

## Sirma Group Holding

Buy

Initiation of coverage

Price: BGN 0.56/share

Price target: BGN 0.90/share

## Small player, but growing quickly

We initiate coverage of Sirma Group Holding (Sirma), the largest information and communication technology (ICT) name in the Balkan region, with a BUY rating and a 12M price target (PT) of BGN 0.90/share (61% upside potential). The company's operations encompass software development, and providing IT services for many sectors, including banks and industrial companies. Sirma's largest market is Europe (56% of its 2019 top line), followed by North America (24%). We like the company for: i) its growth profile (we expect a 2019-22E EBITDA CAGR of 10% vs. the Bloomberg consensus of 7% for its regional peers); ii) its low valuation (2020E EV/EBITDA at only 3.5x, indicating a 60% discount to its peers); and iii) the option for a large buyback (up to c.34% of the total number of shares may be repurchased by the end of 2022E, with a cap price of BGN 2.0/share). As the main sources of risk, we see: uncertainty over the development of COVID-19 and, hence, the ICT market outlook in 2021E; as well as the stock's low liquidity (3M ADTV of just USD 22k).

**Sirma operates in the two fastest-growing segments of the ICT market.** According to Gartner's forecasts, the ICT market should enjoy a 2019-24E CAGR of c.3%. However, the growth rates vary a lot between the segments, and the two fastest growing (in which Sirma operates) are software and IT services, which should enjoy growth rates of +8% and +5%, respectively.

**It should continue to outpace its competitors' growth.** Historically, Sirma has outpaced the ICT market growth significantly (a 2014-19 CAGR of +17% vs. +3% for IT and +8% for services). We believe this may be related to the small size of the company (2019 EBITDA at only c.EUR 6m), which implies that winning a single large contract could boost its revenues significantly. Moreover, we believe it should continue to grow faster than its competitors, going forward, and we expect a 2019-22E EBITDA CAGR of 10% vs. 7% for its regional peers (Bloomberg consensus).

**No dividends expected, but option for a large buyback programme.** At this stage, we do not pencil in any dividend payments over the next three years, as we believe that Sirma may focus on investing in organic growth. Nonetheless, we highlight that, at its 2019 AGM, the shareholders approved a stock buyback option for up to c.34% of the total number of shares to be repurchased by the end of 2022E, with a cap price of BGN 2.0/share.

**We rate Sirma a BUY, with a 12M PT of BGN 0.90/share, implying 61% upside potential.** We derive our PT based purely on our DCF analysis (ax100% weight), assigning 0% to the peer group valuation. We believe that, in the case of a high-growth micro-cap company, it is the cash generation capacity that should be the reference point for the stock's valuation. On our 2020-22E EV/EBITDAs, Sirma trades at 3.5-2.5x, indicating a 57-60% discount vs. its peers.

**Risks:** Brexit; GDP growth worldwide; competition; employee turnover; litigation; FX risk; and low liquidity.

## Expected events

3Q20 30 November

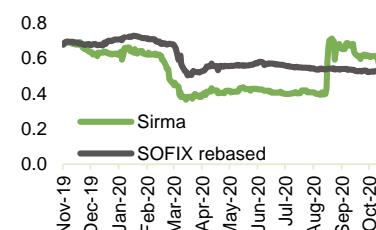
## Key data

Market Cap	USD 20m
3M ADTV	USD 22k
Free float	54%
Shares outstanding	59m
Major Shareholder	
	Georgi Parvanov Marinov (8.9%)
	Tsvetan Borisov Alexiev (8.2%)
	Chavdar Velizarov Dimitrov (8.0%)
Bloomberg Code	SKK BU
SOFIX Index	428

## Price performance

52-w range	BGN 0.36-0.71
52-w performance	-17%
Relative performance	6%

## Sirma 12M share price performance



	Revenues BGNm	EBITDA BGNm	EBIT BGNm	NI BGNm	EPS BGN	DPS BGN	P/E x	EV/EBITDA x	Div. yield	ND/EBITDA x
2018	57.0	11.6	7.2	5.9	0.10	0.00	5.6x	3.5x	0.0%	0.7x
2019	59.3	11.6	6.4	6.0	0.10	0.00	5.5x	4.3x	0.0%	1.5x
2020E	61.4	13.6	6.9	6.2	0.10	0.00	5.4x	3.5x	0.0%	1.1x
2021E	66.7	14.3	7.5	6.3	0.11	0.00	5.3x	3.0x	0.0%	0.7x
2022E	74.6	15.6	8.8	7.2	0.12	0.00	4.6x	2.5x	0.0%	0.3x

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## Closing Prices as of 30 October 2020

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# Company snapshot – BUY, PT BGN 0.90/share

Sirma

BUY

Bloomberg ticker

SKK BU

Closing price (BGN/share)

0.56

PT (BGN/share)

0.90

Upside to PT

61%

Shares outstanding (m)

59

Market cap (USDm)

20

Free float

54%

Average daily turnover (USDk)

21.6

52 Week performance

-17%

52 Week relative performance

6%

52 Week Range (BGN)

0.36-0.71

SHARE PRICE PERFORMANCE

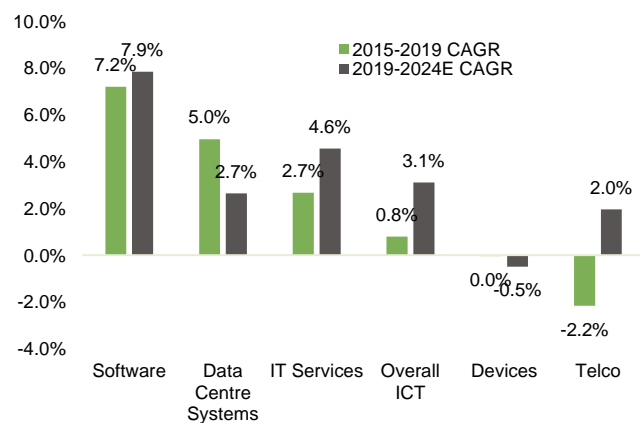
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## Investment case

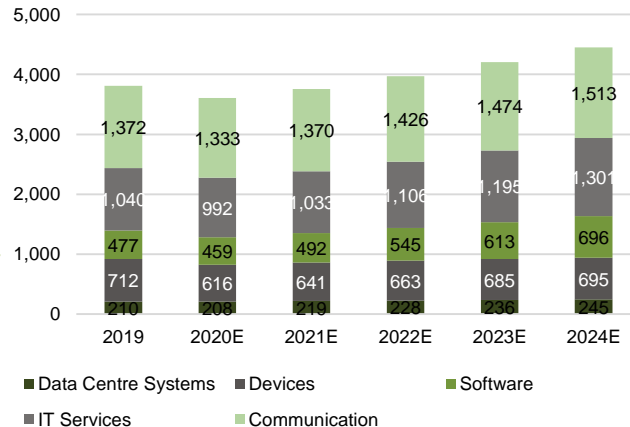
We initiate coverage of Sirma Group Holding (Sirma), the largest information and communication technology (ICT) name in the Balkan region, with a BUY rating and a 12M price target (PT) of BGN 0.90/share (61% upside potential). The company's operations encompass software development, and providing IT services for many sectors, including banks and industrial companies. Sirma's largest market is Europe (56% of its 2019 top line), followed by North America (24%). We like the company for: i) its growth profile (we expect a 2019-22E EBITDA CAGR of 10% vs. the Bloomberg consensus of 7% for its regional peers); ii) its low valuation (2020E EV/EBITDA at only 3.5x, indicating a 60% discount to its peers); and iii) the option for a large buyback (up to c.34% of the total number of shares may be repurchased by the end of 2022E, with a cap price of BGN 2.0/share). As the main sources of risk, we see: uncertainty over the development of COVID-19 and, hence, the ICT market outlook in 2021E; as well as the stock's low liquidity (3M ADTV of just USD 22k).

**Software and IT services should be the fastest-growing segments of the ICT market**, according to forecasts from global IT research and advisory firm Gartner. The fastest-growing segment of the ICT market is expected to be software, which should expand by c.8% yoy over the next five years, slightly above its growth rate over 2015-19. Consequently, the segment is expected to grow from c.USD 0.5trn in 2019 to c.USD 0.7trn in 2024E. The second-fastest, IT services should enjoy a 2019-24E CAGR of 4.6%, expanding from c.USD 1.0trn to USD 1.3trn between 2019 and 2024E. Overall, the ICT market is to forecast grow from c.USD 3.8trn in 2019 to c.USD 4.3trn (a 2019-24E CAGR of 3%). Only devices is expected to contract, by c.0.5% yoy.

