

PGS Software

Buy
(Previous: Buy)

Recovery following the sudden slowdown

Target price: 13.6 PLN
Upside: 27%

PGS Software has been relatively hard hit by the slowdown caused by the pandemic, however, a significant improvement in annual revenue dynamics should already be visible in 4Q20, with a marginal y/y decline as compared to -13% and -15% in 2Q20 and 3Q20, respectively. Given the above improvement in the dynamics and taking into account the strong stock price correction in September, we see the current levels as attractive to take a position in anticipation of a rebound in 2021–2022. Long-term trends remain favourable for the Company – we assume that Poland will maintain a strong position on the market for outsourcing advanced IT services and that PGS will be one of the beneficiaries of this scenario. We believe that the Company will return to the growth path and that in 2H21 it will already generate results comparable to the record-high results in 2018–2019, while focusing on increasing sales, although in the initial phase this may result in lower profitability compared to the previous years.

2Q20 results: Q2 revenues fell 13% y/y and 21% q/q to PLN 31.3m, while operating profit was down 39% y/y and 26% q/q. Net profit was down 19% y/y (+78% q/q) to PLN 5.5m. Gross profit on sales was PLN 2.7m, down from PLN 8.0m in 1Q20. After a good April, the Company booked a slight loss on sales in May and June. Sales and marketing costs remained unchanged at PLN 2.3m, which confirms our focus on growth in the medium term.

Prospects for the coming months: Until September, the Company had cut costs substantially, and the total number of employees was cut by about 100 compared to the peak in autumn 2019, that is over 15% of the workforce. Revenues have been recovering gradually and sales in Q4 should increase by 5% q/q, while expenditures on development and attracting new customers may weigh on the results. We believe that the Company will only restore its results closer to the 2H21, depending on the rate of growth of its customers' spending and its ability to attract new customers. Currently, the bench is very short and the teams are being supplemented (the number of job ads on the Company's website has exceeded 70 compared to about 40 in August). Taking into account revenue growth vs Q2, cost reductions and the end of the discount period, we assume that the H2 sales result will be similar to H1 (11m), and this year's net profit will be down by 1/3 to 18m. For the next year we assume an increase in orders from existing customers, but still slow attraction of new ones (still limited travel). Relations with customers acquired in 2Q20 and 3Q20 were established even before the pandemic. At the same time, we assume that net profit will increase 11% y/y in 2021 and 12% y/y in 2022.

Valuation: We value PGS Software based on the DCF method (100% weighting at the target price PLN 13.6, 3% below the previous price of PLN 14.0).

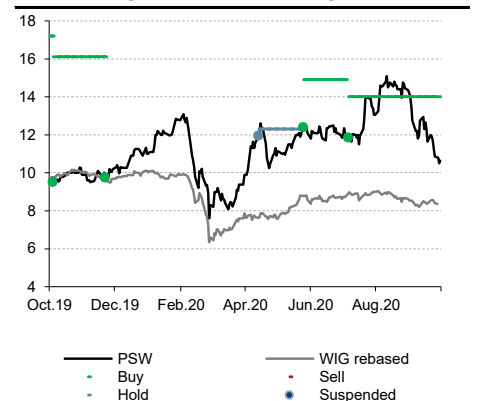
m PLN	2017	2018	2019	2020F	2022F	2022F
Sales	99,1	124,0	144,7	138,2	153,0	171,4
EBITDA	23,0	27,7	27,7	23,0	25,3	28,2
EBIT	21,4	26,0	25,8	21,1	23,2	25,8
Net profit	20,1	21,5	26,8	18,2	21,0	23,4
EPS (PLN)	0,71	0,76	0,95	0,65	0,74	0,83
P/E (x)	15,0	14,1	11,3	16,6	14,4	12,9
EV/EBITDA (x)	12,6	10,5	9,7	11,6	10,4	9,4
P/BV (x)	12,9	11,0	5,6	5,3	5,1	4,8
DY (%)	5,0%	5,8%	0,0%	4,7%	5,4%	6,3%

