

# PGS Software (Buy; PLN 15,0)

Return of demand for software development services globally

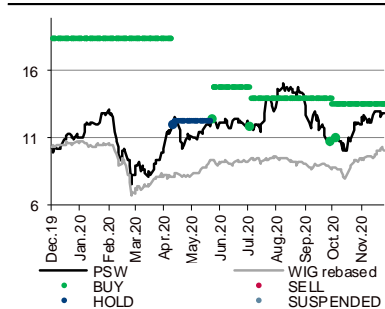
| Income statement (PLNm)            | 2017        | 2018         | 2019         | 2020E        | 2021E        | 2022E        |
|------------------------------------|-------------|--------------|--------------|--------------|--------------|--------------|
| <b>Revenues</b>                    | <b>99,1</b> | <b>124,0</b> | <b>144,7</b> | <b>140,6</b> | <b>156,1</b> | <b>176,3</b> |
| COGS                               | 77,6        | 98,1         | 118,8        | 116,9        | 130,5        | 147,5        |
| <b>Gross profit</b>                | <b>21,5</b> | <b>25,9</b>  | <b>25,9</b>  | <b>23,7</b>  | <b>25,6</b>  | <b>28,9</b>  |
| Sales expenses                     | 0,0         | 0,0          | 0,0          | 0,0          | 0,0          | 0,0          |
| Management costs                   | 0,0         | 0,0          | 0,0          | 0,0          | 0,0          | 0,0          |
| Profit from sales                  | 21,5        | 25,9         | 25,9         | 23,7         | 25,6         | 28,9         |
| Result on other operating activity | -0,1        | 0,1          | 0,0          | -0,1         | 0,0          | -0,2         |
| <b>EBITDA</b>                      | <b>23,0</b> | <b>27,7</b>  | <b>27,7</b>  | <b>25,4</b>  | <b>27,5</b>  | <b>30,9</b>  |
| <b>EBITDA adj.</b>                 | <b>23,0</b> | <b>27,7</b>  | <b>27,7</b>  | <b>25,4</b>  | <b>27,5</b>  | <b>30,9</b>  |
| Amortization                       | 1,5         | 1,7          | 1,9          | 1,9          | 1,9          | 2,2          |
| <b>EBIT</b>                        | <b>21,4</b> | <b>26,0</b>  | <b>25,8</b>  | <b>23,6</b>  | <b>25,6</b>  | <b>28,7</b>  |
| Financial net                      | 3,5         | 0,4          | 3,3          | -1,2         | 0,2          | 0,2          |
| <b>Gross profit</b>                | <b>24,9</b> | <b>26,3</b>  | <b>29,0</b>  | <b>22,4</b>  | <b>25,8</b>  | <b>28,9</b>  |
| Income tax                         | 4,8         | 4,8          | 2,2          | 1,5          | 2,1          | 2,6          |
| Minority interest                  | 0,0         | 0,0          | 0,0          | 0,0          | 0,0          | 0,0          |
| <b>Net profit</b>                  | <b>20,1</b> | <b>21,5</b>  | <b>26,8</b>  | <b>20,9</b>  | <b>23,7</b>  | <b>26,3</b>  |
| <b>Net profit adj.</b>             | <b>20,1</b> | <b>21,5</b>  | <b>26,8</b>  | <b>20,9</b>  | <b>23,7</b>  | <b>26,3</b>  |
| gross margin (%)                   | 21,7%       | 20,9%        | 17,9%        | 16,9%        | 16,4%        | 16,4%        |
| EBITDA adj. margin (%)             | 23,2%       | 22,4%        | 19,2%        | 18,1%        | 17,6%        | 17,5%        |
| EBIT margin (%)                    | 21,6%       | 21,0%        | 17,9%        | 16,8%        | 16,4%        | 16,3%        |
| net margin (%)                     | 20,3%       | 17,4%        | 18,6%        | 14,9%        | 15,2%        | 14,9%        |

| Indicators         | 2017 | 2018 | 2019 | 2020E | 2021E | 2022E |
|--------------------|------|------|------|-------|-------|-------|
| P/E (x)            | 18,3 | 17,1 | 13,7 | 17,6  | 15,5  | 14,0  |
| EV/EBITDA (x)      | 15,4 | 12,9 | 12,0 | 12,9  | 11,9  | 10,6  |
| EV/EBITDA adj. (x) | 15,4 | 12,9 | 12,0 | 12,9  | 11,9  | 10,6  |
| P/BV (x)           | 15,7 | 13,4 | 6,8  | 6,2   | 5,9   | 5,6   |