Global ICT market: growth pace



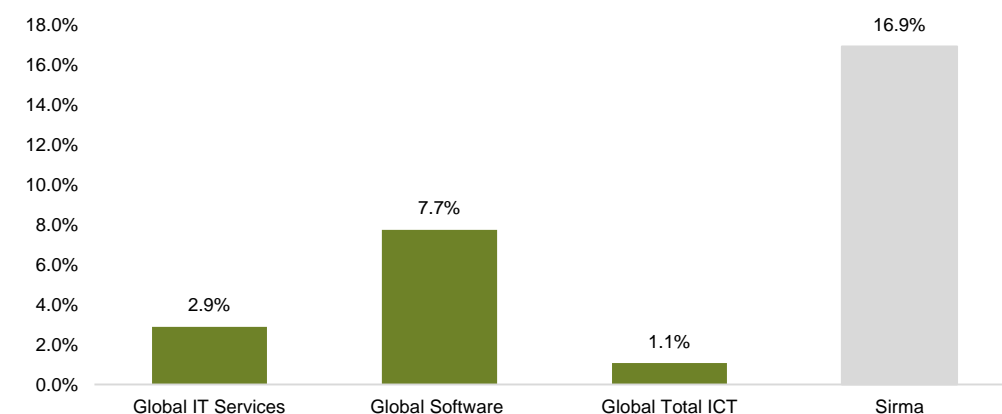
Size by segments (as of October 2020)



Source: Gartner, WOOD Research

**Sirma's revenues outpace the growth of the ICT market.** The company enjoyed a 2014-19 top-line CAGR of c.17%, vs. single-digit growth for the ICT market and its fastest-growing segments. In our view, the company's dynamic growth is related to its small size (2019 EBITDA at c.EUR 6m), and operations in the two most rapidly-expanding segments of the market (IT services and software).

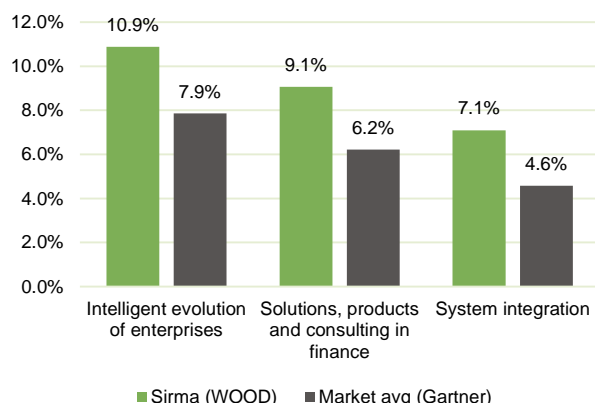
Revenues: 2014-19 CAGR by segment



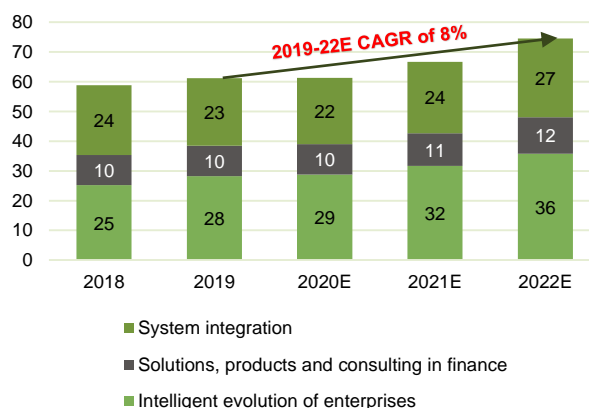
Source: Gartner, WOOD Research, company data

**We expect the trend of faster growth than the market to continue, pencilling in a conservative 2019-22E top-line CAGR of 8%.** We believe that the arguments for Sirma outpacing the ICT market are still valid, and pencil in a 2019-24E top-line CAGR of 9.2%. In our view, the fastest-growing segment should be the “intelligent evolution of enterprises” (a 2019-24E CAGR of 10.9% vs. 7.9% for the global software segment, as forecast by Gartner), followed by solutions, products, and consulting in finance (9.1% vs. the 6.2% average growth rate expected by Gartner for the IT services and software segments of the ICT market).

#### 2019-24E revenues CAGR\*



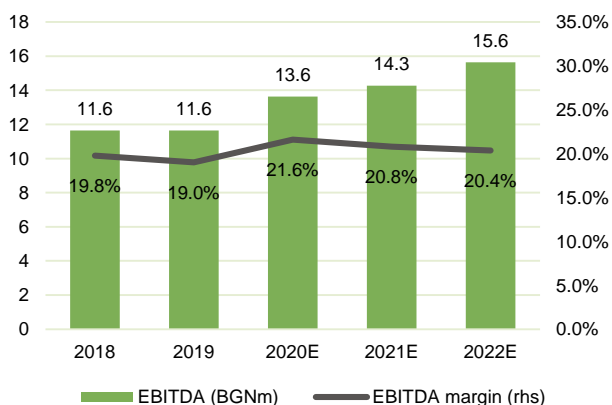
#### 2019-22E revenues CAGR



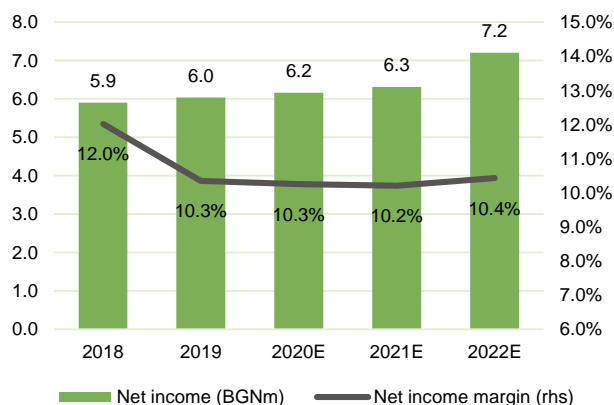
Source: Company data, WOOD Research; \*the market average is the 2019-24E CAGR expected by Gartner for the segments of ICT market respective to Sirma's segments; we have assigned intelligent evolution of enterprises to the software segment, system integration to IT services, and solutions, products, and consulting in finance – as both IT services and software (for this segment, we assume that market growth is the mid-point between IT services and the software segment)

**We expect a 2019-22E EBITDA CAGR of 10%, 4ppts above the average for its regional peers.** We believe that the EBITDA should expand to BGN 13.6m in 2020E (+17% yoy), mainly on the back of cost savings undertaken in 1H20 (EBITDA margin at 24%). In the following years, we expect the EBITDA margin to stay at a level of 20-21%, and profit growth to be driven mainly by top-line expansion, as described above. Finally, on top of this, we pencil in the bottom-line expansion to be driven by deleveraging (and, consequently, lower financing costs). Taking Sirma's 1H20 results into consideration, we believe our 2020E figures may be conservative.

#### EBITDA and EBITDA margins



#### Net income and net margins



Source: Company data, WOOD Research

**Sirma has a wide client portfolio, consisting of both international and local firms.** A significant proportion of its customers operate in the financial industry (e.g., JP Morgan, Credit Agricole, KBC), although it offers its services to non-financial companies from a variety of sectors (including media, pharma, culture/art) as well.

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## Clients

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Source: Company data, WOOD Research

**Sirma does not pay a dividend, but has a large buyback option.** We see the company as orientated towards organic growth; thus, it may not distribute dividends over the next three years. It does, however, have a buyback option, which was approved by AGM in June 2019. The scheme assumes that it may repurchase up to 19m shares (c.34% of the total number of shares) by the end of 2022E, with a cap price of BGN 2.0/share. Moreover, the total spending on the programme should not exceed BGN 20m. So far, the company has repurchased only a small number of its shares under the scheme (c. BGN 0.11m), spending c.BGN 75k. Nonetheless, given the lack of clarity over the possible timing and size of the stock repurchase, we do not pencil any further buybacks into our model at this stage.

**Sirma trades at massive discounts to the other regional ICT companies, growing faster than its peers, but paying no dividend.** Based on our numbers, the company trades at 2020-22E EV/EBITDAs of 3.5-2.5x, implying massive discounts (57-60%) to the other European firms operating in the ICT market, despite its profits growing 4ppts above the rate of its peers over the next three years, on our estimates. On the other hand, we pencil in no dividend distributions over the period, whereas the Bloomberg consensus sees dividend yields of 1.9-3.0% for its peers.

**Risks:** Brexit; GDP growth worldwide; competition; employee turnover; litigation; FX risk; and low liquidity.

## Valuation

**We rate Sirma a BUY, with a 12M PT of BGN 0.90/share, implying 61% upside potential.** We derive our PT based solely on our DCF analysis, with the peer group valuation assigned a 0% weight. We have decided to disregard the peers-based valuation, given the small size of the company (market cap of only USD 20m; 2019 EBITDA at c.EUR 6m), and because, in the case of a company with high organic growth, as we perceive Sirma, we believe that cash generation capacity should be taken as the reference point for the valuation.

### Valuation summary

	Weight	PT	Current price	Upside
DCF	100%	0.90	0.56	61%
Peer-based valuation	0%	1.35	0.56	140%
<b>Weighted PT</b>	<b>100%</b>	<b>0.90</b>	<b>0.56</b>	<b>61%</b>

Source: WOOD Research

### DCF: 12M PT at BGN 0.90/share

We base our DCF valuation on the following assumptions:

- ✓ A WACC of c.11%.
- ✓ A present value of the discounted free cash flows of BGN 32m for 2021-28E.
- ✓ An end-2020E net debt of BGN 14m.
- ✓ A present value of the terminal value of BGN 47m.
- ✓ A terminal growth rate of 0.5%.
- ✓ Issued shares of c.59m.

