

SIRMA GROUP HOLDING
INDUSTRY: IT
FOCUSED ON INVESTMENTS

LEADING BULGARIAN IT DEVELOPER SIRMA GROUP HOLDING DELIVERED RESULTS IN LINE WITH MANAGEMENT ESTIMATES ONCE AGAIN. IN H1'16, THE GROUP'S TOP LINE EXPANDED 10.5% Y/Y WITH US MARKET KEY GROWTH DRIVER AS INVESTMENTS IN SALES AND MARKETING CAPACITY EXPANSION STARTED TO PAY OFF. YET THE BOTTOM LINE TURNED NEGATIVE WHICH SHOULD BE TEMPORARY AS TOP LINE GROWTH SPEEDS UP IN H2'16

TOP LINE IN LINE WITH ESTIMATES

Sirma Group Holding delivered 10.5% y/y rise in consolidated revenues in H1'16 to BGN 16.2m. Top line expansion decelerated in Q2'16 to 4.2% y/y on less public services projects. Management expects pace to accelerate in Q3'16 and Q4'16, thus it kept its initial estimates. Key growth driver were software developer and system integrator Sirma Solutions together with Sirma ITT (new name Sirma Enterprise Solutions, Sirma ES) and EngView Systems. Ontotext stabilized top line performance with US sales expanding above expectations.

BOTTOM LINE AFFECTED BY INVESTMENTS

New sales and marketing workforce expansion and higher depreciation on new products, however, dragged the bottom line to a loss. The latter came at negative BGN 194k in H1'16 vs. BGN 193k net profit in H1'15. The Group labor costs rose 10% y/y to BGN 8.9m with 15% to 20% expansion expected in 2016. The latter is in line with our estimate. Depreciation surprised with 85% y/y rise to BGN 3.97m on Loyax and Sirma ES products entering exploitation.

US EXPANSION EFFORTS SHOWING RESULTS

After raising BGN 11m in an IPO in Sofia last year to fund sales scale up mainly in the US, Sirma Group Holding's efforts start to deliver results. Sales in North America, mostly US, expand 48% y/y to BGN 4.5m or 28% of total group revenues vs. 18% a year earlier. Key contributors were Sirma Solutions, Ontotext and Sirma ES, all of which add considerable new business across on the market.

FOCUS ON CROSS SELLING IN KEY VERTICALS

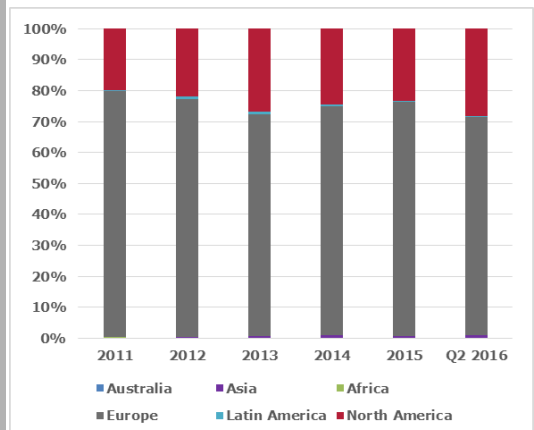
The Company also announced further sales and marketing capacity enhancement via focused marketing in six key verticals – fin tech, manufacturing, cultural heritage & media, health care, public sector and cross industry. It is also adding salesforce solutions to improve sales effectiveness and increase cross selling among own products, which should bring positives in the mid and long-term.

VALUATION/RISKS

VALUATION: The Company delivered top line expectations with the exception of Ontotext. The bottom line and the stock's liquidity over the past year, however, turned out below expectations. We also raise our cost of equity due to higher global risk premiums. Thus, we arrive at a lower one year target price of BGN 1.38 per share, which includes a 10% liquidity discount to fundamental value. We keep our BUY recommendation though as considerable upside exists to current market quotes. **RISKS:** We consider slower economic growth, significant competition and potential slower international scaling pace as key risks for the Group.

