

SIRMA GROUP HOLDING
INDUSTRY: IT
IN LINE WITH GUIDANCE

SIRMA GROUP HOLDING DELIVERED FY2015 GUIDANCE RESULTS DESPITE LOWER THAN ANTICIPATED CAPITAL RAISE FROM ITS IPO. IN 2016 IT ANNOUNCED FIRST STEPS OF ITS INTERNATIONAL EXPANSION STRATEGY TO TAP ON NEW POCKETS OF BOTH TOP AND BOTTOM LINE GROWTH.

EXPECTED 2015 TOP AND BOTTOM LINE DELIVERED

The leading IT developer in Bulgaria Sirma Group Holding delivered initial management guidance on both top and bottom line for FY2015. Consolidated sales added 21.9% y/y to BGN 34m, while net income was down 42% y/y to BGN 1.6m compared to normalized FY2014 consolidated earnings. Bottom line results were below our estimate as one big lower margin project in Q4 dragged down profitability. Software development and system integration vertical outperformed in 2015, while semantics performance disappointed due to personnel restructuring in Ontotext which led to a 10% decrease in the subsidiaries results.

2016 MANAGEMENT FORECASTS PARTIALLY IN LINE WITH IPO GUIDANCE

In March, 2016, Sirma's management reiterated FY 2016 results guidance with a further 25% y/y rise in sales, 30% y/y rise in EBITDA and net income doubling. These are partially in line with pre-IPO guidance on sales and EBITDA development, but are more conservative on the bottom line

SPEEDING UP INTERNATIONAL EXPANSION

After raising BGN 11.5m in an IPO in Sofia at the end of 2015, in 2016 Sirma's key goal is speeding up international expansion strategy by boosting sales and marketing capacity, especially in the US. It already announced opening up a new office in New York, USA, to be led by founder and member of the board Yavor Djonev. The office will exploit synergies within the Group and do cross selling in among products. Sirma plans to grow its personnel by 15% to 20% in 2016, with major (50% to 60%) increase to be in sales and marketing team to unlock new pockets of revenue growth. The Group may also engage in M&A in 2016 to grow its developer's base in Bulgaria and Central and Eastern European region with no immediate details yet on any potential deals.

STOCK PRICE SLIPPED BELOW IPO PRICE

Sirma Group Holding IPO-ed in Sofia in mid-October 2015 at the lower bound of its initial price range of BGN 1.20 per share. Despite considerably investor interest from both institutional and retail investors as the first IPO in a long time in Bulgaria, the stock fell below its IPO price in secondary trading due to early-2016 market volatility. The stock price drop came with lower volumes as investors await Sirma Group Holding to post first results with post IPO investments. Investments to start delivering in late 2016.

VALUATION/RISKS

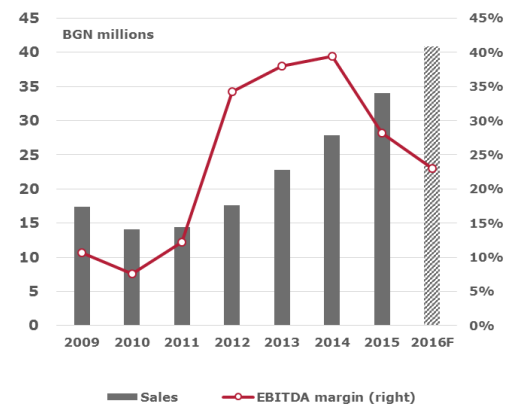
VALUATION: With the Group delivering its pre-IPO guidance we are comfortable with our initial fundamental analysis of the Company. Accordingly, keep our one year target price BGN 1.78 per share and our BUY recommendation. **RISKS:** We consider slower economic growth, significant competition and potential slower international scaling pace of the Company as key risks for the Group.