### DCF valuation

BGN m	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E	Terminal
<b>Revenues</b>	<b>68.7</b>	<b>76.7</b>	<b>86.7</b>	<b>98.0</b>	<b>108.3</b>	<b>117.6</b>	<b>125.9</b>	<b>132.8</b>	<b>132.8</b>
yoy	9%	12%	13%	13%	10%	9%	7%	6%	0%
EBIT	7.5	8.8	9.6	11.2	11.9	13.4	13.9	13.8	13.8
EBIT margin	11%	11%	11%	11%	11%	11%	11%	10%	10%
Cash tax on EBIT	-0.8	-0.9	-1.0	-1.1	-1.2	-1.3	-1.4	-1.4	-1.4
<b>NOPAT</b>	<b>6.8</b>	<b>7.9</b>	<b>8.7</b>	<b>10.1</b>	<b>10.7</b>	<b>12.1</b>	<b>12.5</b>	<b>12.4</b>	<b>12.4</b>
(+) D&A	6.7	6.9	7.1	7.3	7.6	7.8	8.0	8.5	8.5
(-) Capex	-8.3	-9.2	-10.0	-10.1	-10.1	-9.8	-9.5	-8.5	-8.5
(-) Change in WC	-0.8	-1.2	-1.5	-1.7	-1.6	-1.4	-1.3	-1.1	-1.1
Net investment	-2.4	-3.6	-4.5	-4.5	-4.1	-3.4	-2.7	-1.0	-1.0
<b>Free cash flow</b>	<b>4.4</b>	<b>4.3</b>	<b>4.2</b>	<b>5.6</b>	<b>6.6</b>	<b>8.7</b>	<b>9.8</b>	<b>11.4</b>	<b>11.4</b>
Terminal growth [g(t)]	0.5%								
PV TV	47								
PV FCF 2021-28E	32								
Enterprise value	79								
Net debt (end-2020E)	14								
Minorities (end-2020E)	16								
<b>Equity value, BGN m</b>	<b>48</b>								
Number of shares (m)	59								
Value per share (BGN, 1 Jan 2021)	0.82								
<b>12M PT (BGN/share)</b>	<b>0.90</b>								

Source: WOOD Research

## DCF sensitivity

		WACC						
		8%	9%	10%	11%	12%	13%	14%
Terminal growth rate	-0.4%	0.87	0.86	0.84	0.83	0.82	0.81	0.80
	-0.1%	0.89	0.88	0.87	0.85	0.84	0.83	0.82
	0.2%	0.92	0.90	0.89	0.88	0.86	0.85	0.84
	0.5%	0.94	0.93	0.91	<b>0.90</b>	0.89	0.87	0.86
	0.8%	0.97	0.95	0.94	0.93	0.91	0.90	0.89
	1.1%	1.00	0.98	0.97	0.95	0.94	0.93	0.91
	1.4%	1.03	1.01	1.00	0.98	0.97	0.96	0.94

Source: WOOD Research

**Sirma trades at massive discounts to the other regional ICT companies, growing faster than its peers, but paying no dividend.** Based on our numbers, the company trades at 2020-22E EV/EBITDAs of 3.5-2.5x, implying massive discounts (57-60%) to the other European firms operating in the ICT market, despite its profits growing 4ppts above its peers over the next three years, on our estimates. In our valuation, we consider only EV/EBITDA multiples, as we see EBITDA as the proxy for cash generation capacity, and assign a smaller weight to the 2020E multiple, as the 1H20 results have been reported already.

## Peer valuation

	Country	Mcap USDm	ND/ EBITDA (x)	P/E			EBITDA CAGR 19-22E	EV/EBITDA			Dividend yield		
				2020E	2021E	2022E		2020E	2021E	2022E	2020E	2021E	2022E
<b>Sirma</b>	<b>Bulgaria</b>	<b>20</b>	<b>1.1x</b>	<b>5.4</b>	<b>5.3</b>	<b>4.6</b>	<b>10%</b>	<b>3.5</b>	<b>3.0</b>	<b>2.5</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>
Asseco Poland	Poland	1,343	0.5x	13.7	12.5	11.9	7%	4.5	4.3	3.9	4.5%	4.4%	4.4%
S&T	Austria	1,221	0.9x	20.2	15.1	12.3	16%	8.8	7.0	5.9	1.3%	1.5%	1.9%
Asseco SEE	Poland	500	-0.1x	17.7	15.9	14.6	12%	8.7	7.8	7.0	1.9%	2.4%	3.0%
Nnit	Denmark	421	1.0x	21.9	15.9	14.7	0%	7.4	6.3	6.0	2.6%	2.9%	3.2%
Comarch	Poland	396	-0.5x	17.4	13.6	13.1	3%	6.1	5.8	5.3	0.8%	1.4%	1.6%
Asseco Business Sols.	Poland	275	0.5x	14.8	14.1	13.6	2%	9.8	9.5	9.3	5.5%	5.5%	6.1%
Bittnet Systems (WOOD)*	Romania	21	1.9x	61.2	15.2	9.2	36%	16.4	10.0	6.8	0.0%	0.0%	0.0%
<b>Peers median</b>			<b>0.5x</b>	<b>17.7</b>	<b>15.1</b>	<b>13.1</b>	<b>7%</b>	<b>8.7</b>	<b>7.0</b>	<b>6.0</b>	<b>1.9%</b>	<b>2.4%</b>	<b>3.0%</b>
<b>Sirma vs. peers' median</b>			<b>0.6x</b>	<b>-69%</b>	<b>-65%</b>	<b>-65%</b>	<b>3.6pp</b>	<b>-60%</b>	<b>-57%</b>	<b>-58%</b>	<b>-2pp</b>	<b>-2pp</b>	<b>-3pp</b>

Source: Bloomberg, WOOD Research; \*2018-22E EBITDA CAGR

## Peer valuation

	P/E (x)			EV/EBITDA (x)		
	2020E	2021E	2022E	2020E	2021E	2022E
Total weighted median (x)	17.66	15.08	13.12	8.68	7.02	5.96
EPS (BGN/share) for P/E and EBITDA (BGNm) for EV/EBITDA	0.1	0.1	0.1	14	14	16
Sirma: implied enterprise value				118	100	93
Sirma implied Equity value	109	95	94	87	73	70
Sirma: implied Equity value per share (BGN)	1.83	1.60	1.59	1.47	1.24	1.18
Weight (%)	0.0%	0.0%	0.0%	10.0%	45.0%	45.0%
<b>Implied weighted equity value per share (BGN)</b>				<b>1.20</b>		
<b>12M price target (PT)</b>				<b>1.35</b>		

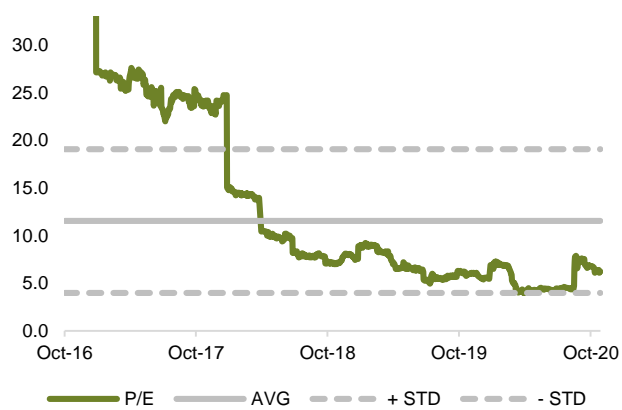
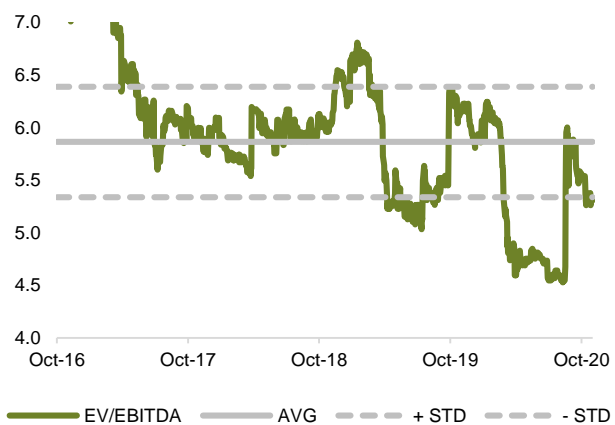
Source: Bloomberg, WOOD Research

**Sirma is valued at 5.3x EV/12M trailing EBITDA, on the Bloomberg figures, implying a 9% discount to its long-term average.** It is at an even greater discount on its P/12M trailing EPS of 6.2x, i.e., below the 11.5x average.



