

# PGS Software

**Buy**

(previous: Buy, 13,6 PLN)

**Target price: 13,6 PLN**

**Current price 10,75 PLN**

**Upside potential 27%**

## Quarterly report

27.11.2020

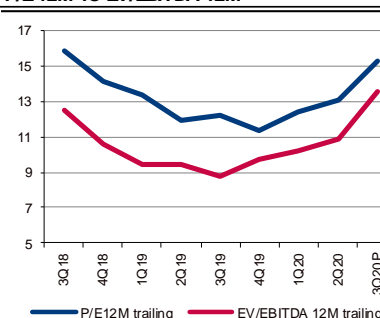
A significant **improvement in annual revenue dynamics should already be visible in 4Q20**, with a marginal y/y decline vs -13% and -15% in 2Q20 and 3Q20, respectively. Given the above improvement in the dynamics and taking into account the strong stock price correction in September, we see the current levels as attractive to gain a foothold 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 such scenario. We believe that the Company will be back on a growth path and that in 2H21 it will already generate results comparable to the record-high results in 2018–2019, while focusing on boosting sales – although, initially, this may result in lower profitability than in previous years.

By September, the Company had cut costs substantially, and the total **number of employees was down by about 100**, or more than 15% of the workforce, compared to the peak in autumn 2019. Revenues have been recovering gradually and Q4 sales should go up by 5% q/q, while expenditures on development and acquiring new customers may weigh on the results. The bench is currently very short and people are being recruited to join the teams (the number of job ads on the Company's website in previous weeks exceeded 70 vs 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 close to the H1 level (11m), and this year's net profit will be down by a third to 18m. For the next year we assume an increased order inflow from existing customers, but still slow acquisitions of new ones (due to still limited travels). Relations with customers acquired in 2Q20 and 3Q20 were established before the pandemic.

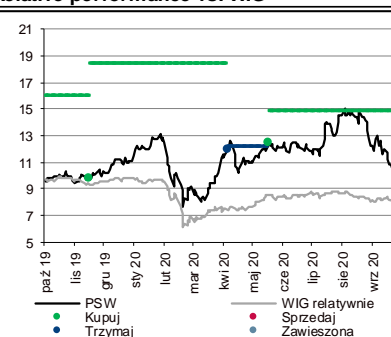
**3Q20:** Better revenue performance in July, a slowdown in August and a recovery in September resulted in a 5% q/q revenue growth in line with the preliminary results reported at the beginning of the month. Some of the discounts to customers applied until September, but at the same time costs were gradually falling and reached their minimum in September. We believe the Company can achieve slight q/q improvement of its operating profit (we assume further small reversals of write-offs for receivables), while currency hedges will be visible at the level of finance costs (PLN 0.8m). We estimate sales profit at PLN 4.4m vs just under PLN 3m in 2Q20 and PLN 8.6m in 3Q19.

Company data		Recommendation history		Date	Price
Ticker	PSW	Buy		15.10.2020	13,6
Sector	IT	Buy		20.07.2020	14,0
Price (PLN)	10,8	Buy		08.06.2020	14,9
52w min/max (PLN)	7,45 / 15,1	Hold		27.04.2020	12,3
Shares (m)	28,3	Buy		06.12.2019	18,5
MC (PLNm)	304	Buy		18.10.2019	16,1
Free-float	35,3%	Buy		17.09.2019	17,2
Avg. 3M turnover (PLN m)	0,10	Buy		18.07.2019	19,6
Zmiana kursu	1M	3M	1Y		
	-14,1%	-7,6%	15,3%		

P/E 12M vs EV/EBITDA 12M



Relative performance vs. WIG



m PLN	3Q18	4Q18	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20P	y/y	q/q
Sales	32,0	34,9	35,0	36,1	38,5	35,2	39,5	31,3	32,9	-15%	5%
EBITDA	7,9	7,6	7,7	7,5	9,1	3,5	6,3	4,7	5,1	-44%	7%
EBIT	7,5	7,1	7,2	7,0	8,6	3,0	5,8	4,3	4,6	-46%	8%
Net profit	7,5	6,0	5,3	6,8	6,8	7,9	3,1	5,5	3,5	-50%	-37%
P/E12M trailing	15,9	14,1	13,3	11,9	12,2	11,3	12,3	13,0	15,2		
EV/EBITDA 12M trailing	12,5	10,6	9,5	9,4	8,8	9,7	10,2	10,8	13,6		
sales growth y/y	19%	37%	30%	19%	20%	1%	13%	-13%	-15%		
EBITDA margin	25%	22%	22%	21%	24%	10%	16%	15%	15%		
EBIT margin	23%	20%	21%	19%	22%	8%	15%	14%	14%		
Net margin	23%	17%	15%	19%	18%	22%	8%	18%	11%		