Consolidated results

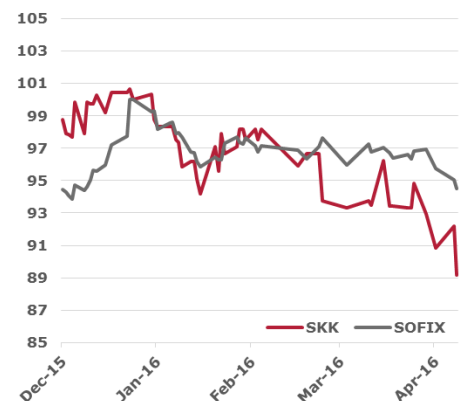
(⁰⁰⁰ BGN)	2014	2015	2016F	2017F
Revenues	27 866	33 972	40 910	53 423
EBITDA	11 001	9 566	9 413	14 852
Net profit (normalized)	2 855	1 566	2 355	5 159
EBITDA margin	39.48%	28.16%	23.01%	27.80%
Profit Margin	10.25%	10.18%	5.76%	9.66%
Book Value	82 329	100 336	105 180	110 647
Debt/Equity	0.06	0.02	0.02	0.03
ROE	3.47%	4.10%	2.75%	5.74%
ROA	3.03%	2.88%	2.04%	4.12%
P/S	2.15	1.83	1.52	1.17
P/E	29.18	39.80	26.47	12.08

RESULTS ANALYSIS
BUY
ONE YEAR PRICE TARGET: BGN 1.78
CURRENT PRICE: BGN 1.05
EXCHANGE RATES
EUR/BGN (FIXED): 1.95583
USD/BGN: 1.75332
MARKET DATA

Shares Outstanding:	59.36m
Share Capital:	BGN 59.36m
Free-float:	38%
Treasury Shares	0%
Market Cap.:	BGN 62 m
Avg. Daily Vol.:	BGN 5, 000
52 Weeks Range:	BGN 1.05 – 1.272
BSE Ticker	SKK
Bloomberg Ticker	SKK BU

TOP LINE ON A STEADY UP TREND


Source: Company data, Elana Trading estimates

THE STOCK SLIPPED BELOW IPO QUOTES


Source: Bloomberg

SIRMA GROUP HOLDING'S CONSOLIDATED RESULTS REVIEW

Sirma Group Holding delivered 21.9% y/y rise in overall revenues in FY2015 to BGN 34m on bigger system integration projects. Profitability was down 42% y/y vs normalized 2014 net income to BGN 1.6m on higher labor and external service costs. The Group did not add new headcount, but used subcontractors to complete bigger system integration project.

2015 key developments: The software developing and system integration subsidiary Sirma Solutions was the best performer within the Group in FY2015. It outperformed expectations with sales expanding 28% y/y to BGN 15.7m and net income at BGN 1.36m, up 2.7x over normalized 2014 earnings. Sales growth was due to bigger system integration and e-services projects in Bulgaria while profitability came at sustained labor costs and higher capitalized expenses due to new product development – loyalty platform Loyax and new mobile payment prototype Paymobilio. The Group will focus on further sales capacity expansion in Sirma Solutions in 2016 as well as improving its presence in Europe, which is currently underdeveloped. It revised upwards its Sirma Solutions' 2016 performance expectations a.k.a. 29% y/y rise in sales to BGN 20m. Thus, Sirma Solutions to remain key contributor to Sirma Group Holding's growth. The Group is working on positioning the subsidiary in niche software developing areas to sustain service margins. In addition, it is working on spinning off the Loyax project, including by attracting a minority outside investment.

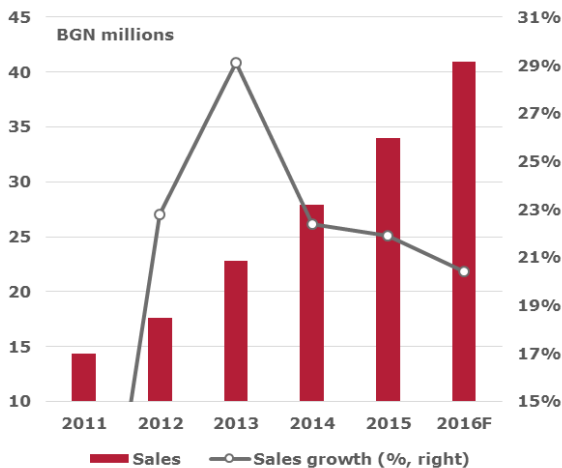
However, the second key contributor to Sirma Group Holding's results, semantic developer Ontotext, disappointed.

It posted 11.2% y/y decline in sales to BGN 6.1 m due to key personnel in the US departing at the end of 2015 and product repositioning. Sirma plans to invest in marketing Ontotext's GraphDB (semantic graph database) in the US in 2016 and expects to overcome the temporary disturbance within the Company. The new US office was position especially in New York where Ontotext sales leads are highest. Still, Sirma revised downward Ontotext's 2016 sales guidance from BGN 10m to BGN 8m. The Group considers GraphDB key own product which it plans to further position within the media and publishing vertical as well among developers.

