

SIRMA GROUP HOLDING
INDUSTRY: IT
STEPPING UP SALES, R&D AND STREAMLINING

SIRMA GROUP HOLDING MISSED FY2016 GUIDANCE BUT OUTPERFORMED OUR EXPECTATION ON TOP AND BOTTOM LINE AS US AND DOMESTIC SALES ADVANCED WELL. MULTI-INDUSTRY SOLUTIONS, SYNERGIES AND A MAJOR STREAMLINING OF OPERATIONS TO BOOST LONG TERM PERFORMANCE

SALES GROWTH SUSTAINED ABOVE 20% Y/Y

Growth accelerated in H2'16 allowing Sirma Group Holding to sustain sales performance above 20% y/y. Top line expanded 22% y/y to BGN 41.5m, slightly below management guidance but above our expectations, as US sales advanced well together with strong domestic performance. Q3'16 was best in history followed by a strong Q4. Bottom line outperformed our expectations but missed guidance on higher depreciation.

SOFTWARE DEVELOPMENT AND SYSTEM INTEGRATION TOP PERFORMERS IN 2016

The Group's key software developing and integration arm- Sirma Solutions, was a top performer contributing most to both top and bottom line improvement. Semantic arm – Ontotext, stabilized performance while financial, data storage and measurement solutions also delivered satisfactory results. Software development in cyber security and cross industry solutions as well as system integration top performing verticals.

HEAVY R&D IN CLOUD & COGNITIVE SOLUTIONS

Amid sales expansion with a new sales office in the US, the Group continued heavy R&D in cloud and cognitive tech solutions. The Company already beta tests a new video image recognition product in the US as announced at the IPO. It also upgraded its data storage capabilities to faster Flash storage thus arming itself for the cloud opportunities on the market. The latter two expected to be corner stone in future tech solution focus of the Company building on its semantic data mining and software development expertise.

SIGNIFICANT STREAMLINING AHEAD

Sirma plans a major Group streamlining to boost synergies and offer more multi-industry solutions. Cloud, data and cognitive tech solutions to be in the heart of the Group's enterprise solutions. Multi-industry solutions already 1/3 of sales.

CONSIDERABLE VALUE POTENTIAL WITH A DIVIDEND SWEETENER

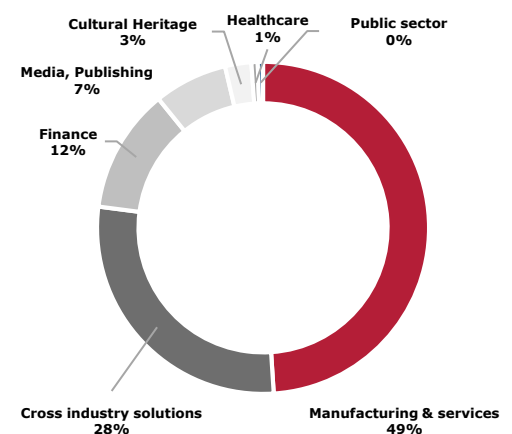
Post IPO stock performance disappointed due to slower than initial estimates sales expansion. However, it leaves the stock with a major upside potential yet to be catalyzed as the Group works on streamlining and sales boost. Potential upcoming small dividend payout of 20% to 40% of unconsolidated profits as a sweetener.

VALUATION/RISKS

VALUATION: The Company delivered top line expectations. All subsidiaries performed outperformed or were in line with estimates with the exception of Ontotext. The Group's bottom line yet to strengthen and prove resilient. Thus, we keep our recommendation and price target unchanged. **RISKS:** Slower international scaling and monetization of tech solutions key risk for the Company' Ontotext minority investor uncertainty.

RESULTS ANALYSIS
BUY
ONE YEAR PRICE TARGET: BGN 1.38
CURRENT PRICE: BGN 1.11
EXCHANGE RATES
EUR/BGN (FIXED): 1.95583
USD/BGN: 1.75238
MARKET DATA

Shares Outstanding:	59.36m
Share Capital:	BGN 59.36m
Free-float:	41%
Treasury Shares	0.44%
Market Cap.:	BGN 66 m
Avg. Daily Vol.:	BGN 7,000
52 Weeks Range:	BGN 0.86 – 1.20
BSE Ticker	SKK
Bloomberg Ticker	SKK BU

SERVICES AND CROSS INDUSTRY SOLUTIONS
KEY VERTICALS


Source: Company data

In kBGN, excl. ratios	Q1 2015	Q2 2015	Q3 2015	Q4 2015	Q1 2016	Q2 2016	Q3 2016	Q4 2016
Revenues	7 044	7 548	7 290	12 095	8 265	7 862	11 543	13 917
<i>Growth y/y</i>	<i>29.41%</i>	<i>-3.97%</i>	<i>15.97%</i>	<i>46.13%</i>	<i>17.33%</i>	<i>4.16%</i>	<i>58.34%</i>	<i>15.06%</i>
EBITDA	1 517	1 545	4 666	1 936	2 548	1 805	4 145	4 188
EBIT	404	514	1 698	232	562	-182	2 249	1 818
Net profit	182	193	1 290	-39	217	-411	1 624	928
Equity	67 289	67 809	64 656	74 776	74 572	71 563	74 154	79 937
ROE (TTM)	22.08%	17.22%	8.56%	2.40%	2.38%	1.50%	1.93%	3.14%
ROA (TTM)	15.13%	11.74%	5.70%	1.60%	1.58%	0.99%	1.31%	2.15%
EBITDA margin	21.5%	20.5%	64.0%	16.0%	30.8%	23.0%	35.9%	30.1%
Net profit margin	2.58%	2.56%	17.70%	-0.32%	2.63%	-5.23%	14.07%	6.67%
EPS	0.00	0.00	0.03	0.00	0.00	-0.01	0.03	0.02
Debt/equity	6.18%	7.67%	9.00%	2.89%	2.42%	2.78%	2.66%	4.39%
P/E	n/a	n/a	n/a	36.64	34.74	48.73	44.81	27.69
P/S	n/a	n/a	n/a	2.10	1.92	1.79	1.57	1.57
EV/EBITDA	n/a	n/a	n/a	6.90	6.32	5.80	5.97	5.15