RESULTS ANALYSIS
BUY
ONE YEAR PRICE TARGET: BGN 1.38
CURRENT PRICE: BGN 1.05
PREVIOUS PRICE TARGET: BGN 1.78
EXCHANGE RATES
EUR/BGN (FIXED): 1.95583
USD/BGN: 1.75238
MARKET DATA

Shares Outstanding:	59.36m
Share Capital:	BGN 59.36m
Free-float:	38%
Treasury Shares	0%
Market Cap.:	BGN 67 m
Avg. Daily Vol.:	BGN 5,000
52 Weeks Range:	BGN 1.025 – 1.272
BSE Ticker	SKK
Bloomberg Ticker	SKK BU

NORTH AMERICAN SALES IN ADVANCE


Source: Company data

In kBGN, excl. ratios	Q3 2014	Q4 2014	Q1 2015	Q2 2015	Q3 2015	Q4 2015	Q1 2016	Q2 2016
Revenues	6 286	8 277	7 044	7 548	7 290	12 095	8 265	7 862
<i>Growth y/y</i>	n/a	n/a	<i>29.41%</i>	<i>-3.97%</i>	<i>15.97%</i>	<i>46.13%</i>	<i>17.33%</i>	<i>4.16%</i>
EBITDA	2 919	4 758	1 517	1 545	4 666	1 936	2 548	1 805
EBIT	1 550	2 876	404	514	1 698	232	562	-182
Net profit	7 297	3 859	182	193	1 290	-39	217	-411
Equity	58 884	64 009	67 289	67 809	64 656	74 776	74 572	71 563
ROE (ttm)	n/a	n/a	22.08%	17.22%	8.56%	2.40%	2.38%	1.50%
ROA (ttm)	n/a	14.75%	15.13%	11.74%	5.70%	1.60%	1.58%	0.99%
EBITDA	46.4%	57.5%	21.5%	20.5%	64.0%	16.0%	30.8%	23.0%
Net profit	116.08%	46.62%	2.58%	2.56%	17.70%	-0.32%	2.63%	-5.23%
EPS	0.15	0.08	0.00	0.00	0.03	0.00	0.00	-0.01
Debt/equity	5.95%	7.47%	6.18%	7.67%	9.00%	2.89%	2.42%	2.78%
P/E	n/a	n/a	n/a	n/a	n/a	36.64	34.74	48.73
P/S	n/a	n/a	n/a	n/a	n/a	2.10	1.92	1.79
EV/EBITDA	n/a	n/a	n/a	n/a	n/a	6.90	6.32	5.80

SIRMA GROUP HOLDING'S CONSOLIDATED RESULTS REVIEW

After posting a strong start of the year with 17% y/y rise of the top line in Q1 2016, Sirma Group Holding's revenue expansion expectedly decelerated in Q2 to only 4.2% y/y.

H1 2016 key top line development: Overall, H1'16 revenues added 10.5% y/y to BGN 16.2m on stronger US sales for Sirma Solutions, Ontotext and Sirma ITT (renamed to Sirma Enterprise Solutions, Sirma ES). All three gained new software development and product sales deals. Sirma Solutions worked on new cyber security projects in the US, while Ontotext tap on new media leads and contracts, according to management guidance. Sirma ES stroke a new project following the completion of the Conservation Space initiative, this time for curators.

On a webinar for investors in September, Sirma's management reiterated once again it will deliver FY2016 targets with revenues rising 20% y/y to BGN 40m. It expects growth to accelerate in Q3 and Q4 as public sector projects also add to the top line. The latter underperformed during the first half of the year.

Bottom line development: Cost growth expectedly accelerated over the period. Labor expenses are up 10% y/y to BGN 8.9m while depreciation expanded, above expectations, 85% y/y on new products like loyalty platform Loyax and Sirma ES develop-

ments coming into exploitation.