## COMPANY DATA

|                         |             |        |       |
|-------------------------|-------------|--------|-------|
| Ticker                  | PSW         |        |       |
| Sector                  | IT          |        |       |
| Price (PLN)             | 13,00       |        |       |
| 52 week min/max (PLN)   | 7,45 / 15,1 |        |       |
| No. of shares (mln)     | 28,3        |        |       |
| Market cap (PLNm)       | 367         |        |       |
| EV (PLNm)               | 328         |        |       |
| Free-float              | 35,3%       |        |       |
| Avg. turnover 3M (PLNm) | 0,09        |        |       |
| Price change            | 1M          | 3M     | 1Y    |
|                         | 11,7%       | -12,5% | 31,6% |

## PSW vs. WIG



| PLNm                   | 4Q18  | 1Q19  | 2Q19  | 3Q19  | 4Q19  | 1Q20  | 2Q20  | 3Q20  | 4Q20E |
|------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Revenues               | 34,9  | 35,0  | 36,1  | 38,5  | 35,2  | 39,5  | 31,3  | 33,2  | 36,7  |
| EBITDA                 | 7,6   | 7,7   | 7,5   | 9,1   | 3,5   | 6,3   | 4,7   | 5,9   | 8,5   |
| EBIT                   | 7,1   | 7,2   | 7,0   | 8,6   | 3,0   | 5,8   | 4,3   | 5,5   | 8,0   |
| Net profit             | 6,0   | 5,3   | 6,8   | 6,8   | 7,9   | 3,1   | 5,5   | 4,8   | 7,4   |
| P/E12M trailing        | 17,1  | 16,1  | 14,4  | 14,8  | 13,7  | 14,9  | 15,7  | 17,2  | 17,6  |
| EV/EBITDA 12M trailing | 12,9  | 11,5  | 11,5  | 10,8  | 12,0  | 12,6  | 13,5  | 16,2  | 12,9  |
| revenue y/y            | 37%   | 30%   | 19%   | 20%   | 1%    | 13%   | -13%  | -14%  | 4%    |
| EBITDA margin          | 21,7% | 21,9% | 20,8% | 23,7% | 9,8%  | 15,9% | 15,2% | 17,9% | 23,1% |
| EBIT margin (%)        | 20,4% | 20,6% | 19,5% | 22,4% | 8,4%  | 14,6% | 13,7% | 16,6% | 21,9% |
| net margin (%)         | 17,0% | 15,3% | 18,8% | 17,8% | 22,5% | 7,8%  | 17,6% | 14,5% | 20,3% |
| Net debt               | -11   | -16   | -16   | -25   | -35   | -36   | -48   | -36   | -39   |

