84
<b>CASH FLOW STATEMENT, BGNm</b>		<b>2020</b>	<b>2021</b>	<b>2022E*</b>	<b>2023E</b>	<b>2024E</b>	Equity of owners of parent company		91	95	86	88	92
CF from operations		6	8	8	10	11	Minority equity		16	18	20	22	25
Cash receipts from customers		58	67	69	73	77	Long-term borrowings		10	13	13	13	13
Payments to suppliers		-33	-36	-29	-33	-34	Other LT liabilities		3	3	3	3	3
Other		-19	-24	-32	-31	-32	Total non-current liabilities		13	16	16	16	16
CF from investments		-4	-10	36	-4	-4	ST Debt		16	16	11	11	11
o/w Capex (PPE)		-1	-3	-1	-1	-2	ST trade payables		10	5	6	6	6
o/w Capex (intan.assets & other)		-2	-4	-2	-2	-2	Other ST liabilities		8	14	14	14	14
o/w Acquisition/sale of a subsidiary, net of cash		-1	-4	39	0	0	Total current liabilities		33	36	31	31	32
o/w other		0	1	0	0	0	Total equity and liabilities		154	164	153	158	165
CF from fin. activities		0	2	-6	-3	-2	Gross debt		29	33	28	28	28
Net Borrowings		2	4	-5	0	0	Net debt		16	21	-21	-24	-30
Dividends		0	0	-1	-5	-3	ND/EBITDA		1.5x	1.8x	-2.1x	-2.1x	-2.3x
Other		-2	-2	0	2	2	<b>Dividends</b>						
<b>ND/EBITDA and capex</b>													
BGN m													
BGN/share													

Source: WOOD Research, Bloomberg, company data, \* Pro-forma annual results excluding Sirma AI/Ontotext for the full year

# Valuation

## DCF

After transferring coverage of the stock, we have upgraded our rating on Sirma to BUY, with a 12M price target (PT) of BGN 1.52/share, offering 114% upside potential. We use a 50/50 blend of our DCF analysis and peer group valuation to derive our PT.

### Valuation Summary

	Weight	PT	Current price	Upside
DCF	50%	1.74	0.71	145%
Peers	50%	1.30	0.71	82%
<b>Weighted PT</b>	<b>100%</b>	<b>1.52</b>	<b>0.71</b>	<b>114%</b>

Source: WOOD Research

## DCF: 12M PT of BGN 1.74/share

Our DCF analysis is based on the following inputs:

- ✓ A WACC of 14%, based on a 5% risk free rate, a Damodaran beta of 1.3x and an effective tax rate of 10%.
- ✓ A terminal growth rate of 1%.