Labor costs expectedly rose as the Company is currently expanding its sales and marketing as well as project management team in the US. The Company invested in a new office in New York to coordinate cross selling and synergies among the Group's subsidiaries. The workforce shall expand by 15% to 20% in 2016, with major (50% to 60%) increase in the sales and marketing, according to management guidance.

This led to a consolidated loss in Q2'16 as well as in H1'16. However, we see it as a temporary event as investments in top line expansion start to deliver results.

Valuation revision: The latter results together with our revision on key market factors as equity risk premium make us revise our Sirma Group Holding's valuation.

On the one hand, we revise slightly downward our Ontotext and Sirma Business Consulting expectations.

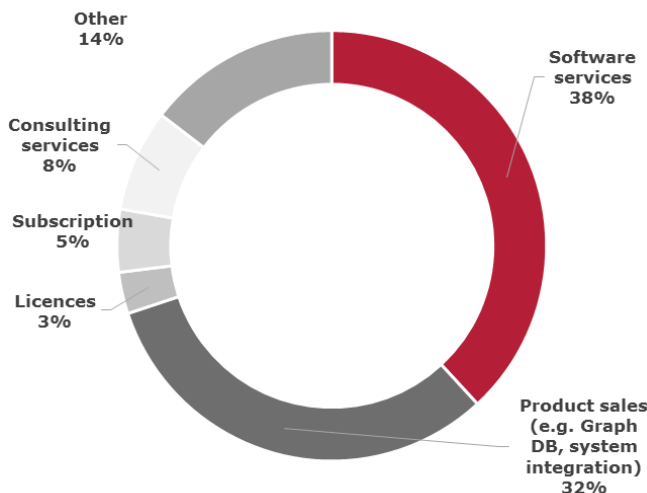
On the other, we raise our cost of equity. Finally, we add a liquidity discount to our new fair value as market performance of the stock is below our expectations.

Exhibit 3: Top line growth fairly stable with some exceptions



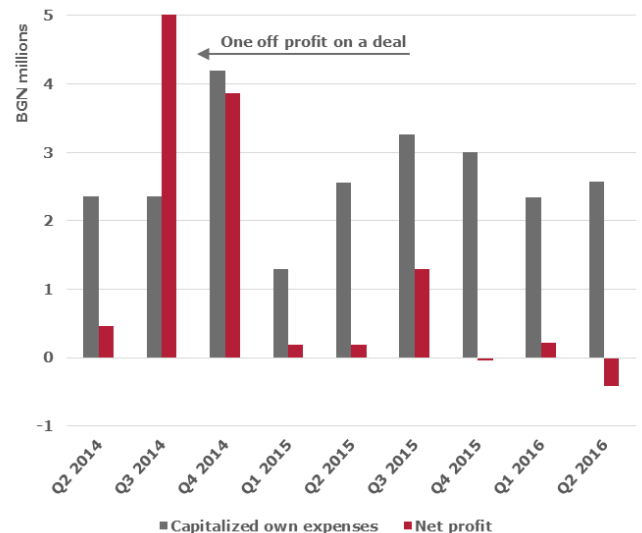
Source: Company data

Exhibit 5: Software and product sales evening out in the revenue mix



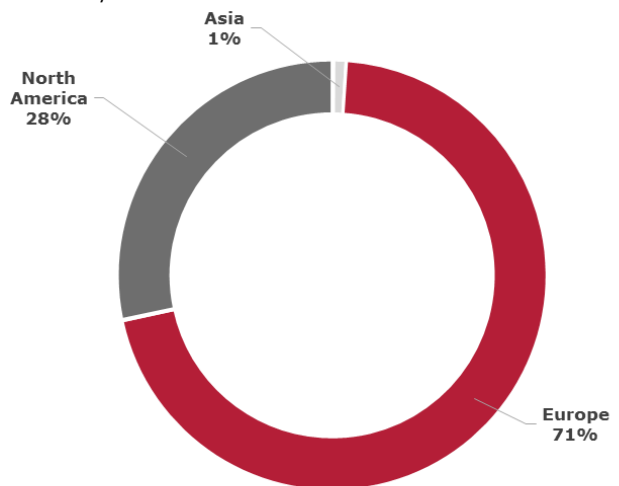
Source: Company data

Exhibit 4: ...while the bottom line is yet to stabilize



Source: Company data

Exhibit 6: US market growth key driver in H1 2016 coming close to 1/3 of sales.