| Balance sheet (PLN m)         | 2017        | 2018        | 2019        | 2020E       | 2021E       | 2022E       |
|-------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|
| <b>Fixed assets</b>           | <b>4,2</b>  | <b>5,3</b>  | <b>5,3</b>  | <b>5,2</b>  | <b>5,7</b>  | <b>6,5</b>  |
| <b>Current assets</b>         | <b>30,1</b> | <b>34,7</b> | <b>60,7</b> | <b>67,1</b> | <b>71,2</b> | <b>75,6</b> |
| Inventory                     | 0,0         | 0,0         | 0,0         | 0,0         | 0,0         | 0,0         |
| Trade receivables             | 15,4        | 20,3        | 19,2        | 19,3        | 21,5        | 25,1        |
| Cash                          | 14,1        | 11,5        | 35,2        | 39,8        | 41,6        | 42,3        |
| <b>Assets</b>                 | <b>34,3</b> | <b>40,1</b> | <b>67,6</b> | <b>72,2</b> | <b>76,9</b> | <b>82,0</b> |
| <b>Equity</b>                 | <b>23,5</b> | <b>27,5</b> | <b>54,3</b> | <b>59,3</b> | <b>62,6</b> | <b>65,9</b> |
| <b>Minority capital</b>       | <b>0,0</b>  | <b>0,0</b>  | <b>0,0</b>  | <b>0,0</b>  | <b>0,0</b>  | <b>0,0</b>  |
| <b>Long-term liabilities</b>  | <b>0,7</b>  | <b>0,9</b>  | <b>0,5</b>  | <b>0,5</b>  | <b>0,5</b>  | <b>0,5</b>  |
| Interest-bearing liabilities  | 0,0         | 0,0         | 0,5         | 0,5         | 0,5         | 0,5         |
| <b>Short-term liabilities</b> | <b>8,9</b>  | <b>10,5</b> | <b>11,4</b> | <b>11,0</b> | <b>12,2</b> | <b>13,8</b> |
| Interest-bearing liabilities  | 0,5         | 0,7         | 0,2         | 0,2         | 0,2         | 0,2         |
| Trade liabilities             | 4,2         | 5,3         | 7,3         | 7,1         | 7,1         | 7,1         |
| <b>Liabilities</b>            | <b>34,3</b> | <b>40,1</b> | <b>67,6</b> | <b>72,2</b> | <b>76,9</b> | <b>82,0</b> |
| Net debt adj.                 | -13,7       | -10,8       | -34,5       | -39,1       | -41,0       | -41,6       |
| ND/EBITDA (x)                 | -0,6        | -0,4        | -1,2        | -1,5        | -1,5        | -1,3        |
| ROE (%)                       | 171,3%      | 84,5%       | 65,6%       | 36,8%       | 38,9%       | 40,9%       |
| CCC (days)                    | 41          | 39          | 34          | 31          | 31          | 34          |

| Cash Flow (PLNm)                             | 2017         | 2018         | 2019        | 2020E        | 2021E        | 2022E        |
|--|--------------|--------------|-------------|--------------|--------------|--------------|
| <b>Cash flows from operating activities</b>  | <b>18,7</b>  | <b>18,4</b>  | <b>25,4</b> | <b>22,3</b>  | <b>24,8</b>  | <b>26,5</b>  |
| Net profit (loss)                            | 20,1         | 21,5         | 26,8        | 20,9         | 23,7         | 26,3         |
| Amortization                                 | 1,5          | 1,7          | 1,9         | 1,9          | 1,9          | 2,2          |
| <b>Cash flows from investment activities</b> | <b>-1,8</b>  | <b>-2,0</b>  | <b>-2,4</b> | <b>-1,8</b>  | <b>-2,5</b>  | <b>-2,9</b>  |
| CAPEX  | -2,5         | -2,5         | -2,1        | -1,8         | -2,4         | -2,8         |
| <b>Cash flows from financial activities</b>  | <b>-15,5</b> | <b>-17,9</b> | <b>-0,5</b> | <b>-15,9</b> | <b>-20,4</b> | <b>-23,0</b> |
| Dividend                                     | -15,2        | -17,5        | 0,0         | -14,1        | -18,8        | -21,3        |
| Net cash flows                               | 1,4          | -1,5         | 22,5        | 4,6          | 1,9          | 0,6          |
| Cash opening balance                         | 10,9         | 14,1         | 11,5        | 35,2         | 39,8         | 41,6         |
| Closing balance of cash                      | 14,1         | 11,5         | 35,2        | 39,8         | 41,6         | 42,3         |
| FCF  | 16,2         | 16,0         | 23,3        | 20,5         | 22,4         | 23,6         |
| FCF Yield (%)                                | 4,4%         | 4,3%         | 6,3%        | 5,6%         | 6,1%         | 6,4%         |
| DPS  | 0,54         | 0,62         | 0,00        | 0,50         | 0,67         | 0,76         |
| DY (%)                                       | 4,1%         | 4,8%         | 0,0%        | 3,8%         | 5,1%         | 5,8%         |

