

PGS Software

Deferred growth

The IT services market, especially the contracting/outsourcing market which are the speciality of PGS Software, has been experiencing a strong upward trend for many years. Outsourcing experienced workers in the face of a structural shortage of programmers is a natural choice for businesses. However, in a situation caused by the pandemic, the natural choice was to abandon such services in order to seek savings. It seems like the novel coronavirus pandemic will reverse the trend on the market of outsourcing IT services, but in our opinion it will be a short-term change. Once the situation becomes stable enough for projects to resume, this segment will, in our opinion, see a sharp uptick as depleted corporate IT departments find themselves in need of outside support. A temporary deceleration in the trend of wage growth, may further support performance in the initial phase of the recovery. Since 2019, PGS Software has been incurring additional costs in order to increase its scale of operations, the effects of which were supposed to become apparent from 2Q20. In the current environment, that horizon is shifting. Following the 1Q20 results, we are upgrading our forecasts slightly, increasing our price target to PLN 14.9 per share, and changing our recommendation to *Buy*.

We assume a significant 2Q20 reduction in projects (-14% y/y and -21% q/q). According to the MB's estimates, which take into account the applicable notice periods, the company's revenue should gradually decrease during Q2, reaching a 25–30% decline in June from this year's January-February average. We believe the low base may still be present by year-end, we do not expect the Company to win any large-scale projects in 2020, and we don't expect more contracts coming back before 2021. The one-off effect of savings and measures taken in connection with the expected decline in orders from 2Q20 onwards was noticeable in 1Q20 revenue. Withholding employee training and internal activities allowed for expanding the scope of work offered to customers and higher invoicing.

Anticipating reduced demand and discounts to customers in distress, the Company has implemented cost savings, including **salary cuts for all employees (-20% from April this year)**. It also reported record bad debt write-offs of PLN 2.3m. **PGS Software has decided not to lay off** any employees, and it is using the period of reduced involvement in work for customers to train its staff (resumed in 2Q20), which will certainly help the company be better prepared for the return of orders, but **it will also keep its costs high** (in 4Q19 operating expenses increased by nearly PLN 5m y/y to PLN 32.3m, to then fall to PLN 31.4m in Q1). Due to salary cuts and reduced marketing expense, we estimate that operating expenses will fall to PLN 28m from 2Q20, which should support operating profitability. The Management Board's objective for the next quarter is to keep operating profit, and especially cash flow, positive.

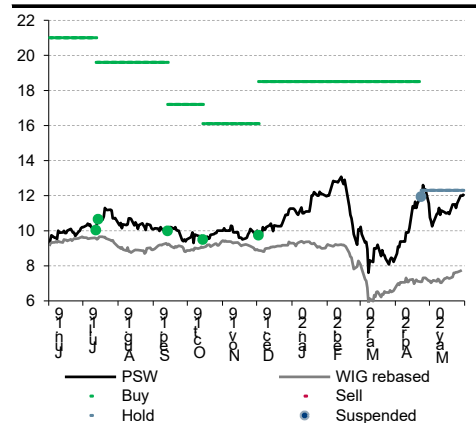
Our valuation is based on the DCF model, which implies a PLN 14.9 target price and a *buy* recommendation (upside of 25%). The market multiples valuation implies a price of PLN 26.5 per share.

Buy
(previously: Hold)
TP: PLN 14,9
Upside: +25%

FACT SHEET

Ticker	PSW		
Sector	TMT		
Price (PLN)	11,90		
52wk Range (PLN)	9,5 / 19		
Number of share (m)	28,3		
Market Cap (mPLN)	466		
Free-float	35,5%		
Avg Vol 3M (mPLN)	0,17		
Price performance	1M	3M	1Y
	1,9%	24,1%	32,5%

RELATIVE SHARE PRICE PERFORMANCE



Recommendation history	Date	Price
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
Buy	18.04.2019	21,0
Buy	07.12.2018	18,1

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

Important dates

3Q'19 Results	30.09.2020
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Analyst