Source: Company data

VALUATION UPDATE

SIRMA SOLUTIONS SUM OF THE PARTS VALUATION

Company	Stake	Fair Value, old (^{'000} BGN)	Fair Value, new (^{'000} BGN)	Value estimated, old (^{'000} BGN)	Value estimated, new (^{'000} BGN)	Valuation method
Sirma Solutions (Individual)	100.00%	39 082	41 093	39 082	41 093	FCFE
Sirma Business Consulting	55.23%	20 566	13 902	11 359	7 678	FCFE
Daticum	60.50%	13 334	13 024	8 067	7 879	FCFE
SIRMA SOLUTIONS CONSOLIDATED				58 507	56 650	

SIRMA GROUP HOLDING VALUATION

Sirma Solutions Consolidated	81.05%	58 507	56 650	47 420	45 915	FCFE
EngView Systems	72.90%	15 835	15 045	11 544	10 968	FCFE
Ontotext	56.21%	39 166	26 322	22 015	14 796	FCFE
Sirma ITT	90.00%	27 143	21 699	24 428	19 529	FCFE
Sirma Group Holding (^{'000} BGN)				105 407	91 207	
Liquidity discount				0%	10%	
Number of shares outstanding				59 360 518	59 360 518	
VALUE PER SHARE (BGN)				1.78	1.38	

COST OF EQUITY

Cost of Equity Estimation

		Old Estimate	New Estimate
A Risk-free rate	10-year Bulgarian government bond yield	2.50%	2.50%
B Beta	NYU Sterns research estimate for Software development industry	1.06	1.06
C Market risk premium	Developed market risk premium (USA, Germany, etc.)	5.75%	6.75%
D Growth company risk premium	0-3%	2.00%	2.00%
E Cost of equity	E=A+B*C+D	10.6%	11.7%

SENSITIVITY ANALYSIS

MANAGEMENT FORECASTS DISCOUNT

	70%	80%	90%	100%	110%	120%	130%
DISCOUNT RATE							
9.70%	1.48	1.60	1.72	1.84	1.97	2.11	2.26
10.70%	1.27	1.37	1.47	1.58	1.70	1.82	1.94
11.70%	1.12	1.20	1.29	1.38	1.48	1.59	1.70
12.70%	0.99	1.06	1.14	1.23	1.31	1.40	1.50
13.70%	0.89	0.95	1.02	1.10	1.18	1.26	1.34