## EV/EBITDA\*

## P/E\*\*

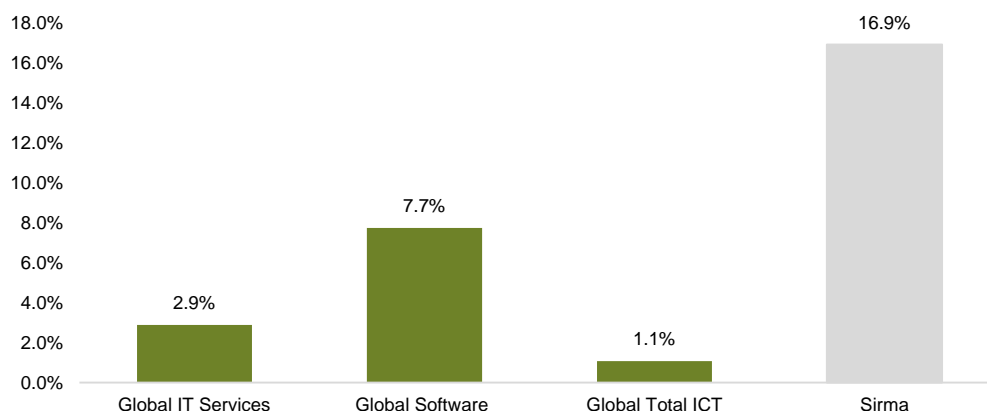


Source: Bloomberg, WOOD Research; \*current EV dividend by the trailing 12M EBITDA; \*\*current price divided by trailing 12M EPS; multiples prior to 2017 treated as outliers for the purpose of the average and standard deviations calculations

## Financial forecasts

**Sirma's revenues outpace the growth of the ICT market.** The company enjoyed a 2014-19 top-line CAGR of c.17%, vs. single-digit growth for the ICT market and its fastest-growing segments. In our view, the company's dynamic growth is related to its small size (2019 EBITDA at c.EUR 6m), and operations in the two most rapidly-expanding segments of the market (IT services and software).

### Revenues: 2014-19 CAGR, by segment

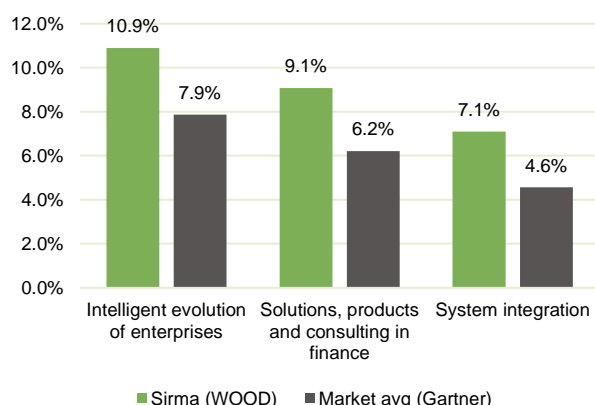


Source: Gartner, WOOD Research

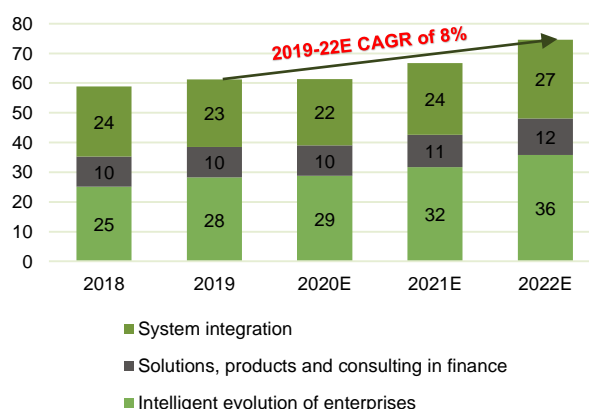
**We expect the trend of faster growth than the market to continue, pencilling in a conservative 2019-22E top-line CAGR of 8%.** We believe that the arguments for Sirma outpacing the ICT market are still valid, and we pencil in a 2019-24E top-line CAGR of 9.2%. In our view, the fastest-growing segment should be the "intelligent evolution of enterprises" (a 2019-24E CAGR of 10.9% vs. 7.9% for the global software segment, as forecast by Gartner), followed by solutions, products, and consulting in finance (9.1% vs. the 6.2% average growth rate expected by Gartner for the IT services and software segments of the ICT market). The segment that may experience a slower pace of growth is system integration (7.1% vs. 4.6% for IT services, expected by Gartner), in our view.

We admit that our numbers seem to be very conservative, but we prefer to take such stance, given the uncertainty regarding the 2021E outlook. We pencil in 9% yoy growth in Sirma's top line in 2021E (still above Gartner's expectations of IT services, +4.1% yoy, and software, +7.2% yoy), accelerating to +12% yoy in 2022E (vs. Gartner's forecasts of +7.7% and +10.8% yoy). We believe that the segment that should enjoy the fastest growth pace is "intelligent evolution of enterprises", mainly on the back of applications for fast-growing artificial intelligence solutions.

### 2019-24E revenues CAGR\*



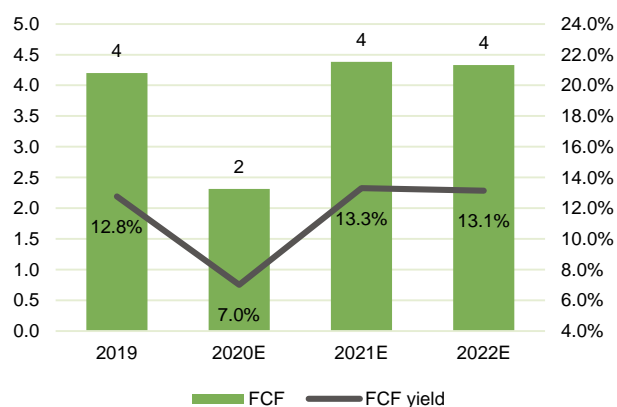
### 2019-22E revenues CAGR



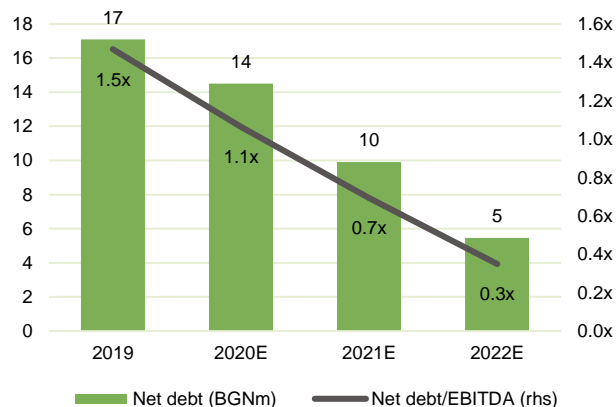
Source: Company data, WOOD Research; \*the market average is the 2019-24E CAGR expected by Gartner for the segments of the ICT market respective to Sirma's segments; we have assigned intelligent evolution of enterprises to the software segment, system integration to IT services, and solutions, products, and consulting in finance – as both IT services and software (for this segment, we assume that market growth is the mid-point between IT services and the software segment)

**The 2020E FCF may be weak, but should improve later, reducing leverage,** according to our forecasts. We believe that the 2020E FCF may be relatively weak, amid the accumulation of working capital seen in 1H20. We expect Sirma's generation capacity to recover along with the acceleration of top-line growth in 2021E and 2022E. This should help reduce the leverage (ND/EBITDA from 1.1x in 2020E to 0.3x in 2022E, according to our figures).

## FCF forecasts (BGN m)



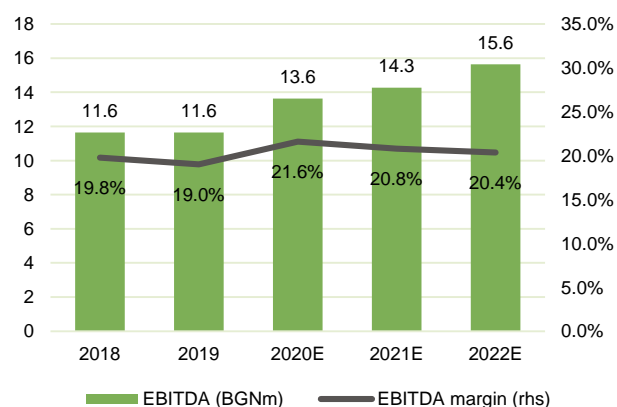
## Capex and leverage forecasts (BGN m)



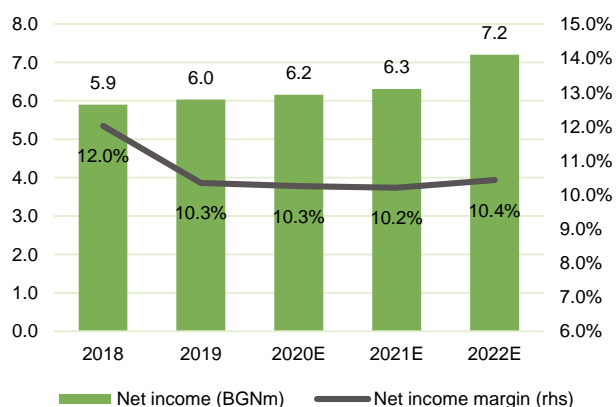
Source: Company data, WOOD Research

**We expect a 2019-22E EBITDA CAGR of 10%.** We believe that the EBITDA should expand to BGN 13.6m in 2020E (+17% yoy), mainly on the back of cost savings undertaken in 1H20 (EBITDA margin at 24%). In the following years, we expect the EBITDA margin to stay at a level of 20-21%, and profit growth to be driven mainly by top-line expansion, as described above. Finally, on top of this, we pencil in the bottom-line expansion to be driven by deleveraging (and, consequently, lower financing costs). Taking into consideration Sirma's 1H20 results, we believe our 2020E figures may be conservative. On the other hand, we flag the relatively low 2020-22E ROIC that we expect the company to report (c.5-6%), which is related to growing spending on intangible assets, when the long-term profitability may be under pressure (we conservatively assume the average 2020-22E EBITDA margin at 21% vs. the 28% average for 2014-19).