Martyna Szymczykowska

m PLN	2017	2018	2019	2020F	2022F	2022F
Sales	99,1	124,0	144,7	135,2	151,1	171,5
EBITDA	23,0	27,7	27,7	22,1	23,1	24,9
EBIT	21,4	26,0	25,8	20,3	21,3	22,8
Net profit	20,1	21,5	26,8	18,1	19,0	20,3
EPS (PLN)	0,71	0,76	0,95	0,64	0,67	0,72
P/E (x)	16,7	15,6	12,5	18,6	17,7	16,6
EV/EBITDA (x)	14,0	11,7	10,9	12,9	12,3	11,5
P/BV (x)	14,3	12,2	6,2	4,8	4,7	4,6
DY (%)	4,5%	5,2%	0,0%	0,0%	4,8%	5,1%

Source: data of the company, Trigon DM

Risk factors

Backlog changes (risk that the company will not renew contracts), FX risk of legal changes (IP box, B2B regulations), labour cost inflation risk, risk of losing key employees.

Valuation

PGS Software: DCF valuation

	2020P	2021P	2022P	2023P	2024P	2025P	2026P	2027P	2028P	2029P	Terminal
EBIT	21,1	25,2	28,8	29,2	29,3	29,3	29,3	29,6	29,7	30,4	
ETR	11%	11%	11%	11%	11%	11%	11%	11%	11%	11%	
NOPLAT	18,8	22,4	25,7	26,0	26,0	26,1	26,0	26,4	26,5	27,0	26,8
D&A	1,9	2,1	2,4	2,6	2,9	3,1	3,4	3,7	4,0	5,5	
CAPEX	1,7	2,8	3,0	3,3	3,7	4,0	4,4	4,7	5,1	5,5	
WC	-0,2	-1,8	-1,9	-0,9	-1,3	-1,3	-1,4	-1,4	-1,4	-1,5	
FCF	18,8	20,0	23,1	24,3	24,0	23,9	23,8	24,0	23,9	25,5	25,3
ND / Equity	0%										
RFR	2,0%										
MRP	6,0%										
Beta unlevered	1,0										
Debt costs after tax (%)	3,2%										
CoE (%)	8,0%										
WACC (%)	8,0%										
Sum PV FCF 2019-28	153										
Terminal growth rate > '28	2%										
Discounted TV	192										
Net debt	-35										
Minorities	0										
Nonoperating assets	0										
Equity (PLN, m)	380										
# of shares (m)	28,3										
Value per share (PLN, 1/1/2019)	13,4										
Target Price (12m)	14,9										

Source: Trigon DM

Peer group valuation

	M Cap (m EUR)	P/E			EV/EBITDA			FCF Y		
		2020P	2021P	2022P	2020P	2021P	2022P	2020P	2021P	2022P
GLOBANT	4625	62,3	64,8	47,5	53,8	40,9	40,4	3,0	3,7	1,6
ENDAVA	2378	41,0	40,1	32,5	41,4	31,3	25,8	1,2	0,4	0,4
EPAM SYSTEMS	11005	41,8	40,7	31,9	33,4	26,9	24,7	7,0	8,6	4,5
Mediana		41,8	40,7	32,5	41,4	31,3	25,8	3,0	3,7	1,6
PGS Software	77	18,9	18,0	16,8	13,9	13,3	12,3	5,0	5,1	5,1
PGS Software wycena wynikowa		26,8	27,4	23,4	33,6	26,9	24,0	20,3	16,9	39,5
Wycena (średnia roczna)		25,8			28,2			25,6		

Source: Bloomberg, Trigon DM estimates

Trigon Dom Maklerski S.A.

Plac Unii, Budynek B, ul. Puławska 2

02-566 Warszawa

T: +48 22 330 11 11 | F: +48 22 330 11 12

<http://www.trigon.pl> | E: recepcja@trigon.pl

Research:

Grzegorz Kujawski, Head of Research
Konsument, Finanse

Maciej Marcinowski, Deputy Head of Research
Strategia, Banki, Finanse, Przemysł drzewny

Kacper Koproń
Gaming, TMT

Katarzyna Kosiorek
Biotechnologia

Michał Kozak
Paliwa, Chemia, Energetyka

Dominik Niszcz
TMT

Łukasz Rudnik
Przemysł, Wydobycie

David Sharma

Martyna Szymczykowska

Sales:

Paweł Szczepański, Head of Sales

Paweł Czupryński

Sebastian Kosakowski

Artur Pałka

Michał Sopiński

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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 – PGŚ 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: Martyna Szymczykowska

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