### DCF valuation

	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E	2031E	2032E	Terminal
<b>Revenues</b>	<b>72.9</b>	<b>76.6</b>	<b>80.4</b>	<b>84.0</b>	<b>87.4</b>	<b>90.9</b>	<b>93.6</b>	<b>96.4</b>	<b>99.3</b>	<b>102.3</b>	<b>103.3</b>
yoy	6%	5%	5%	4%	4%	4%	3%	3%	3%	3%	1.0%
EBIT	8.4	9.2	10.5	10.9	11.4	11.8	12.2	12.6	12.9	13.3	13.5
EBIT margin	12%	12%	13%	13%	13%	13%	13%	13%	13%	13%	13%
(-) Cash tax (15%)	-0.8	-0.9	-1.0	-1.1	-1.1	-1.2	-1.2	-1.3	-1.3	-1.3	-1.3
<b>NOPAT</b>	<b>7.6</b>	<b>8.3</b>	<b>9.4</b>	<b>9.9</b>	<b>10.2</b>	<b>10.7</b>	<b>11.0</b>	<b>11.3</b>	<b>11.6</b>	<b>12.0</b>	<b>12.1</b>
(+) D&A	3.4	3.5	3.7	3.9	4.0	4.2	4.3	4.4	4.6	4.7	4.7
(-) Capex	-3.6	-3.8	-4.0	-4.2	-4.4	-4.5	-4.6	-4.7	-4.8	-4.9	-4.9
(-) Working capital growth	-1.0	-0.9	-0.9	-0.9	-0.8	-0.8	-0.7	-0.7	-0.7	-0.7	-0.7
<b>Net investment</b>	<b>-1.3</b>	<b>-1.2</b>	<b>-1.3</b>	<b>-1.2</b>	<b>-1.2</b>	<b>-1.2</b>	<b>-1.0</b>	<b>-0.9</b>	<b>-0.9</b>	<b>-0.9</b>	<b>-0.9</b>
<b>FCF</b>	<b>6.3</b>	<b>7.1</b>	<b>8.2</b>	<b>8.6</b>	<b>9.1</b>	<b>9.4</b>	<b>10.0</b>	<b>10.4</b>	<b>10.7</b>	<b>11.1</b>	<b>11.2</b>
Terminal growth [g(t)]	1.0%										
PV TV	26										
PV FCF 2022-2031E	44										
Enterprise value (BGNm)	70										
Add Net cash (end 2022)	21										
Less Minorities	20										
Add Inv. in associates	19										
<b>Equity value (BGNm)</b>	<b>91</b>										
Number of shares (m)	59										
Value per share	1.53										
<b>12M PT (BGN)</b>	<b>1.74</b>										

Source: WOOD Research

### DCF: sensitivity table, WACC vs. g

		WACC						
		11%	12%	13%	14%	15%	16%	17%
g	0.1%	2.06	1.92	1.80	1.70	1.62	1.54	1.48
	0.4%	2.09	1.94	1.82	1.71	1.63	1.55	1.48
	0.7%	2.11	1.96	1.83	1.73	1.64	1.56	1.49
	1.0%	2.14	1.98	1.85	1.74	1.65	1.57	1.50
	1.3%	2.16	2.00	1.87	1.75	1.66	1.58	1.50
	1.6%	2.19	2.02	1.88	1.77	1.67	1.58	1.51
	1.9%	2.23	2.05	1.90	1.78	1.68	1.59	1.52

Source: WOOD Research

## Peer valuation

### Sirma: peers

	Country	Mcap EURm	Net inc. CAGR 2021-24E	P/E (x)			EBITDA CAGR 2021-24E	EV/EBITDA (x)			Sales CAGR 2021-24E	EV/sales (x)		
				2022E	2023E	2024E		2022E	2023E	2024E		2022E	2023E	2024E
<b>Sirma Group</b>	<b>Bulgaria</b>	<b>22</b>	<b>19%</b>	<b>8.8</b>	<b>6.1</b>	<b>5.6</b>	<b>14%</b>	<b>4.0</b>	<b>3.4</b>	<b>2.9</b>	<b>6%</b>	<b>0.6</b>	<b>0.5</b>	<b>0.5</b>
Tietoevry Oyj	Finland	2,859	0%	10.5	10.0	9.3	n.a.	7.7	6.8	6.2	3%	1.2	1.1	1.0
Softcat Plc	Britain	2,594	8%	20.8	20.1	18.8	n.a.	15.4	14.1	13.3	8%	1.7	1.6	1.5
Asseco Poland	Poland	1,210	5%	11.5	12.2	11.0	6%	3.7	3.5	3.3	10%	0.6	0.5	0.5
Atos Se	France	1,096	n.a.	31.6	7.7	4.1	n.a.	3.4	3.6	2.9	0%	0.3	0.3	0.3
Asseco SEE	Poland	462	8%	10.7	12.0	11.4	8%	6.8	6.3	5.8	13%	1.4	1.3	1.2
<b>Peers median</b>			<b>5%</b>	<b>11.1</b>	<b>12.0</b>	<b>9.3</b>	<b>5%</b>	<b>6.8</b>	<b>6.3</b>	<b>4.8</b>	<b>8%</b>	<b>0.7</b>	<b>0.7</b>	<b>0.6</b>
<i>vs. peers median</i>			<i>13.3pp</i>	<i>-21%</i>	<i>-49%</i>	<i>-40%</i>	<i>8.7pp</i>	<i>-41%</i>	<i>-46%</i>	<i>-39%</i>	<i>-1.2pp</i>	<i>-19%</i>	<i>-18%</i>	<i>-18%</i>