m PLN	2017	2018	2019	2020P	2021P	2022P
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
DPS (PLN)	0,54	0,62	0,00	0,50	0,58	0,67
P/E (x)	15,1	14,1	11,3	16,7	14,4	13,0
EV/EBITDA (x)	12,6	10,6	9,7	11,6	10,5	9,4
P/BV (x)	12,9	11,1	5,6	5,4	5,1	4,9
DY (%)	5,0%	5,8%	0,0%	4,7%	5,4%	6,2%

Valuation/weight	Current		Previous		Change
DCF valuation	13,6	100%	13,6	100%	0,0%
Peer valuation	32,6	0%	32,6	0%	0,0%

Estimates revision m PLN	2021E			2022E			2022E		
	New	Old	Change	New	Old	Change	New	Old	Change
Sales	138	138	0%	153	153	0%	171	171	0%
EBITDA	23	23	0%	25	25	0%	28	28	0%
EBIT	21	21	0%	23	23	0%	26	26	0%
Net profit	18	18	0%	21	21	0%	23	23	0%
P/E (x)	16,7	16,7		14,4	14,4		13,0	13,0	
EV/EBITDA (x)	11,6	11,6		10,5	10,5		9,4	9,4	
P/BV (x)	5,4			5,1			4,9		
DY (%)	4,7%			5,4%			6,2%		

MARKET RATIOS	2018	2019	2020P	2021P	2022P
P/E (x)	14,1	11,3	16,7	14,4	13,0
P/E adj. (x)	14,1	11,3	16,7	14,4	13,0
P/BV (x)	11,1	5,6	5,4	5,1	4,9
EV/EBITDA (x)	10,6	9,7	11,6	10,5	9,4
EV/EBITDA adj. (x)	10,6	9,7	11,6	10,5	9,4
EV/Sales (x)	2,4	1,9	1,9	1,7	1,5
FCF Yield (%)	5,3%	7,7%	5,9%	6,5%	6,9%
DY (%)	5,8%	0,0%	4,7%	5,4%	6,2%

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

OPERATING INDICATORS	2018	2019	2020P	2021P	2022P
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%	32,9%	36,2%	38,3%
ROA (%)	57,9%	49,9%	26,6%	29,4%	30,8%
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 (x)	-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)	39	34	32	31	34
Inventory turnover (days)	0	0	0	0	0
Receivables turnover ratio (days)	53	50	50	48	48
Accounts payable turnover ratio (days)	14	16	19	17	15

INCOME STATEMENT (PLNm)	2017	2018	2019	2020P	2021P	2022P
<b>Sales</b>	<b>99,1</b>	<b>124,0</b>	<b>144,7</b>	<b>138,2</b>	<b>153,0</b>	<b>171,4</b>
COGS	77,6	98,1	118,8	116,9	129,7	145,4
<b>Gross profit from sales</b>	<b>21,5</b>	<b>25,9</b>	<b>25,9</b>	<b>21,3</b>	<b>23,3</b>	<b>26,0</b>
Sales expenses						
G&A						
Profit from sales	21,5	25,9	25,9	21,3	23,3	26,0
Result on other operating activity	-0,1	0,1	0,0	-0,2	-0,2	-0,2
<b>EBITDA</b>	<b>23,0</b>	<b>27,7</b>	<b>27,7</b>	<b>23,0</b>	<b>25,3</b>	<b>28,2</b>
<b>EBITDA adj.</b>	<b>23,0</b>	<b>27,7</b>	<b>27,7</b>	<b>23,0</b>	<b>25,3</b>	<b>28,2</b>
Amortization	1,5	1,7	1,9	1,9	2,1	2,4
<b>EBIT</b>	<b>21,4</b>	<b>26,0</b>	<b>25,8</b>	<b>21,1</b>	<b>23,2</b>	<b>25,8</b>
Financial net	3,5	0,4	3,3	-1,3	0,2	0,2
<b>Income before income taxes</b>	<b>24,9</b>	<b>26,3</b>	<b>29,0</b>	<b>19,7</b>	<b>23,4</b>	<b>26,0</b>
Income tax	4,8	4,8	2,2	1,5	2,3	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>18,2</b>	<b>21,0</b>	<b>23,4</b>
<b>Net profit adj.</b>	<b>20,1</b>	<b>21,5</b>	<b>26,8</b>	<b>18,2</b>	<b>21,0</b>	<b>23,4</b>