## EBITDA and EBITDA margins (BGN m)

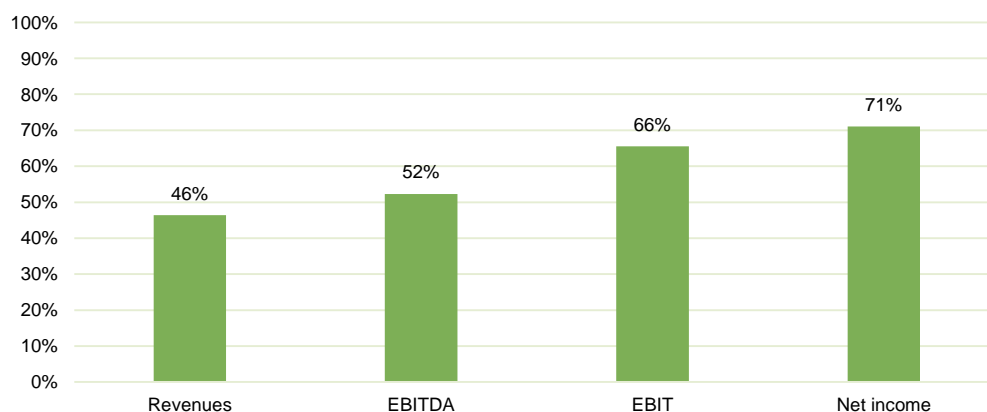


## Net income and net margins (BGN m)



Source: Company data, WOOD Research

## 1H20 as a % of WOOD's 2020E forecast



Source: Company data, WOOD Research

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**Sirma does not pay a dividend, but has a large buyback option.** We see the company as orientated towards organic growth; thus, it may not distribute dividends over the next three years. It does, however, have a buyback option, which was approved by the AGM in June 2019. The scheme assumes that it may repurchase up to 19m shares (c.34% of the total number of shares) by the end of 2022E, with a cap price of BGN 2.0/share. The total spending on the programme should not exceed BGN 20m. So far, the company has repurchased only a small number of its shares under the scheme (c.BGN 0.11m), spending c.BGN 75k. Nonetheless, given the lack of clarity over the possible timing and size of the stock repurchase, we do not pencil any further buybacks into our model at this stage.

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## Risks

**GDP growth.** The ICT market is sensitive to GDP growth fluctuations. Should the second wave of COVID-19 affect the economic recovery in 2021E, it could pose a potential downside risk for the market growth outlook. Sirma is operating in segments of the ICT market (IT services, and software) that, according to Gartner, should be the least affected by the pandemic, and enjoy the fastest recovery rates.

**FX risk.** The company operates in more than 50 countries, and is exposed to currency risk (mainly GBP and USD vs. the BGN). According to Sirma's estimates, a 5% move in the BGN/USD translates into a BGN 4k effect on the net financial result (or c. +/-2% of the 2019 financial income). For the BGN/GBP, the relationship stands at BGN 25k (c +/- 10% of the income).

**Brexit.** According to Sirma, c.19% of its 2019 top line was generated from operations in the UK. At this stage, we do not know what the final shape of the UK's agreement with the EU will be, or even if there will be one.

**Competition.** The ICT market has various segments, and different competitors in each (for selected competitors identified by Sirma, please see the Appendix of this report). Intensifying competition may erode the company's profitability. Moreover, given its small size, gaining or losing new large contracts can change its financial results significantly. We note, however, that the company has been able to outpace the average growth rate of the ICT market segments it operates in significantly, as discussed previously, which proves that it has been successful in operating in the competitive environment, in our view.

**Employee turnover.** We see skilled and experienced employees, who are crucial for completing projects, as the company's key competitive assets. Should key people leave Sirma, it could endanger its operations.

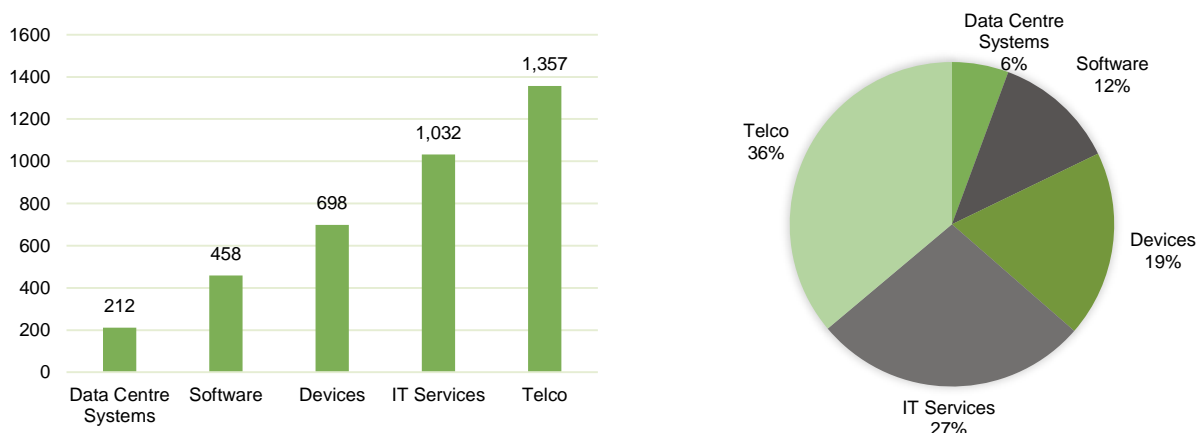
**Low liquidity.** Sirma's 3M ADTV stands at only USD 22k; hence, both opening and closing positions in the security may take a long time and cause price fluctuations. Moreover, should management decide to launch the buyback option (detailed above), the stock's liquidity could deteriorate further.

**Litigation risk.** Sirma is involved in an ongoing legal dispute with the former CEO of one of its subsidiaries, Mr. Tianko Sashkov Latev. The disputed amount stands at c.BGN 69k (i.e., c.0.6% of the 2019 EBITDA).

## The ICT market

The global ICT market was worth c.USD 3.8trn in 2019. Telcos (36% market share/c USD 1.4trn) and IT services (27%/USD 1.0trn) accounted for nearly two-thirds of the market. The third-largest segment is devices (19%/USD 0.7trn), followed by software (12% /USD 0.5trn), and data centre systems (6%/USD 0.2trn).

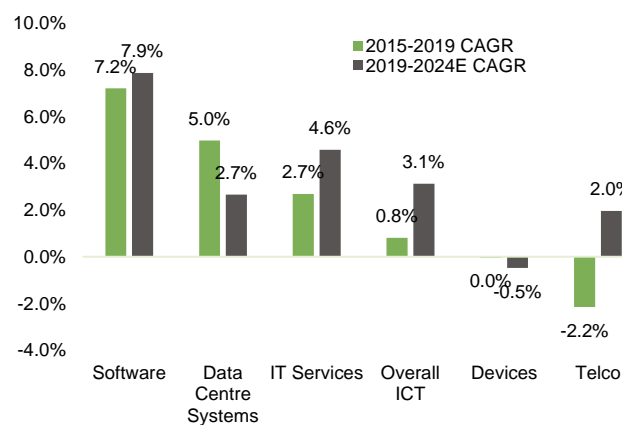
Global ICT market, 2019: segments by value (USD bn) Segmental structure



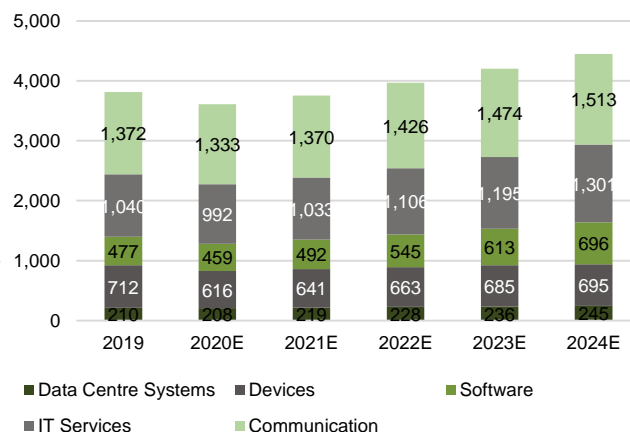
Source: Gartner, WOOD Research

Software and IT services should be the fastest-growing segments, according to Gartner. Software is expected to be the fastest-growing segment of the ICT market, expanding by c.8% yoy over the next five years, slightly above its growth rate in 2015-19. Consequently, the segment should grow from c.USD 0.5trn in 2019 to c.USD 0.7trn in 2024E. Next is IT services, which should enjoy a 2019-24E CAGR of 4.6%, expanding from c.USD 1.0trn to USD 1.3trn between 2019 and 2024E. Overall, the ICT market is expected to expand from c.USD 3.8trn in 2019 to c.USD 4.3trn in 2024E. Only devices is expected to contract, by c.1% yoy.

