

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

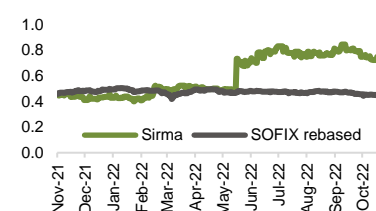
Key data

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

Analysts: Aidar Ulan; Piotr Raciborski, CFA

E-mail: aidar.ulan@wood.cz, piotr.raciborski@wood.com

Prague: +420 222 096 111

Website: www.wood.com

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Closing Prices as of 31 October 2022

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Requests for permission to make copies of any part of this report should be mailed to:

WOOD & Company Financial Services a.s.
Palladium, Namesti Republiky 1079/1a,
110 00 Prague 1 – Czech Republic
tel.: +420 222 096 111
fax: +420 222 096 222
<http://www.wood.cz>

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

Sirma		SHARE PRICE PERFORMANCE					COMPANY DESCRIPTION					
BUY							<p>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.</p>					
Bloomberg ticker	SGH BU											
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											
RATIOS												
BGN'share		2020	2021	2022E	2023E	2024E	VALUATION RATIOS	2020	2021	2022E	2023E	2024E
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%
FINANCIAL RATIOS							FCF BREAKDOWN (BGNm)					
EBITDA margin		18.9%	18.3%	14.9%	16.1%	16.6%	FCF yield	10.4%	-23.2%	104.3%	14.9%	16.8%
EBIT margin		9.9%	9.9%	10.3%	11.5%	12.0%	Dividend yield	0.0%	0.0%	3.3%	11.4%	8.2%
Net margin		8.1%	9.4%	9.3%	12.6%	13.1%	FCF	3.3	-6.8	44.0	6.3	7.1
Effective tax rate		7.7%	8.9%	10.0%	10.0%	10.0%	Organic FCF	4.2	-2.7	4.9	6.3	7.1
ROE		4.5%	5.3%	7.4%	10.4%	10.8%						
ROA		3.1%	3.6%	4.2%	5.8%	6.1%						
ROIC		3.0%	3.6%	3.9%	5.8%	6.0%						
COMPANY FINANCIALS												
INCOME STATEMENT, BGNm						BALANCE SHEET, BGNm						
	2020	2021	2022E*	2023E	2024E		2020	2021	2022E*	2023E	2024E	
Revenues	59.4	63.8	68.8	72.9	76.6	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	
CASH FLOW STATEMENT, BGNm						Equity of owners of parent company						
	2020	2021	2022E*	2023E	2024E	Minority equity	16	18	20	22	25	
CF from operations	6	8	8	10	11	Long-term borrowings	10	13	13	13	13	
Cash receipts from customers	58	67	69	73	77	Other LT liabilities	3	3	3	3	3	
Payments to suppliers	-33	-36	-29	-33	-34	Total non-current liabilities	13	16	16	16	16	
Other	-19	-24	-32	-31	-32	ST Debt	16	16	11	11	11	
CF from investments	-4	-10	36	-4	-4	ST trade payables	10	5	6	6	6	
o/w Capex (PPE)	-1	-3	-1	-1	-2	Other ST liabilities	8	14	14	14	14	
o/w Capex (intan.assets & other)	-2	-4	-2	-2	-2	Total current liabilities	33	36	31	31	32	
o/w Acquisition/sale of a subsidiary, net of cash	-1	-4	39	0	0	Total equity and liabilities	154	164	153	158	165	
o/w other	0	1	0	0	0	Gross debt	29	33	28	28	28	
CF from fin. activities	0	2	-6	-3	-2	Net debt	16	21	-21	-24	-30	
Net Borrowings	2	4	-5	0	0	ND/EBITDA	1.5x	1.8x	-2.1x	-2.1x	-2.3x	
Dividends	0	0	-1	-5	-3	Dividends						
Other	-2	-2	0	2	2							

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%
Weighted PT	100%	1.52	0.71	114%

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
Revenues	72.9	76.6	80.4	84.0	87.4	90.9	93.6	96.4	99.3	102.3	103.3
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
NOPAT	7.6	8.3	9.4	9.9	10.2	10.7	11.0	11.3	11.6	12.0	12.1
(+) 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
Net investment	-1.3	-1.2	-1.3	-1.2	-1.2	-1.2	-1.0	-0.9	-0.9	-0.9	-0.9
FCF	6.3	7.1	8.2	8.6	9.1	9.4	10.0	10.4	10.7	11.1	11.2
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										
Equity value (BGNm)	91										
Number of shares (m)	59										
Value per share	1.53										
12M PT (BGN)	1.74										

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
Sirma Group	Bulgaria	22	19%	8.8	6.1	5.6	14%	4.0	3.4	2.9	6%	0.6	0.5	0.5
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
Peers median			5%	11.1	12.0	9.3	5%	6.8	6.3	4.8	8%	0.7	0.7	0.6
<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
Fair value per share (BGN)	1.4	1.2	1.3	1.1	0.9	0.8
Weight (%)	16.7%	16.7%	16.7%	16.7%	16.7%	16.7%
Fair value per share (BGN), weighted			1.1			
12M PT			1.3			

Source: Bloomberg, WOOD Research

Financials

Profit and loss

BGNm	2020	2021	2022E*	2023E	2024E
Revenue	59.4	63.8	68.8	72.9	76.6
Other income	2.4	2.3	2.5	2.7	2.8
OPEX	-53.5	-57.5	-58.5	-61.1	-63.8
EBITDA	11.2	11.7	10.3	11.8	12.7
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
Profit before tax	5.2	6.6	7.1	10.2	11.1
Tax	-0.4	-0.6	-0.7	-1.0	-1.1
Net income to shareholders	3.7	4.5	4.8	6.9	7.6