2016 group guidance: Overall in 2016, Sirma should start delivering its international expansion strategy results with significant investment in sales and marketing capacity. Its key target market is the US. The Group plans to expand its team both in the US, mostly sales people and project managers, and in Bulgaria, mostly developers to speedy up its expansion. Overall, Sirma Group Holding expects personnel to increase by 15% to 20% in 2016, with major (50% to 60%) increase in the sales and marketing.

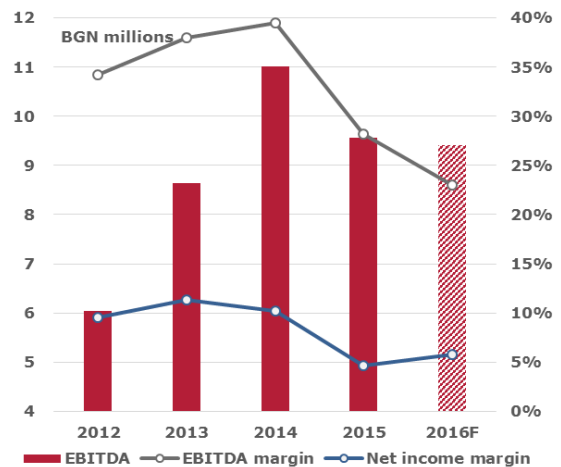
The Group expects to double net income in 2016 as it plans to grow the top line by 25%, the latter slightly below and the former in line with pre IPO guidance. It expect EBITDA to increase by 30%, also in line with pre IPO guidance. This guidance are in line with our 2016 estimates as well, slightly better on the bottom line. We would like to see H1'16 before we make any revisions

Exhibit 3: Top line performance delivered...



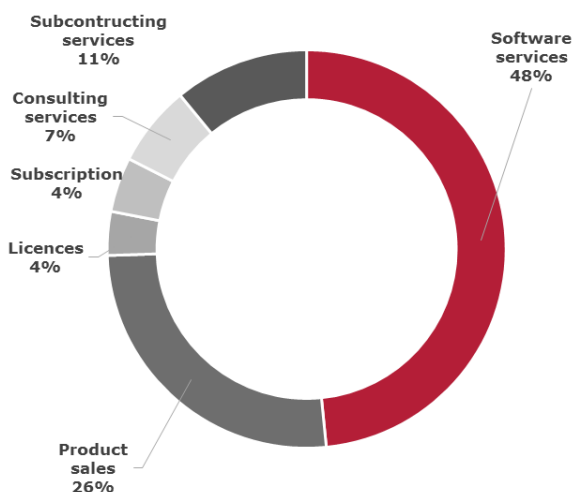
Source: Company data

Exhibit 4: ...while margins yet to start growing as post IPO investments start to bear fruits.



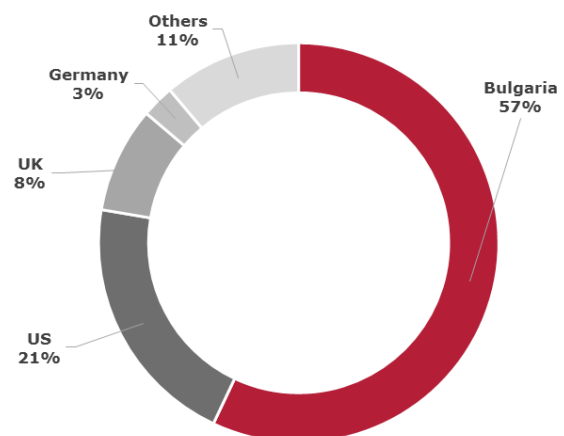
Source: Company data

Exhibit 5: Software services dominate the revenues mix



Source: Company data

Exhibit 6: US and Europe target growth markets



Source: Company data;

FINANCIAL DATA (AUDITED UP TO 2014)