Global ICT market: growth pace



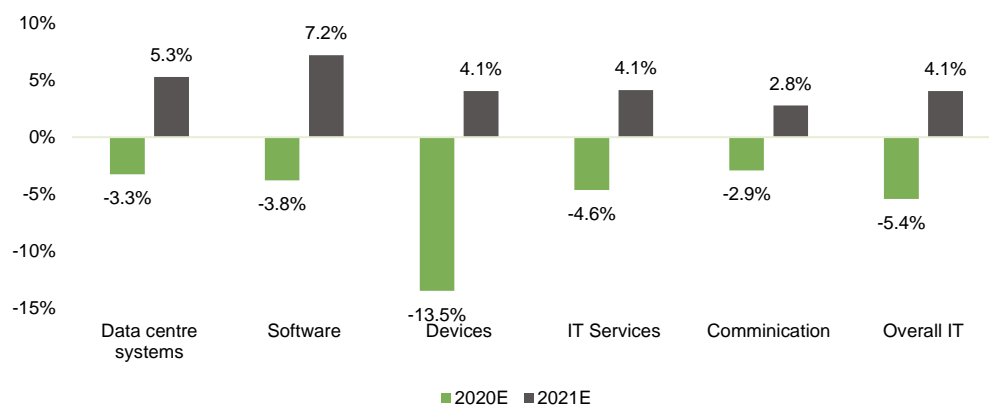
Size by segments (as of October 2020)



Source: Gartner, WOOD Research

The same sectors seem likely to have suffered the least from COVID-19, and should recover the fastest in 2020E and 2021E, in our view. Gartner's forecasts suggest that the software segment may contract by 4% yoy in 2020E, followed by a 7% yoy recovery the following year. IT services is likely to suffer a deeper contraction of 5% yoy in 2020E, followed by expansion of 4% yoy in 2021E. The overall ICT market is forecast to drop 5% yoy in 2020E, then enjoy 4% yoy growth in 2021E. The segment hit most by COVID-19 in 2020E has been devices (-13% yoy), while the most stable, in terms of the contraction in 2020E and a recovery in 2021E, should be telecoms, at -3% yoy and +3% yoy, respectively.

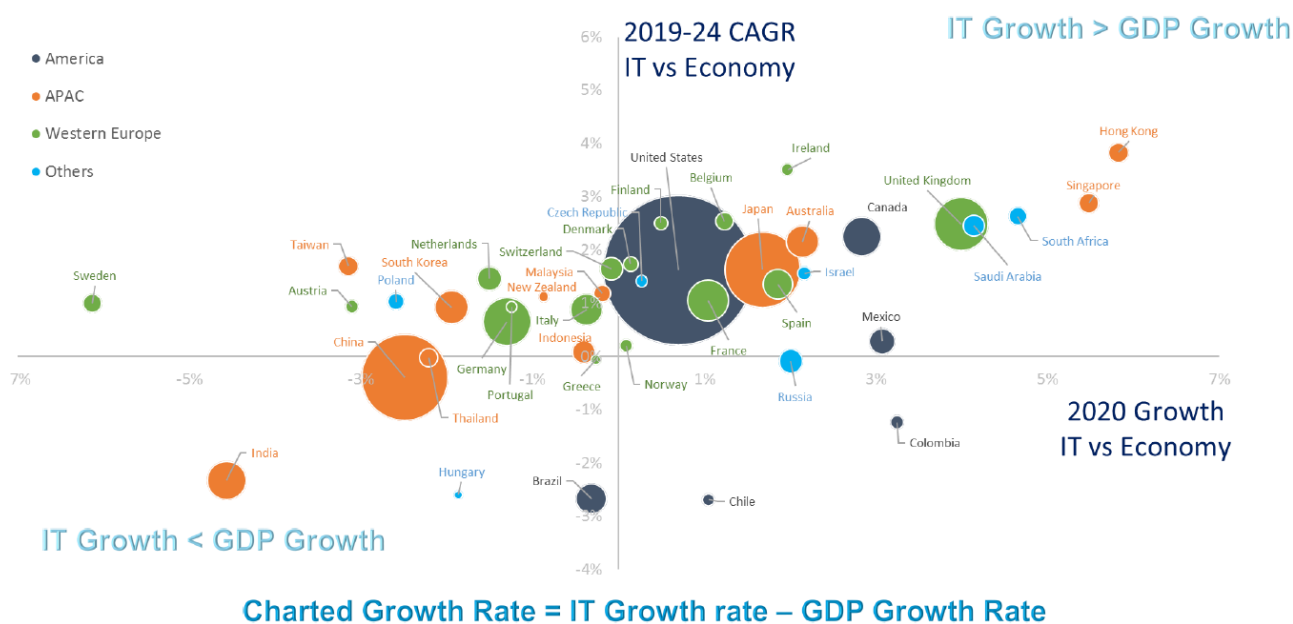
## Global ICT market yoy growth in 2020E and 2021E, by segments (as of October 2020)



Source: Gartner, WOOD Research

**ICT market expansion should outpace GDP growth in the next five years.** We note that, according to Gartner, North America and half of Western Europe should see their ICT market growth outpacing GDP in 2020E. Over a longer period, however (2014-24E), the ICT market should be growing faster than the GDP in the vast majority of countries.

## ICT market growth vs. GDP growth rate

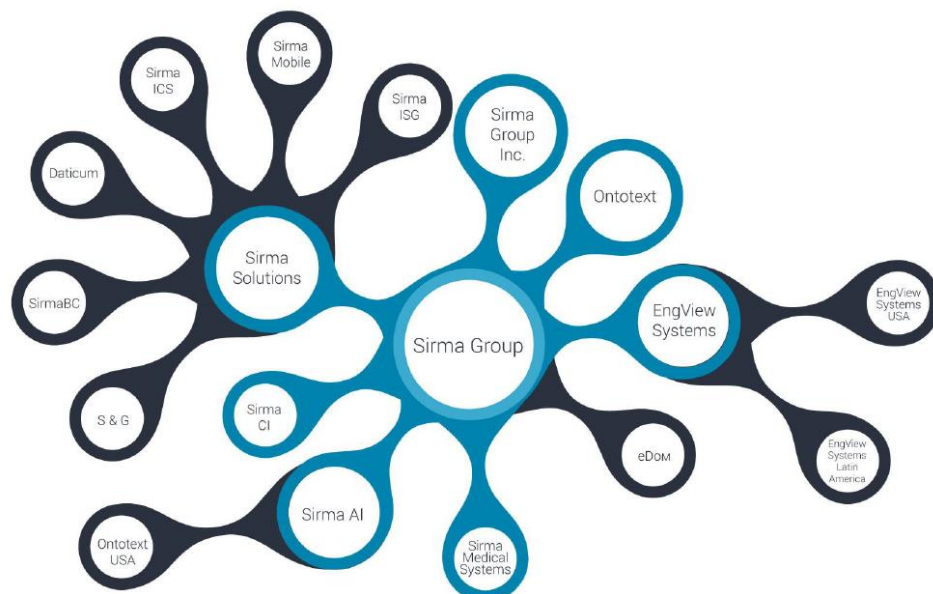


Source: Gartner, WOOD Research

## Company description

**Sirma Group Holding (Sirma) is one of the largest ICT companies in the region, and has been in operation for 28 years.** It was listed on the Bulgarian Stock Exchange, in Sofia, in 2015. It has completed over 400 projects in 185 countries. Its main scope of operations is software development and providing IT services for many sectors, including banks and industrial companies. It operates as a holding company, consisting of over 20 subsidiaries created over the years.

### Sirma Group Holding: organisational structure



Source: Company data, WOOD Research

### Key milestones

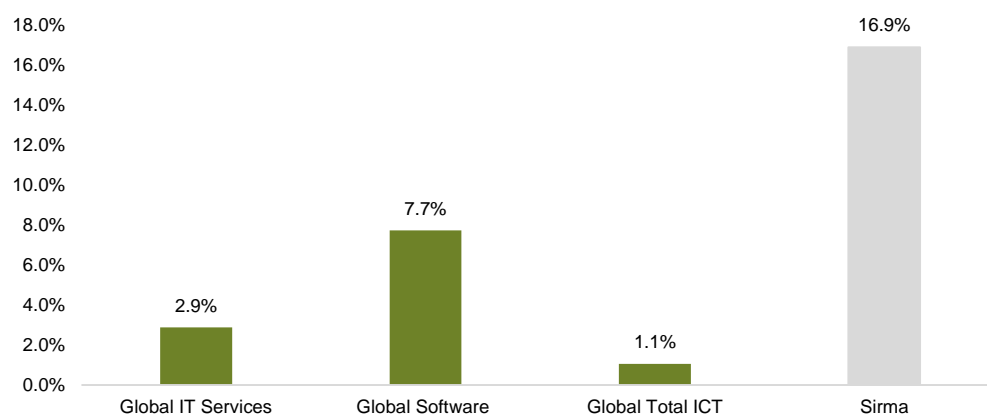
1992	The first company, Sirma AI, established in Bulgaria and Canada
1998-2000	The CAD / CAM division and a Semantic tech lab are started
2014	Sirma becomes the biggest local IT group
2015	IPO of an IT company in Bulgaria, and the biggest IPO since 2007
2016	Registers a new company in the US. Brings to the market its insurance broker platform and app for the management of chronic disease – diabetes
2017	Five-year business and technology strategy published
2018	Moves to the Premium segment on the BSE, Sofia, with the most liquid & best corporate governance companies

Source: Company data, WOOD Research

**Sirma operates in the fastest-growing segments of the ICT market.** Its main business activities are focused on financial technology, semantics, industrial software, and healthcare. As a result, its operations may be classified under the two fastest-growing segments of the ICT market: IT services and enterprise software. Given the company's small size (2019 EBITDA at EUR 6m), it may grow faster than the larger players, as a result of which, its top-line expansion could outpace not only the wider ICT industry, but the two fastest-growing segments as well, as depicted in the below chart.