## PGS SOFTWARE (BUY, PLN 15.0)

- We maintain our Buy recommendation and increase our target price from PLN 13.6 to PLN 15.0.
- Global leaders comparable to PGS Software see a significant rebound in demand for software development services (Epam, Globant) in 3Q20 and the last months of the year. Epam, which recruited 1–2k new employees a quarter in the past, has returned to 1.5k in 3Q20 after a decline in 2Q20, and is expected to recruit over 2k employees in the last quarter (the most the Company has recruited so far). Despite the expected increase in employment, Epam's Management Board expects it will take several quarters to adjust the supply of workers to the demand.
- We assume an increased demand for PGS Software services to be seen again at the end of 2020 and the beginning of 2021. The lack of qualified staff on the market may prove to be a barrier to growth, but given that the largest competitors are in a similar situation, we believe that the Company will be able to increase prices of services and compensate for the growing staff costs.
- The bench cut at the end of 3Q20 combined with the return of demand should result in an improvement in q/q results. We raise our net profit forecast from PLN 18m to PLN 21m in 2020 and from PLN 21m to PLN 24m for 2021. We model revenue growth of 11% in 2021 (there is a risk of cooling if the current rebound is due to a desire to consume 2020 budgets, but we assume that the current rebound is not only short-term).
- Risk factors: demand for outsourced IT specialists in Western Europe, FX changes, cost inflation, reputation risk.

**Change of forecasts**

|              |     | 2020E |     | 2021E |     | 2022E |     | 2020E |      | 2021E |      | 2022E |      | 2020E |      | 2021E |      | 2022E |      |
|--------------|-----|-------|-----|-------|-----|-------|-----|-------|------|-------|------|-------|------|-------|------|-------|------|-------|------|
|              |     | New   | Old | New   | Old | New   | Old | New   | Old  | New   | Old  | New   | Old  | New   | Old  | New   | Old  | New   | Old  |
| PGS Software | PSW | 141   | 138 | 156   | 153 | 176   | 171 | 25,4  | 23,0 | 27,5  | 25,3 | 30,9  | 28,2 | 20,9  | 18,2 | 23,7  | 21,0 | 26,3  | 23,4 |

**History of recommendations**

| PGS Software           |            |       |
|------------------------|------------|-------|
| RECOMMENDATION HISTORY | Date       | TP    |
| BUY                    | 20.10.2020 | 13,60 |
| BUY                    | 15.10.2020 | 13,60 |
| BUY                    | 20.07.2020 | 14,00 |
| BUY                    | 08.06.2020 | 14,90 |

**Change in recommendation**

| Company      | Ticker | Recommendation | TP     | Previous recommendation | Previous TP |
|--------------|--------|----------------|--------|-------------------------|-------------|
| PGS Software | PSW    | Buy            | 15,0 ↑ | Buy                     | 13,60       |

**Summary of valuations**

| PGS Software |      |
|--------------|------|
| Valuation    |      |
| DCF          | 15,0 |
| Peers        | 31,2 |



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capitalisation – product of multiplication of the market price and the number of shares issued by a company  
 free float (%) – portion of the number of shares in the hands of shareholders that own below 5% of the total number of shares less the treasury stock owned by the company  
 min/max 52 weeks – minimum/maximum market share price from the past 52 weeks  
 average volume – average volume of trading in shares in the past month

EBIT – operating profit  
 EBITDA – operating profit plus D&A  
 adjusted profit – net profit adjusted for one-off transactions  
 CF – cash flow  
 CAPEX – sum of investment expenditure on fixed assets

ROA – rate of return on total assets  
 ROE – rate of return on equity  
 gross profit on sales margin – gross profit on sales divided by net revenues from sales  
 EBITDA margin – earnings before interest, taxes, depreciation and amortization divided by net revenues from sales  
 EBIT margin – earnings before interest and taxes divided by net revenues from sales  
 net margin – net profit divided by net revenues from sales

EPS – net earnings per share  
 DPS – dividend per share  
 P/E – market price divided by net profit per share  
 P/BV – market price divided by the book value of one share  
 EV/EBITDA – EV divided by EBITDA of a company  
 EV – sum of present capitalisation and net debt of a company  
 DY – dividend yield, i.e. ratio of the dividend paid to the stock price

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### Applied valuation methods

In general, Dom Maklerski uses two valuation methods: the DCF (discounted cash flow) model and the market multiples valuation method, which involves comparing the core market multiples of a company with those of its peer companies. Alternatively, the dividend discount model may be used.

On the negative side, the methods based on discounted flows are highly sensitive to the adopted assumptions. On the positive side, these methods are not dependent on the current market valuation of a company. In turn, the CCA method is flawed by the risk that the market valuation of peer companies at a given point in time may inadequately reflect their actual value. On the plus side, it shows the market valuation of a company generated on the basis of market valuations of peer companies.

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