BALANCE SHEET (PLNm)	2017	2018	2019	2020P	2021P	2022P
<b>Fixed assets</b>	<b>4,2</b>	<b>5,3</b>	<b>5,3</b>	<b>5,1</b>	<b>5,6</b>	<b>6,3</b>
<b>Current assets</b>	<b>30,1</b>	<b>34,7</b>	<b>60,7</b>	<b>64,3</b>	<b>68,0</b>	<b>71,8</b>
Inventory	0,0	0,0	0,0	0,0	0,0	0,0
Trade receivables	15,4	20,3	19,2	19,0	21,1	24,4
Cash	14,1	11,5	35,2	37,3	39,0	39,3
<b>ASSETS</b>	<b>34,3</b>	<b>40,1</b>	<b>67,6</b>	<b>69,4</b>	<b>73,7</b>	<b>78,1</b>
<b>Equity</b>	<b>23,5</b>	<b>27,5</b>	<b>54,3</b>	<b>56,6</b>	<b>59,6</b>	<b>62,5</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>10,8</b>	<b>12,0</b>	<b>13,5</b>
Interest-bearing liabilities	0,5	0,7	0,2	0,2	0,2	0,2
Trade liabilities	4,2	5,3	7,3	7,0	7,0	7,0
<b>Liabilities</b>	<b>34,3</b>	<b>40,1</b>	<b>67,6</b>	<b>69,4</b>	<b>73,7</b>	<b>78,1</b>

CASH FLOW STATEMENT (PLNm)	2017	2018	2019	2020P	2021P	2022P
<b>Cash flow from operations</b>	<b>18,7</b>	<b>18,4</b>	<b>25,4</b>	<b>19,8</b>	<b>22,4</b>	<b>23,9</b>
Net profit (loss)	20,1	21,5	26,8	18,2	21,0	23,4
Amortization	1,5	1,7	1,9	1,9	2,1	2,4
<b>Cash flow from investing</b>	<b>-1,8</b>	<b>-2,0</b>	<b>-2,4</b>	<b>-1,7</b>	<b>-2,7</b>	<b>-3,1</b>
CAPEX	-2,5	-2,5	-2,1	-1,8	-2,6	-3,0
<b>Cash flows from financial activities</b>	<b>-15,5</b>	<b>-17,9</b>	<b>-0,5</b>	<b>-15,9</b>	<b>-18,0</b>	<b>-20,5</b>
Dividend	-15,2	-17,5	0,0	-14,1	-16,4	-18,9
<b>Net cash flow</b>	<b>1,4</b>	<b>-1,5</b>	<b>22,5</b>	<b>2,1</b>	<b>1,6</b>	<b>0,3</b>
Cash opening balance	10,9	14,1	11,5	35,2	37,3	39,0
Closing balance of cash	14,1	11,5	35,2	37,3	39,0	39,3



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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

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 NEUTRAL – we expect the price of an flow (DCF) and multiples methods (a comparison of a company's trading multiples with the metrics of comparable companies). Alternatively, a discounted dividend model may also be used. The key disadvantage of methods based on discounted cash flows is high sensitivity to adopted assumptions, whereas their advantage is a lack of relation to a company's current market price. On the other hand, the main disadvantage of the multiples method is a risk that at a given point in time the market prices of comparable companies might not reflect their true value, whereas its advantage lies in the fact that it shows a company's market value obtained based on the market values of comparable companies.

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