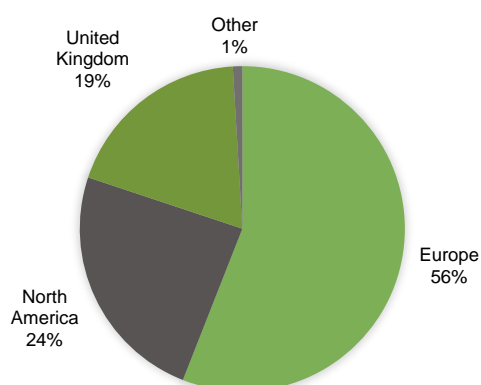
## 2014-19 revenues CAGR



Source: Company data, Gartner, WOOD Research

The company's most important markets are Europe and North America, which accounted for 80% of the 2019 revenues. Another important contributor is the UK, with a 19% share of the top line.

## 2019 revenues by regions



Source: Company data, WOOD Research

Sirma has a wide client portfolio, consisting of both international and local firms. A significant proportion of its customers operate in the financial industry (e.g., JP Morgan, Credit Agricole, KBC), although it offers its services to non-financial companies from a variety of sectors (including media, pharma, culture/art) as well.

## Clients



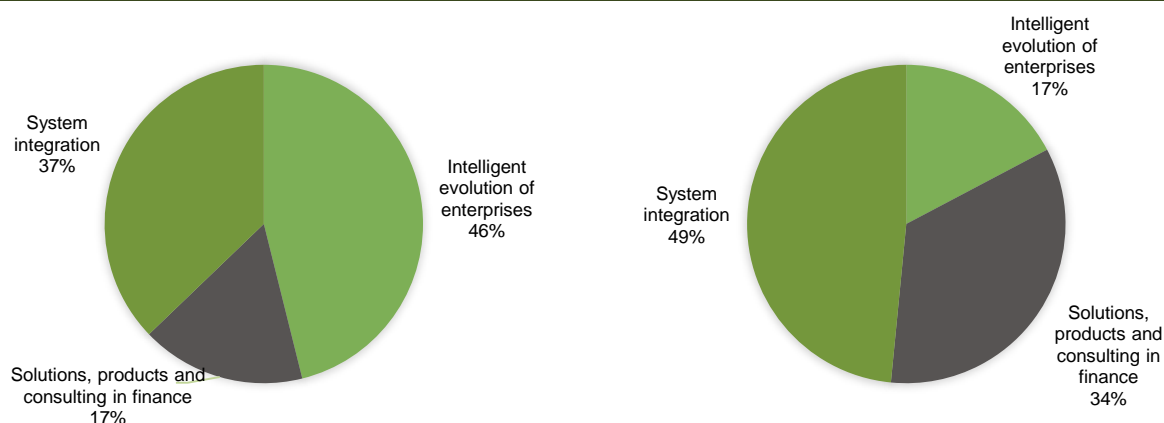
Source: Company data, WOOD Research

System integration made the largest contribution to Sirma's 2019 profit. The company's business consists of three segments: "intelligent evolution of enterprises"; system integration; and solutions, products, and consulting in finance. The largest share of 2019 revenues came from the "intelligent

evolution of enterprises” segment, which accounted for 46%, followed by system integration (37%). The latter segment generated nearly half of last year’s operating profit (49%), however.

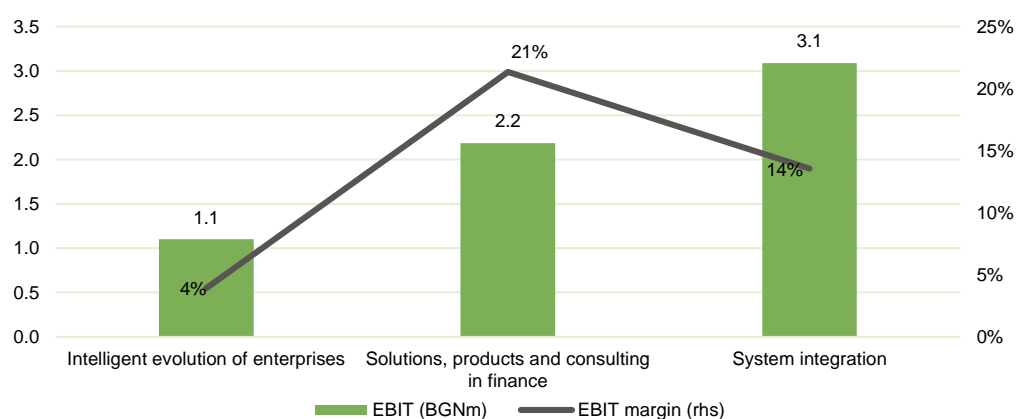
## Revenue structure, 2019

## EBIT structure, 2019



Source: Company data, WOOD Research

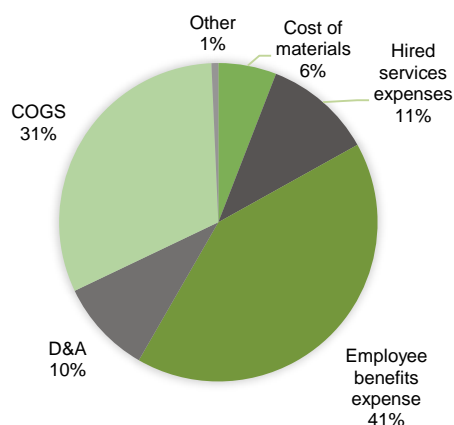
## EBIT (BGN m) and EBIT margins by segments, 2019



Source: Company data, WOOD Research

**Employee costs and COGS accounted for most of the 2019 opex.** The single largest element of Sirma’s opex is employee costs (41% share), followed by COGS (31%). The other two notable cost areas are: hired services (software services, consulting services, subscriptions, hosting, and marketing, among others), accounting for 11% of total costs; and D&A, contributing 10%. The remaining areas contributed only a single-digit share to the company’s cost structure.

## Opex breakdown, 2019



Source: Company data, WOOD Research

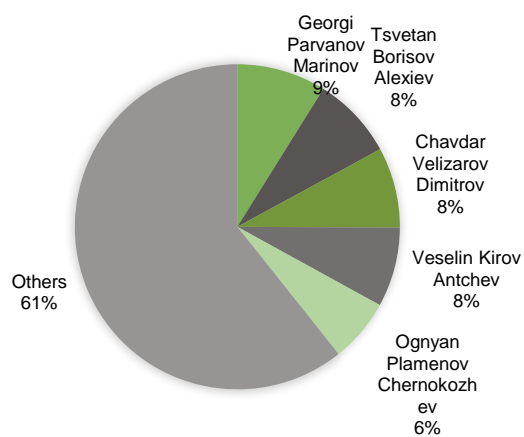
**Sirma’s shareholder structure is highly fragmented, with the key managers having the largest stakes.** None of the shareholders own more than 10% of the company’s shares. The largest stakes are held by: Georgi Pararov Marinov, the Chairman of the Board of Directors (9%), Tsvetan Borisov Alexiev,

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the Executive Director and Member of the Board of Directors (8%), and Chavdar Velizarov Dimitrov, Deputy Chairman of Board of Directors (8%).