FINANCIAL DATA

INCOME STATEMENT ('000 BGN)	2013A	2014A	2015A	H1 2015	H1 2016	TTM	2016F	2017F
Revenues	22 768	27 866	33 972	14 592	16 127	35 512	40 910	50 751
Materials	-610	-481	-2 376	-190	-593	-3 570	-818	-1 015
External services	-4 449	-3 866	-6 910	-2 067	-2 072	-6 915	-4 091	-5 075
Salaries & wages	-11 805	-14 890	-16 368	-8 139	-8 942	-17 172	-22 910	-26 390
Value of stock and assets sold	-2 276	-5 073	-8 416	-4 859	-4 598	-7 214	-8 182	-10 150
Changes in inventories	1 144	-995	498	364	68	203	409	508
Capitalized own expenses	4 701	9 587	10 099	3 839	4 906	11 166	5 727	7 105
Other expenses	-829	-1 147	-933	-478	-543	-1 055	-1 632	-1 624
Total expenses	-14 124	-16 865	-24 406	-11 530	-11 774	-24 557	-31 497	-36 642
EBITDA	8 644	11 001	9 566	3 062	4 353	10 955	9 413	14 109
<i>EBITDA margin</i>	<i>37.97%</i>	<i>39.48%</i>	<i>28.16%</i>	<i>20.98%</i>	<i>26.99%</i>	<i>30.85%</i>	<i>23.01%</i>	<i>27.80%</i>
Amortization	-5 285	-5 809	-6 826	-2 144	-3 973	-8 645	-6 306	-6 755
EBIT	3 359	5 192	2 740	918	380	2 310	3 108	7 354
<i>EBIT margin</i>	<i>14.75%</i>	<i>18.63%</i>	<i>8.07%</i>	<i>6.29%</i>	<i>2.36%</i>	<i>6.50%</i>	<i>7.60%</i>	<i>14.49%</i>
Financial income/expense	-431	5 494	-274	-116	-90	-248	-286	-355
Financial expense	-2 124	-427	-693	-237	-247	-703	-614	-761
Financial income	1 693	206	419	121	157	455	327	406
Other financial positions		5 715						
Part of the profit of the associated companies	263							
EBT	3 191	10 686	2 466	802	290	2 062	2 821	6 999
Taxes	-242	-907	-297			-562	-282	-700
Net Profit	2 949	9 779	2 169	802	290	1 500	2 539	6 299
<i>Less Minority Interest</i>	368	2 596	603	427	484	150	675	1 675
Net Profit (non-normalized)	2 581	7 183	1 566	375	-194	1 350	1 864	4 624
<i>Net profit margin</i>	<i>11.34%</i>	<i>25.78%</i>	<i>4.61%</i>	<i>2.57%</i>	<i>-1.20%</i>	<i>3.80%</i>	<i>4.56%</i>	<i>9.11%</i>

Source: Company IFRS Financial Statements; Elana Trading Estimates

BALANCE SHEET ('000 BGN)	2013A	2014A	2015A	H1 2015	H1 2016	TTM	2016F	2017F
Intangible assets	31 692	30 023	36 800	32 077	33 164	33 164	39 274	38 578
Real estate, machinery and equipment	3 198	4 801	3 588	3 567	3 582	3 582	3 273	4 060
Investments in daughter companies	0	7	40	7	106	106	0	0
Investments in associated companies	8 263	429	301	376	261	261	0	0
Long-term financial assets	0	442	0		0	0	0	0
Deferred taxes	214	27	188	85	200	200	0	0
Capitalized own expenses (products in development)	27 031	11 527	14 984	15 096	19 489	19 489	20 455	20 300
Goodwill	13 744	19 398	19 489	19 398	19 540	19 540	19 637	20 300
Total long-term assets	84 142	66 654	75 390	70 606	76 342	76 342	82 638	83 239
Inventories	1 143	463	892	1 172	1 014	1 014	1 636	2 030
Trade receivables	4 430	7 377	7 144	6 283	8 592	8 592	12 273	15 225
Receivables from connected companies	0	1 060	1 649	657	2 729	2 729	614	761
Tax receivables	0	44	167	103	65	65	0	0
Other receivables and prepaid expenses	321	288	669	4 445	653	653	818	1 015
Cash and cash equivalents	2 460	3 003	11 176	2 876	6 870	6 870	3 580	5 583
Total short-term assets	8 354	12 235	21 697	15 536	19 923	19 923	18 921	24 614
Assets held for sales	0	15 265	15 188	15 265	15 188	15 188	13 930	11 165
Total assets	92 496	94 154	112 275	101 407	111 453	111 453	115 490	119 018
						0		
Share capital	73 341	49 837	59 361	49 837	59 361	59 361	59 361	59 361
Unpaid capital & other		-25				0	0	0
Reserves	2 940	2 222	7 146	5 617	7 181	7 181	9 000	10 150
Retained earnings (accumulated loss)	-1 048	2 197	6 100	11 554	4 731	4 731	13 091	13 703
Current profit/loss	2 950	9 778	2 169	801	290	290	4 091	5 075
Non-controlling stakes	8 150	18 320	23 228	18 815	23 543	23 543	19 637	19 793
Total equity	86 333	82 329	98 004	86 624	95 106	95 106	105 180	108 082
Provisions	63	86	141	188	140	140	327	406
Liabilities to financial institutions	595	860	510	811	507	507	614	811
Financial leasing	34	97	278	94	290	290	450	558
Trade and other liabilities	279	867	1 139	867	1 321	1 321	818	1 015
incl. Other liabilities	0	0	8		190	190	0	0
incl. Deferred taxes	135	867	1 131	867	1 131	1 131	0	0
Financing	137	0	89		0	0	0	0
Total long-term liabilities	1 243	1 910	2 157	1 960	2 258	2 258	2 209	2 790
Short-term part of the long-term liabilities	0	0	1 588	4 391	1 482	1 482	1 145	1 472
Pension and other liabilities to the personnel		929	1 043	1 923	1 694	1 694	1 105	1 421
Provisions	732	728	708	590	505	505	327	355
Liabilities to financial institutions	2 107	3 920	66			0	0	0
Liabilities to related companies	0	185	54			0	205	254
Financial leasing	0	26		14	85	85	0	0
Trade and other liabilities	2 081	4 127	8 655	5 905	10 323	10 323	5 318	7 613
Total short-term liabilities	4 920	9 915	12 114	12 823	14 089	14 089	8 100	11 114
Total liabilities	6 163	11 825	14 271	14 783	16 347	16 347	10 309	13 905
Total Equity & Liabilities	92 496	94 154	112 275	101 407	111 453	111 453	115 490	121 987