Source: data of the company, Trigon DM

FACT SHEET

Ticker	PSW		
Sector	TMT		
Price (PLN)	10,70		
52wk Range (PLN)	7,45 / 15,1		
Number of share (m)	28,3		
Market Cap (mPLN)	302		
Free-float	35,3%		
Avg Vol 3M (mPLN)	0,10		
Price performance	1M	3M	1Y
	-23,6%	-13,4%	11,5%

RELATIVE SHARE PRICE PERFORMANCE



Recommendation history	Date	Price
Buy	20.07.2020	14,0
Buy	08.06.2020	14,9
Hold	27.04.2020	12,3
Buy	06.12.2019	18,5
Buy	18.10.2019	16,1
Buy	17.09.2019	17,2
Buy	18.07.2019	19,6
Buy	16.07.2019	19,6

Shareholders	Share %
Presto FIZ AN	31,9%
Infinitas FIZ AN	31,9%
NN OFE	7,4%

Important dates

Quarterly results	27.11.2020
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Analyst

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PGSSOFT

Bloomberg ticker

PSW PW

Recommendation

Buy

Target Price (PLN)

13,6

Current Price (PLN)

10,7

Upside

27%

Previous Recommendation

Buy

Previous Upside (PLN)

13,6

Number of shares (m)

28,3

Market Cap (mPLN)

302

EV (m PLN)

268

Dominik Niszcz

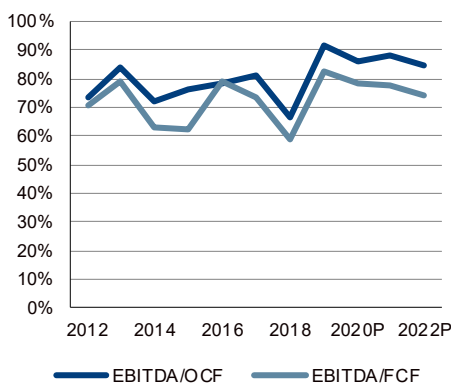
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MARKET RATIOS	2018	2019	2020P	2021P	2022P
P/E (x)	14,1	11,3	16,6	14,4	12,9
P/E adj. (x)	14,1	11,3	16,6	14,4	12,9
P/BV (x)	11,0	5,6	5,3	5,1	4,8
EV/EBITDA (x)	10,5	9,7	11,6	10,4	9,4
EV/EBITDA adj. (x)	10,5	9,7	11,6	10,4	9,4
EV/Sales (x)	2,4	1,9	1,9	1,7	1,5
FCF Yield (%)	5,3%	7,7%	6,0%	6,5%	6,9%
DY (%)	5,8%	0,0%	4,7%	5,4%	6,3%

RATIOS	2018	2019	2020P	2021P	2022P
EPS (PLN)	0,8	0,9	0,6	0,7	0,8
EPS adj. (PLN)	0,8	0,9	0,6	0,7	0,8
DPS (PLN)	0,6	0,0	0,5	0,6	0,7
BVPS (PLN)	1,0	1,9	2,0	2,1	2,2
Number of shares (m)	28,3	28,3	28,3	28,3	28,3
Market Cap (mPLN)	302	302	302	302	302
EV (mPLN)	292	268	266	264	264

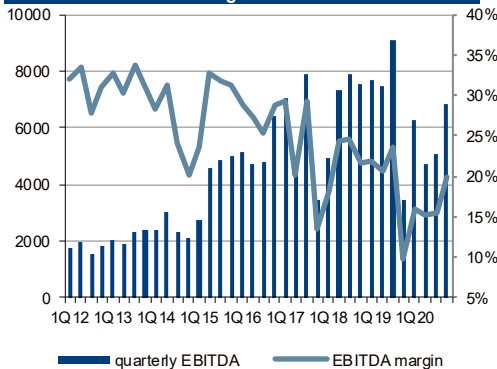
EBITDA conversion into cash



P&L (mPLN)	2018	2019	2020P	2021P	2022P
Sales	124	145	138	153	171
COGS	98	119	117	130	145
Gross profit	26	26	21	23	26
EBITDA	28	28	23	25	28
EBITDA adj.	28	28	23	25	28
D&A	2	2	2	2	2
EBIT	26	26	21	23	26
Gross profit	26	29	20	23	26
Minority interest	0	0	0	0	0
Net profit	22	27	18	21	23
Net profit adj.	22	27	18	21	23