Source: Bloomberg, WOOD Research

### Peer valuation

	P/E		EV/EBITDA		EV/sales	
	2023E	2024E	2023E	2024E	2023E	2024E
Total weighted median (x)	12.0	9.3	6.3	4.8	0.7	0.6
EPS, EBITDA, sales (BGN, BGNm)	0.12	0.13	12	13	73	77
Enterprise value (BGNm)	81	65	74	61	49	45
Equity value (BGNm)	83	71	76	66	51	50
<b>Fair value per share (BGN)</b>	<b>1.4</b>	<b>1.2</b>	<b>1.3</b>	<b>1.1</b>	<b>0.9</b>	<b>0.8</b>
Weight (%)	16.7%	16.7%	16.7%	16.7%	16.7%	16.7%
Fair value per share (BGN), weighted			1.1			
<b>12M PT</b>			<b>1.3</b>			

Source: Bloomberg, WOOD Research

# Financials

## Profit and loss

BGNm	2020	2021	2022E*	2023E	2024E
<b>Revenue</b>	<b>59.4</b>	<b>63.8</b>	<b>68.8</b>	<b>72.9</b>	<b>76.6</b>
Other income	2.4	2.3	2.5	2.7	2.8
OPEX	-53.5	-57.5	-58.5	-61.1	-63.8
<b>EBITDA</b>	<b>11.2</b>	<b>11.7</b>	<b>10.3</b>	<b>11.8</b>	<b>12.7</b>
D&A	-5.4	-5.4	-3.2	-3.4	-3.5
EBIT	5.9	6.3	7.1	8.4	9.2
Net financial cost	-0.6	0.3	0.0	1.8	1.9
<b>Profit before tax</b>	<b>5.2</b>	<b>6.6</b>	<b>7.1</b>	<b>10.2</b>	<b>11.1</b>
Tax	-0.4	-0.6	-0.7	-1.0	-1.1
<b>Net income to shareholders</b>	<b>3.7</b>	<b>4.5</b>	<b>4.8</b>	<b>6.9</b>	<b>7.6</b>

Source: WOOD Research; \*our forecasts are pro-forma adjusted for the recent Ontotext disposal

## Margins

	2020	2021	2022E*	2023E	2024E
EBITDA margin	19%	18%	15%	16%	17%
EBIT margin	10%	10%	10%	12%	12%
Net profit margin	8%	9%	9%	13%	13%
ROA	3%	4%	4%	6%	6%
ROE	4%	5%	7%	10%	11%
ROIC	3%	4%	4%	6%	6%

Source: WOOD Research; \*our forecasts are pro-forma adjusted for the recent Ontotext disposal