**Shareholder structure as of 31 December 2019**

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Source: Company data, WOOD Research

# Financials

## Profit and loss account

BGN m	2018	2019	2020E	2021E	2022E
<b>Revenue</b>	<b>57</b>	<b>59</b>	<b>61</b>	<b>67</b>	<b>75</b>
Intelligent evolution of enterprises	25	28	29	32	36
Solutions, products and consulting in finance	10	10	10	11	12
System integration	24	23	22	24	27
Other income	2	2	2	2	2
Opex	-52	-55	-56	-61	-68
<b>Operating profit</b>	<b>7</b>	<b>6</b>	<b>7</b>	<b>8</b>	<b>9</b>
<b>EBITDA</b>	<b>12</b>	<b>12</b>	<b>14</b>	<b>14</b>	<b>16</b>
Net financial cost	-1	0	0	0	0
Profit before tax	8	7	7	8	9
Tax	-1	-1	-1	-1	-1
<b>Net income</b>	<b>6</b>	<b>6</b>	<b>6</b>	<b>6</b>	<b>7</b>

Source: Company data, WOOD Research

## Margins and profitability ratios

	2018	2019	2020E	2021E	2022E
EBITDA margin	20%	19%	22%	21%	20%
EBIT margin	12%	10%	11%	11%	11%
Net profit margin	12%	10%	10%	10%	10%
ROA	5%	4%	4%	5%	5%
ROE	7%	6%	6%	6%	6%
ROIC	5%	5%	5%	5%	6%

Source: Company data, WOOD Research

## Balance sheet

BGN m	2018	2019	2020E	2021E	2022E
<b>Non-current assets</b>	<b>115</b>	<b>91</b>	<b>90</b>	<b>92</b>	<b>94</b>
Property, plant and equipment	5	9	9	10	11
Intangible assets	87	59	58	59	61
Goodwill	22	22	22	22	22
Other	1	0	0	0	0
<b>Current assets</b>	<b>26</b>	<b>54</b>	<b>60</b>	<b>61</b>	<b>62</b>
Inventories	3	1	1	1	2
Related party receivables	0	0	0	0	0
Trade receivables	11	11	14	15	17
Other	1	32	32	32	32
Cash and cash equivalents	11	11	13	13	12
<b>Total assets</b>	<b>141</b>	<b>145</b>	<b>150</b>	<b>153</b>	<b>156</b>
<b>Total equity</b>	<b>98</b>	<b>104</b>	<b>110</b>	<b>117</b>	<b>125</b>
Equity of owners of parent company	83	88	94	101	108
Non-controlling interest	16	16	16	17	18
<b>Non-current liabilities</b>	<b>10</b>	<b>12</b>	<b>12</b>	<b>12</b>	<b>12</b>
Long-term borrowings	9	8	8	8	8
Other	1	3	3	3	3
<b>Current liabilities</b>	<b>32</b>	<b>29</b>	<b>28</b>	<b>24</b>	<b>19</b>
Bank loans	9	16	16	11	6
Trade payables	10	7	6	6	7
Other	13	7	7	7	7
<b>Total liabilities and equity</b>	<b>141</b>	<b>145</b>	<b>150</b>	<b>153</b>	<b>156</b>
<b>Debt (BGN m)</b>					
Gross debt	19	28	28	23	18
Net debt	8	17	14	10	5
Net debt/EBITDA	0.7x	1.5x	1.1x	0.7x	0.3x

Source: Company data, WOOD Research

## Cash flow statement

BGN m	2018	2019	2020E	2021E	2022E
Net income	6	6	6	6	7
D&A	4	5	7	7	7
WC	-6	2	4	1	1
Other	5	-10	-8	-1	-2
<b>Cash flow from operations</b>	<b>9</b>	<b>3</b>	<b>9</b>	<b>13</b>	<b>14</b>
CAPEX	-11	-5	-7	-8	-9
Organic CAPEX	-7	-3	-7	-8	-9
M&A	-4	-2	0	0	0
Other	0	2	0	0	0
<b>Cash flow from investing</b>	<b>-11</b>	<b>-7</b>	<b>-7</b>	<b>-8</b>	<b>-9</b>
Proceeds from bank loans	8	5	0	-5	-5
Other	1	1	0	0	0
<b>Cash flow from financial activities</b>	<b>7</b>	<b>4</b>	<b>0</b>	<b>-5</b>	<b>-5</b>
<b>Net change in cash</b>	<b>5</b>	<b>-1</b>	<b>3</b>	<b>0</b>	<b>-1</b>
Cash at the beginning of the period	6	11	11	13	13
<b>Cash at the end of the period</b>	<b>11</b>	<b>11</b>	<b>13</b>	<b>13</b>	<b>12</b>

Source: Company data, WOOD Research

## Valuation multiples

	2018	2019	2020E	2021E	2022E
P/E (x)	5.6	5.5	5.4	5.3	4.6
EV/EBITDA (x)	3.5	4.3	3.5	3.0	2.5
Dividend yield (%)	0%	0%	0%	0%	0%
FCF yield (%)	18%	13%	7%	13%	13%

Source: Company data, WOOD Research

## Appendix: Sirma Group – subsidiaries

Company	Operations	Customers	Competition
Daticum	The company functions as a data storage centre of the highest calibre. The main services provided by the company include: <ul style="list-style-type: none"> <li>- Cloud services</li> <li>- Infrastructure aaS</li> <li>- Hosting virtualisation</li> <li>- Communications and network services</li> <li>- Archiving and storage of information</li> <li>- Building test environments</li> </ul>	<ul style="list-style-type: none"> <li>- Insurance</li> <li>- Media and information</li> <li>- Industries</li> <li>- Municipal</li> <li>- Industrial production</li> <li>- Wholesale and retail sales</li> <li>- Courier services and transport.</li> </ul>	Neterra OOD, Evolink AD, Teleponet OOD, 3DC EAD and international companies providing cloud services such as Amazon, Rackspace, Microsoft, IBM
Sirma Solutions	The largest company in the Sirma group, Solutions deals mainly with: <ul style="list-style-type: none"> <li>- Global delivery of complex systems software</li> <li>- IT consulting</li> <li>- System integration</li> <li>- IT/comprehensive software support</li> </ul>	<ul style="list-style-type: none"> <li>- Various industries</li> </ul>	
Sirma AI	Concentrates the technological and business knowledge in AI in Sirma Group. Using proprietary semantic graph DB technology, text mining and machine learning, the company helps enterprises identify meaning across diverse datasets and massive amounts of unstructured information	<ul style="list-style-type: none"> <li>- Media</li> <li>- Publishing</li> <li>- Pharma</li> <li>- Finance</li> </ul>	Oracle Corporation, Microsoft, Neo4J, Marklogic, StarDog
EngView Systems Sofia	Provides CAD/CAM products and services in two areas: <ul style="list-style-type: none"> <li>- The packaging industry</li> <li>- Quality control and measurement for serial production in various industries</li> </ul>	<ul style="list-style-type: none"> <li>- Packaging producers</li> <li>- Companies utilising video measurement and control</li> </ul>	- ESKO
Sirma Business Consulting JSC	Offers own software products and services to financial institutions, Licensed Oracle FlexCube provider. Strong in: <ul style="list-style-type: none"> <li>- Core banking systems</li> <li>- Payment systems</li> <li>- Compliance and risk management</li> <li>- IT implementation and consulting services</li> </ul>	<ul style="list-style-type: none"> <li>- Banks</li> <li>- Non-banking financial institutions</li> <li>- Regulatory banking</li> <li>- Payment systems operators</li> </ul>	
Sirma Group Inc./ DBA Panaton	The company operates exclusively in North America and offers services and solutions (information analysis, cyber security, digital sales platforms, etc.) in a wide variety of IT segments	<ul style="list-style-type: none"> <li>- B2B</li> <li>- Financial companies</li> </ul>	
Sirma ICS	Aims to concentrate the technological and business knowledge of Sirma Group in the field of insurance. Has a major share of local insurance broker platform market. Currently operates only in Bulgaria, but plans to expand to other Balkan markets	<ul style="list-style-type: none"> <li>- Insurance brokers and insurance companies</li> </ul>	
S&G Technology Services	Incorporated in the UK, the company specialises in providing IT services to financial institutions : <ul style="list-style-type: none"> <li>- Temenos consulting</li> <li>- Software integration</li> <li>- Data management</li> <li>- Mobile technologies</li> </ul>	<ul style="list-style-type: none"> <li>- Mainly British banks, but also banks in Ireland, Kenya and Luxembourg</li> </ul>	
Sirma CI JSC	Offers intelligent solutions, based on AI, aimed mainly at the retail sector and trade organisations. These deal with digital adaptation, i.e., unifying trading companies by introducing solutions proven by the company at every stage of its development	<ul style="list-style-type: none"> <li>- Retailers</li> <li>- Online trade platforms</li> </ul>	
Sirma Medical Systems JSC	Focused telemedicine and control of chronic diseases. Developed and selling several products in the field as SaaS globally	<ul style="list-style-type: none"> <li>- B2C</li> <li>- Medical Practitioners</li> <li>- GPs and Private Practices</li> <li>- Clinics and Hospitals</li> <li>- Governments</li> <li>- Pharma Companies</li> <li>- Medical Device Manufacturers</li> </ul>	<ul style="list-style-type: none"> <li>- Telemedicine SaaS companies</li> <li>- Medical mobile app developers</li> <li>- Pharma companies with their own software solutions</li> <li>- EHR software companies</li> </ul>

Source: Company data, WOOD Research

# Important disclosures

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This investment research was completed on 02/11/2020 at 15:30 CET and disseminated on 03/11/2020 at 07:35 CET.

## WOOD&Co's rating and price target history for Sirma Group Holding in the preceding 12-month period:

Date	Rating	Date	PT
03/11/2020	BUY – initiation of coverage	03/11/2020	BGN 0.90

A history of all WOOD&Co's investment research disseminated during the preceeding 12-month period can be accessed via our website at <https://research.wood.com>.

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**BUY:** The stock is expected to generate total returns of over 15% during the next 12 months as measured by the price target.

**HOLD:** The stock is expected to generate total returns of 0-15% during the next 12 months as measured by the price target.

**SELL:** The stock is expected to generate a negative total return during the next 12 months as measured by the price target.

**RESTRICTED:** Financial forecasts, and/or a rating and/or a price target is restricted from disclosure owing to Compliance or other regulatory/legal considerations such as a blackout period or a conflict of interest.

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PKO BP	4, 5

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