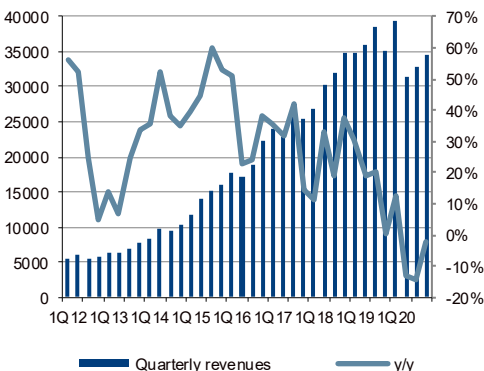
CASH FLOW STATEMENT (mPLN)	2018	2019	2020P	2021P	2022P
Cash flow from operations	18	25	20	22	24
Cash flow from investing	-2	-2	-2	-3	-3
CAPEX	-2	-2	-2	-3	-3
Cash flow from financing	-18	0	-16	-18	-21
Dividend	-18	0	-14	-16	-19
FCF	16	23	18	20	21
Net cash flow	-2	22	2	2	0

EBITDA and EBITDA margin



BALANCE SHEET (mPLN)	2018	2019	2020P	2021P	2022P
ASSETS	40	68	69	74	78
PPE	4	4	4	4	5
Goodwill	0	0	0	0	0
Intangible assets	0	0	0	0	0
Cash and equivalents	11	35	37	39	39
EQUITY AND LIABILITIES	40	68	69	74	78
Equity	27	54	57	60	62
Minority shareholders capital	0	0	0	0	0
Interest-bearing liabilities	0	1	1	1	1
Net debt	-11	-35	-37	-38	-39
Net working capital	15	12	12	14	17

Revenues



OPERATING INDICATORS	2018	2019	2020P	2021P	2022P
Sales growth (%)	25%	17%	-5%	11%	12%
EPS adj. growth (%)	7%	25%	-32%	15%	11%
Gross profit margin (%)	20,9%	17,9%	15,4%	15,3%	15,1%
EBITDA adj. margin (%)	22,4%	19,2%	16,6%	16,6%	16,4%
Operating profit margin (%)	21,0%	17,9%	15,2%	15,2%	15,0%
Net profit adj. margin (%)	17,4%	18,6%	13,2%	13,7%	13,6%
ROE (%)	84,5%	65,6%	50,5%	47,5%	44,9%
ROA (%)	57,9%	49,9%	38,2%	36,9%	35,5%
CAPEX/Sales (%)	2,0%	1,5%	1,3%	1,7%	1,7%
CAPEX/D&A (x)	1,5	1,1	0,9	1,2	1,2
Net debt/Equity	-0,4	-0,6	-0,6	-0,6	-0,6
Net debt/EBITDA (x)	-0,4	-1,2	-1,6	-1,5	-1,4
Cash conversion cycle (days)	35	31	27	29	32
Inventory turnover (days)	0	0	0	0	0
Receivables turnover (days)	53	50	49	49	51
Liabilities turnover (days)	18	19	22	20	19

Source: Company, Trigon DM

Valuation

DCF valuation assumptions:

Risk-free rate 1,8%, market premium 6,0%; Unlevered beta at 1,1x z due to high exposure of results to macroeconomic slowdown, terminal value growth rate at 1,5%; We assume IP box savings in the forecast period, but 19% tax rate in the terminal value; Our target price is fully based on DCF valuation.