## Balance sheet

BGNm	2020	2021	2022E*	2023E	2024E
<b>Non-current assets</b>	<b>90.4</b>	<b>130.4</b>	<b>79.8</b>	<b>80.1</b>	<b>80.4</b>
Property, plant and equipment	8.7	11.1	11.2	11.4	11.5
Intangible assets +Goodwill	80.6	117.8	48.0	48.1	48.3
Inv. in associated and Other	1.1	1.5	20.7	20.7	20.7
<b>Current assets</b>	<b>63.4</b>	<b>34.1</b>	<b>73.2</b>	<b>77.6</b>	<b>84.2</b>
Inventories	0.8	2.8	3.0	3.2	3.4
Related party receivables	0.1	0.6	0.7	0.7	0.7
Trade receivables	17.5	17.2	18.5	19.6	20.6
Other	32.4	2.1	2.1	2.1	2.1
Cash and cash equivalents	12.5	11.4	48.9	52.0	57.3
<b>TOTAL ASSETS</b>	<b>153.8</b>	<b>164.5</b>	<b>153.1</b>	<b>157.8</b>	<b>164.6</b>
<b>Total equity</b>	<b>107.6</b>	<b>112.9</b>	<b>106.1</b>	<b>110.4</b>	<b>117.0</b>
Equity of owners of parent company	91.1	94.6	86.2	88.3	92.4
Non-controlling interest	16.5	18.3	19.9	22.1	24.6
<b>Non-current liabilities</b>	<b>13.1</b>	<b>15.9</b>	<b>15.9</b>	<b>15.9</b>	<b>15.9</b>
Long-term borrowings	10.3	13.3	13.3	13.3	13.3
Other	2.8	2.6	2.6	2.6	2.6
<b>Current liabilities</b>	<b>33.2</b>	<b>35.7</b>	<b>31.1</b>	<b>31.4</b>	<b>31.7</b>
Bank loans	15.6	16.3	11.3	11.3	11.3
Trade payables	9.6	5.1	5.5	5.9	6.2
Other	8.1	14.3	14.3	14.3	14.3
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>153.8</b>	<b>164.5</b>	<b>153.1</b>	<b>157.8</b>	<b>164.6</b>

Source: WOOD Research; \*our forecasts are pro-forma adjusted for the recent Ontotext disposal

## Debt

(BGNm)	2020	2021	2022E*	2023E	2024E
Gross debt	28.9	32.6	27.6	27.6	27.6
Net debt	16.4	21.3	-21.3	-24.4	-29.7
ND/EBITDA	1.5x	1.8x	-2.1x	-2.1x	-2.3x

Source: WOOD Research

## Cash flow

BGNm	2020	2021	2022E*	2023E	2024E
Net income	3.7	4.5	4.8	6.9	7.6
D&A	5.4	5.4	3.2	3.4	3.5
WC	-3.4	-6.6	-1.2	-1.0	-0.9
Other	0.3	4.4	1.6	0.5	0.5
<b>CFO</b>	<b>5.9</b>	<b>7.7</b>	<b>8.3</b>	<b>9.7</b>	<b>10.7</b>
CAPEX	-3.2	-7.3	-3.4	-3.6	-3.8
M&A	-0.8	-4.1	39.1	0.0	0.0
Other	0.0	0.9	0.0	0.0	0.0
<b>CFI</b>	<b>-4.0</b>	<b>-10.5</b>	<b>35.6</b>	<b>-3.6</b>	<b>-3.8</b>
Net borrowings	1.7	3.7	-5.0	0.0	0.0
Dividends	0.0	0.0	-1.4	-4.8	-3.5
Other	-1.5	-2.2	0.0	1.8	1.9
<b>CFF</b>	<b>0.2</b>	<b>1.5</b>	<b>-6.4</b>	<b>-3.0</b>	<b>-1.5</b>
<b>Net change in cash</b>	<b>2.1</b>	<b>-1.2</b>	<b>37.5</b>	<b>3.1</b>	<b>5.4</b>
Cash at the beginning of the period	10.6	12.5	11.4	48.9	52.0
<b>Cash at the beginning of the period</b>	<b>12.5</b>	<b>11.4</b>	<b>48.9</b>	<b>52.0</b>	<b>57.3</b>

Source: WOOD Research; \*our forecasts are pro-forma adjusted for the recent Ontotext disposal

## Valuation multiples

	2020	2021	2022E*	2023E	2024E
P/E	8.7	6.5	8.8	6.1	5.6
EV/EBITDA	5.8	5.9	4.0	3.4	2.9
Dividend yield	0%	0%	3%	11%	8%
Organic FCF yield	13%	-9%	12%	15%	17%
FCF Yield	10%	-23%	104%	15%	17%

Source: WOOD Research; \*our forecasts are pro-forma adjusted for the recent Ontotext disposal

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