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
Non-current assets	90.4	130.4	79.8	80.1	80.4
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
Current assets	63.4	34.1	73.2	77.6	84.2
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
TOTAL ASSETS	153.8	164.5	153.1	157.8	164.6
Total equity	107.6	112.9	106.1	110.4	117.0
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
Non-current liabilities	13.1	15.9	15.9	15.9	15.9
Long-term borrowings	10.3	13.3	13.3	13.3	13.3
Other	2.8	2.6	2.6	2.6	2.6
Current liabilities	33.2	35.7	31.1	31.4	31.7
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
TOTAL LIABILITIES AND EQUITY	153.8	164.5	153.1	157.8	164.6

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
CFO	5.9	7.7	8.3	9.7	10.7
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
CFI	-4.0	-10.5	35.6	-3.6	-3.8
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
CFF	0.2	1.5	-6.4	-3.0	-1.5
Net change in cash	2.1	-1.2	37.5	3.1	5.4
Cash at the beginning of the period	10.6	12.5	11.4	48.9	52.0
Cash at the beginning of the period	12.5	11.4	48.9	52.0	57.3

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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Date	Rating	Date	PT
14/12/2021	HOLD	14/12/2021	BGN 0.45
		24/06/2022	BGN 0.84
03/11/2022	BUY – transfer of coverage	03/11/2022	BGN 1.52

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CONTACTS

Czech Republic

namesti Republiky 1079/1a
Palladium
110 00 Praha 1
Czech Republic
Tel +420 222 096 111
Fax +420 222 096 222

Poland

Centrum Marszalkowska
Marszalkowska 126/134
7th Floor
00 008 Warszawa
Poland
Tel +48 22 222 1530
Fax +48 22 222 1531

UK

16 Berkeley Street
London
W1J 8DZ
Tel +44 20 3530 0691

Italy

Via Luigi Settembrini, 35
20124 Milan
Italy
Tel +39 02 36692 500

Kristen Andrasko

Head of Equities
+420 222 096 253
kristen.andrasko@wood.com

Romania

Lamda Building
7A Bucuresti-Ploiesti Street
4th Floor
013682 Bucharest 1
Tel.: +40 316 30 11 81

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www.wood.com

Research

Co-Head of Research/ Head of Research Poland

Marta Jezewska-Wasilewska
+48 22 222 1548
marta.jezewska-wasilewska@wood.com

Head of Turkey Research

Atinc Ozkan
+90 542 202 3632
atinc.ozkan@wood.com

Head of Financials

Can Demir
+44 20 3530 0623
can.demir@wood.com

Consumer/Real Estate

Jakub Caithaml
+420 222 096 481
jakub.caithaml@wood.com

Turkey

Can Yurtcan
+420 222 096 780
can.yurtcan@wood.com

Financials

Miguel Dias
+420 735 729 418
miguel.dias@wood.com

Co-Head of Research/Head of Greek Research

Alex Boulougouris
+30 216 200 5261
alex.boulougouris@wood.com

Head of Russia Research

Ildar Davletshin
+44 203 530 0631
ildar.davletshin@wood.com

Head of TMT

Piotr Raciborski
+48 22 222 1551
piotr.raciborski@wood.com

Energy/Utilities

Ondrej Slama
+420 222 096 484
ondrej.slama@wood.com

Greece

Fani Tzioukalia
+30 216 200 5260
fani.tzioukalia@wood.com

Real Estate

Peter Palovic
+420 222 096 486
peter.palovic@wood.cz

Head of Consumer/Industrials

Lukasz Wachelko
+48 22 222 1560
lukasz.wachelko@wood.com

Head of Romania Research

Iuliana Ciopraga
+40 316 30 1185
iuliana.ciopraga@wood.com

Energy

Jonathan Lamb
+44 20 3530 0621
jonathan.lamb@wood.com

Metals/Mining

Artem Bagdasaryan
+420 222 096 710
artem.bagdasaryan@wood.com

Russia

Dmitry Vlasov
+44 750 714 6702
dmitry.vlasov@wood.com

Macroeconomics

Raffaella Tenconi
+44 20 3530 0685
raffaella.tenconi@wood.com

Macroeconomics

Alessio Chiesa
+44 75177 06102
alessio.chiesa@wood.com

Utilities/Mining/Pharma

Bram Buring
+420 222 096 250
bram.buring@wood.com

Gaming/Mid-caps

Maria Mickiewicz
+48 602 450 718
maria.mickiewicz@wood.com

CEE

Aidar Ulan
+420 739 627 170
aidar.ulana@wood.cz

Sales

Head of Sales

Kristen Andrasko
+420 222 096 253
kristen.andrasko@wood.cz

Grzegorz Skowronski
+48 22 222 1559
grzegorz.skowronski@wood.com

Jan Koch
+48 22 222 1616
jan.koch@wood.com

Jarek Tomczynski
+44 203 530 0688
jarek.tomczynski@wood.com

Piotr Kopec
+48 22 222 1615
piotr.kopec@wood.com

Tatiana Sarandinaki
Brasil Plural in association with WOOD&Co.
1 212 388 5613
tsarandinaki@wood-brasilplural.com

Ioana Pop
+44 20 3530 0693
ioana.pop@wood.com

Sales Trading and Execution Services

Zuzana Mora
+420 222 096 283
zuzana.mora@wood.com

Ermir Shkurti
+420 222 096 847
ermir.shkurti@wood.com

Vladimir Vavra
+420 222 096 397
vladimir.vavra@wood.com

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