PGS Software: DCF valuation

	2020P	2021P	2022P	2023P	2024P	2025P	2026P	2027P	2028P	2029P	Terminal
EBIT	21	23	26	27	29	31	31	32	33	33	
Tax rate	8%	10%	10%	10%	10%	10%	10%	10%	10%	10%	
NOPLAT	19	21	23	25	26	27	28	29	29	29	27
D&A	1,9	2,1	2,4	2,7	3,0	3,3	3,6	3,9	4,3	5,5	
CAPEX	-1,8	-2,6	-3,0	-3,3	-3,6	-4,0	-4,4	-4,7	-5,1	-5,5	
WC	-0,3	-0,9	-1,9	-1,0	-1,3	-1,4	-1,4	-1,5	-1,5	-1,6	
FCF	19	20	21	23	24	25	26	27	27	28	25
ND / Equity	0%										
RFR	1,8%										
MRP	6,0%										
Beta unlevered	1,1										
Debt costs after tax (%)	3,2%										
CoE (%)	8,4%										
WACC (%)	8,4%										
Sum PV FCF 2019-28	153										
Terminal growth rate > '28	1,5%										
Discounted TV	162										
Net debt	-35										
Minorities	0										
Nonoperating assets	0										
Equity (PLN, m)	351										
# of shares (m)	28,3										
Value per share (PLN, 1/1/2019)	12,4										
Target Price (12m)	13,6										

Source: Trigon DM

Peer group valuation

Spółka	MC [m EUR]	EV/EBITDA			P/E		
		2020E	2021E	2022E	2020E	2021E	2022E
GLOBANT SA	6 195	47,7	35,3	28,0	80,3	60,6	49,3
ENDAVA PLC- SPON ADR	3 044	38,9	31,8	25,1	53,7	50,4	39,5
EPAM SYSTEMS INC	15 813	38,7	29,8	24,4	56,0	46,2	37,4
Median: foreign peers		38,9	31,8	25,1	56,0	50,4	39,5
PSW	0	11,6	10,4	9,4	16,6	14,4	12,9
Valuation per share		32,9	29,8	26,3	36,1	37,5	32,7
Average valuation for multipliers			29,7			35,4	

Source: Bloomberg, Trigon DM

Risk factors: 1) Currency risk due to exposure to foreign markets (over 90% of revenues not in PLN), 2) Increase in wages that could not be transferred onto clients, 3) Problems with recruiting employees, 4) Level of spending on IT by major clients may quickly translate into revenue change (PGS operators on the basis of short term contracts), 5) Legal risks (in countries where the company offers its services related to off-shoring, in Poland concerning labour law and B2B services taxation).

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Definitions

capitalisation – market price multiplied by the number of a company's shares
free float (%) – a percentage of a company's shares held by shareholders with less than 5% shareholding reduced by treasury shares held by the company
min/max 52 wks – minimum/maximum share price within the last 52 weeks
average turnover – average volume of share trading within the last month

EBIT – operating profit
EBITDA – operating profit increased by depreciation and amortisation
adjusted profit – net profit adjusted for one-off items
CF – cash flow
capex – sum of investment expenditures on fixed assets

ROA – rate of return on assets
ROE – rate of return on equity
gross profit margin – a ratio of gross profit to net revenue
EBITDA margin – a ratio of sum of operating profit and depreciation/amortisation to net revenue
EBIT margin – a ratio of operating profit to net revenue
net margin – a ratio of net profit to net revenue

EPS – earnings per share
DPS – dividends per share
P/E – a ratio of market price to earnings per share
P/BV – a ratio of market price to book value per share
EV/EBITDA – a company's EV to EBITDA ratio
EV – sum of a company's current capitalisation and net debt
DY – dividend yield, dividend paid to share price ratio
ISSUER – PGS Software S.A.

Recommendations of the Brokerage House

BUY – we expect that the rate of return on an investment will be at least 10%
NEUTRAL – we expect the price of an investment to be relatively stable, optionally it will increase no greater than 10%

SELL – we expect that an investment will make a loss greater than 0%
 Recommendation prepared by: Dominik Niszcz

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