INCOME STATEMENT ('000 BGN)	2012A	2013A	2014A	2015A	2016F	2017F
Revenues	17 636	22 768	27 866	33 972	40 910	53 423
				0		
Materials	-480	-610	-481	-2 376	-818	-1 068
External services	-1 401	-4 449	-3 866	-6 910	-4 091	-5 342
Salaries & wages	-9 760	-11 805	-14 890	-16 368	-22 910	-27 780
Value of stock and assets sold	-1 775	-2 276	-5 073	-8 416	-8 182	-10 685
Changes in inventories	56	1 144	-995	498	409	534
Capitalized own expenses	3 086	4 701	9 587	10 099	5 727	7 479
Other expenses	-1 329	-829	-1 147	-933	-1 632	-1 710
Total expenses	-11 603	-14 124	-16 865	-24 406	-31 497	-38 571
EBITDA	6 033	8 644	11 001	9 566	9 413	14 852
<i>EBITDA margin</i>	<i>34.21%</i>	<i>37.97%</i>	<i>39.48%</i>	<i>28.16%</i>	<i>23.01%</i>	<i>27.80%</i>
Amortization	-3 762	-5 285	-5 809	-6 826	-5 565	-6 674
EBIT	2 271	3 359	5 192	2 740	3 849	8 177
<i>EBIT margin</i>	<i>12.88%</i>	<i>14.75%</i>	<i>18.63%</i>	<i>8.07%</i>	<i>9.41%</i>	<i>15.31%</i>
Financial income/expense	-672	-431	5 494	-274	-286	-374
Financial expense	-706	-2 124	-427	-693	-614	-801
Financial income	34	1 693	206	419	327	427
Other financial positions			5 715	0	0	0
Part of the profit of the associated companies	405	263			0	0
EBT	2 004	3 191	10 686	2 466	3 562	7 803
Taxes	-123	-242	-907	-297	-356	-780
Net Profit	1 881	2 949	9 779	2 169	3 206	7 023
<i>Less Minority Interest</i>	191	368	2 596	603	851	1 864
Net Profit (non-normalized)	1 690	2 581	7 183	1 566	2 355	5 159
<i>Net profit margin</i>	<i>9.58%</i>	<i>11.34%</i>	<i>25.78%</i>	<i>4.61%</i>	<i>5.76%</i>	<i>9.66%</i>

Source: Company IFRS Financial Statements; Elana Trading Estimates

BALANCE SHEET ('000 BGN)	2012A	2013A	2014A	2015A	2016F	2017F
Intangible assets	36 605	31 692	30 023	36 800	39 274	40 609
Real estate, machinery and equipment	2 116	3 198	4 801	3 588	3 273	4 274
Investments in daughter companies	0	0	7	40	0	0
Investments in associated companies	8 710	8 263	429	301	0	0
Long-term financial assets	0	0	442	0	0	0
Deferred taxes	263	214	27	188	0	0
Capitalized own expenses (products in development)	0	27 031	11 527	14 984	20 455	21 369
Goodwill	11 587	13 744	19 398	19 489	19 637	21 369
Total long-term assets	59 281	84 142	66 654	75 390	82 638	87 621
Inventories	598	1 143	463	892	1 636	2 137
Trade receivables	1 664	4 430	7 377	7 144	12 273	16 027
Receivables from connected companies	2 182	0	1 060	1 649	614	801
Tax receivables	0	0	44	167	0	0
Other receivables and prepaid expenses	208	321	288	669	818	1 068
Cash and cash equivalents	1 714	2 460	3 003	11 176	3 580	5 877
Total short-term assets	6 366	8 354	12 235	21 697	18 921	25 910
Assets held for sales	20 874	0	15 265	15 188	13 930	11 753
Total assets	86 521	92 496	94 154	112 275	115 490	125 284
Share capital	73 341	73 341	49 837	59 361	59 361	59 361
Unpaid capital & other			-25		0	0
Reserves	2 858	2 940	2 222	7 146	9 000	10 685
Retained earnings (accumulated loss)	-1 793	-1 048	2 197	6 100	13 091	14 424
Current profit/loss	1 881	2 950	9 778	2 169	4 091	5 342
Non-controlling stakes	5 398	8 150	18 320	23 228	19 637	20 835
Total equity	81 685	86 333	82 329	98 004	105 180	110 647
						0
Provisions	49	63	86	141	327	427
Liabilities to financial institutions	187	595	860	510	614	854
Financial leasing	0	34	97	278	450	588
Trade and other liabilities	51	279	867	1 139	818	1 068
incl. Other liabilities	0	0	0	8	0	0
incl. Deferred taxes	34	135	867	1 131	0	0
Financing	0	137	0	89	0	0
Total long-term liabilities	321	1 243	1 910	2 157	2 209	2 937
Short-term part of the long-term liabilities	107	0	0	1 588	1 145	1 549
Pension and other liabilities to the personnel			929	1 043	1 105	1 496
Provisions	304	732	728	708	327	374
Liabilities to financial institutions	1 567	2 107	3 920	66	0	0
Liabilities to related companies	187	0	185	54	205	267
Financial leasing	0	0	26		0	0
Trade and other liabilities	2 350	2 081	4 127	8 655	5 318	8 013
Total short-term liabilities	4 515	4 920	9 915	12 114	8 100	11 700
Total liabilities	4 836	6 163	11 825	14 271	10 309	14 637
Total Equity & Liabilities	86 521	92 496	94 154	112 275	115 490	125 284