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

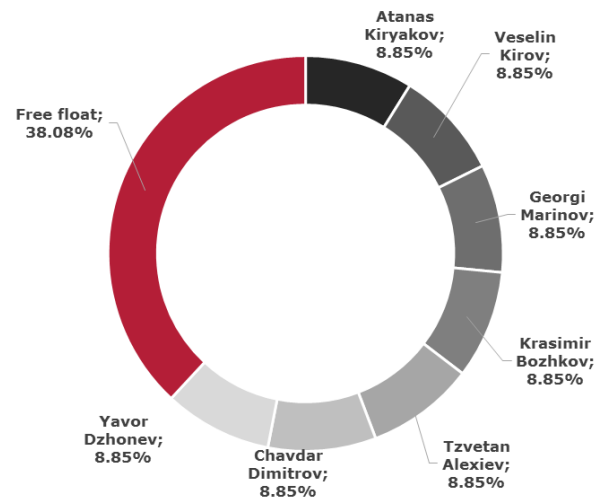
A well-diversified IT group tapping on numerous fast growing areas from software engineering to e-government. Works well both with private and public entities with a customer list including Oracle, Microsoft, IBM, HP, US Government; Canada Government, the BBC, the FT, National Gallery of Art (Washington);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

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

STRENGTHS & OPPORTUNITIES

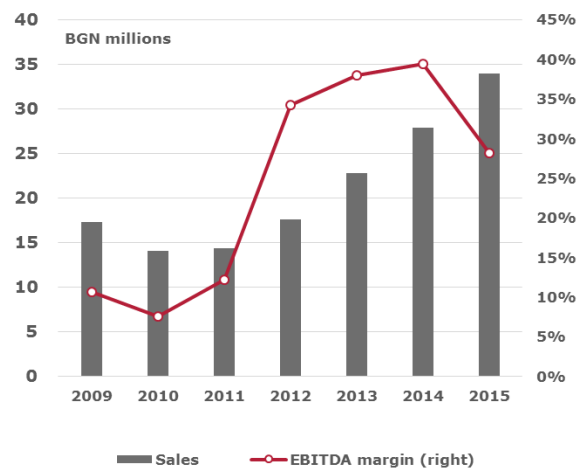
- Well diversified IT company
- Operates in a fastest growing industry in the country
- Good balance between local and international clients

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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Q2 2016 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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