Source: Company IFRS Financial Statements; Elana Trading Estimates

SIRMA GROUP HOLDING Overview

COMPANY PROFILE

Sirma Group Holding is one of the leading software groups in Bulgaria. It was established 23 years ago. Currently, it employs 360 people and manages a diversified portfolio of companies specialized in software engineering and system integration, semantic technologies, big data, business consulting, cloud computing, mobile technologies, e-government and packaging CAD/CAM systems.

Sirma Solutions is the biggest company in the group, key contributor to the top line, specialized in software development and system integration and key incubator of new tech ideas.

Ontotext, the product flagship of the group and key bottom line contributor, disrupts the way organizations identify and manage massive amounts of data with the BBC, the FT, Euromoney, Astra Zeneca, etc., as paying customers.

19% CAGR over the last five years. 47% of overall group sales come outside Bulgaria, with the US main export market (24% of revenues) followed by the UK and Germany. 70% of Ontotext's standalone sales are in the UK and US.

Sirma IPO-ed in Sofia in mid-October 2015 raising BGN 11.5m to fund US expansion and international outreach, new sales and marketing as well new product development.

FUNDAMENTAL STORY

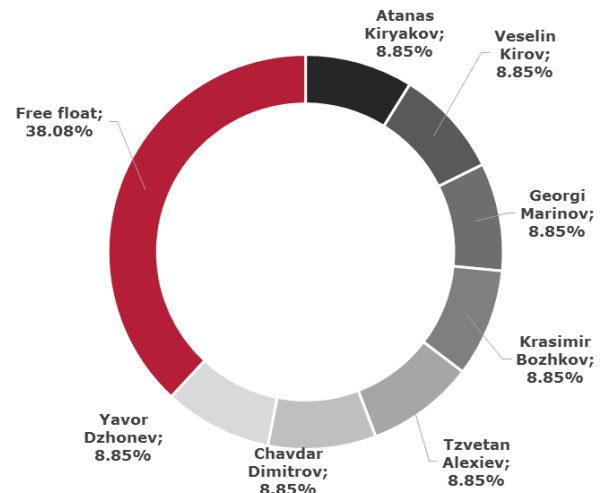
A well-diversified IT group tapping on numerous fast growing areas from software engineering to e-government. Works well both with private and public entities with a customer list including Oracle, Microsoft, IBM, HP, US Government; Canada Government, the BBC, the FT, National Gallery of Art (Washington); Allianz, AstraZeneca, Bloomberg, QVI, etc.

Incubates high-growth disruptive tech ideas which attract additional venture capital.

STRENGTHS & OPPORTUNITIES

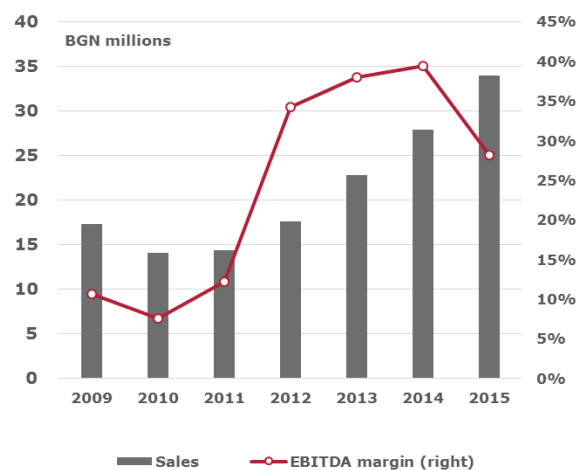
- Well diversified IT company
- Operates in a fastest growing industry in the country
- Good balance between local and international clients

SHAREHOLDERS' STRUCTURE



Source: Company data

TOP & BOTTOM LINE GROWING HAND IN HAND



Source: Company data

WEAKNESSES & THREATS

- Increased IT specialist demand puts upward pressure on employee remuneration and retention

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SELL	Target price is more than 10% below the current quotes

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Q4 2015 Recommendation Review			Market Maker Services
Recommendation	#	Share	
BUY	9	47%	SKK BU
HOLD	7	37%	
SELL	0	0%	
Under review	3	16%	

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