SIRMA GROUP HOLDING'S CONSOLIDATED RESULTS REVIEW

Sirma Group Holding closed on one full year as a public company in 2016 after IPO-ing in Sofia in Oct 2015. The Company outperformed our expectations but missed revised management guidance on top and bottom line. Nevertheless, as management guided performance accelerated well in Q3 and Q4.

Key top line development and contributors: Yet, top line expansion, a key goal post IPO, was sustained above 20% y/y. Sales grew 22.4% y/y to BGN 41.6m, which is slightly above our expectations but a bit below management guidance for a 25% y/y growth. US and domestic sales advanced well, UK followed on semantic technology contacts. Bulgaria remains biggest market followed by the US with 18% of overall sales.

Software development and system integration arm Sirma Solutions was key growth contributor. It outperformed guidance considerably with 43% y/y sales expansion to BGN 22.5m and 61.5% y/y standalone net profit surge to BGN 2.2m. Sirma Solutions is the biggest subsidiary of Sirma Group Holding and in 2016 delivered strong results in the US as well as domestically with key cyber security software development solutions as well as continuing system integration contracts.

Sirma Solutions is also key incubator of the Group with major R&D performance. In 2016, it prototyped and is already beta testing a video image recognition solution to be monetized in the retail industry. It also worked on cloud and customer loyalty solutions. Accordingly, higher capitalized expense (up 88% y/y) affected the bottom line.

Smaller subsidiaries of the Group also delivered strong sales expansion and contributed to overall growth. These include the measurement solutions provider EngView Systems, fintech solutions provider Sirma Business Consulting and cognitive enterprise solutions developer Sirma Enterprise Systems. The latter continues to advance well in the heritage industry but is also preparing a Go Digital solutions targeting US SMEs.

Only, the semantic arm solutions Ontotext is yet to accelerate growth despite semantics being a corner stone in most of the Group's products. Ontotext's top line stabilized in 2016, while the bottom line turned positive as the Company initiated partner-

ships with major information providers like the UK Institute of Engineering and Technology (IET).

Bottom line development: EBITDA and Net Income improved considerably despite major advance in labor costs and accelerated depreciation. Consolidated FY2016 EBITDA is up 31% y/y to BGN 12.7m while net income added 45%y/y to BGN 2.4m. The latter result came with 44% y/y rise in capitalized expenses to BGN 14.5m on new product development, 17% y/y rise in labor costs to BGN 19m and 20% y/y rise in depreciation to BGN 8.2m.

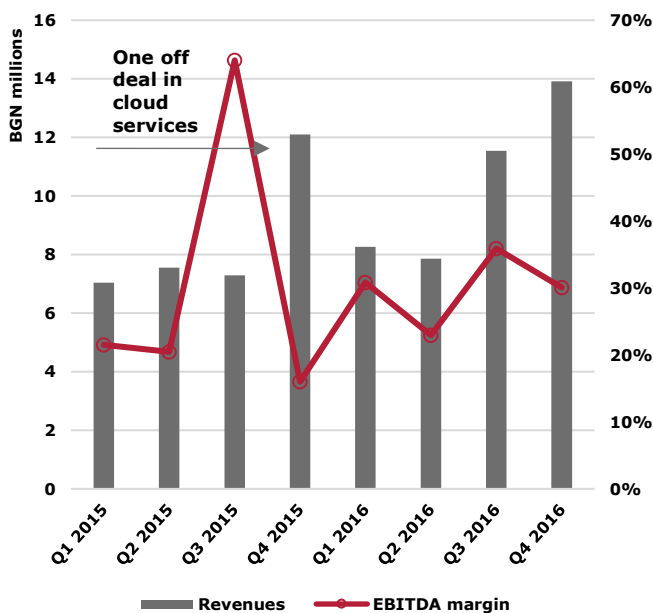
Labor costs, key cost for the Group, increased below our expectations. The Group added 11% to the headcount in 2016 and slightly raised salaries (5% in line in country average). Capitalized expenses surged above our estimates on heavy product development in cloud and image recognition solutions. The latter to be key verticals in Sirma's strategic streamlining of the Group.

Cloud, Data, Cognitive Solutions: To better exploit synergies, accelerate growth and tap on new potential in cross industry solutions, Sirma is planning a major Group streamlining. It plans to lean its structure and streamline the business into three key verticals – Cloud, Data and Cognitive Business Solutions. The latter strategy is yet being discussed with key shareholders.

The Group plans to base its future development in a cognitive core that includes key solutions – GraphDB, semantic databases, computer vision, AI and cognitive data management. It will focus on six key verticals – cross industry solutions, manufacturing and services, fin tech, health care and retail. Currently, cross industry solutions represent c30%% of the operations.

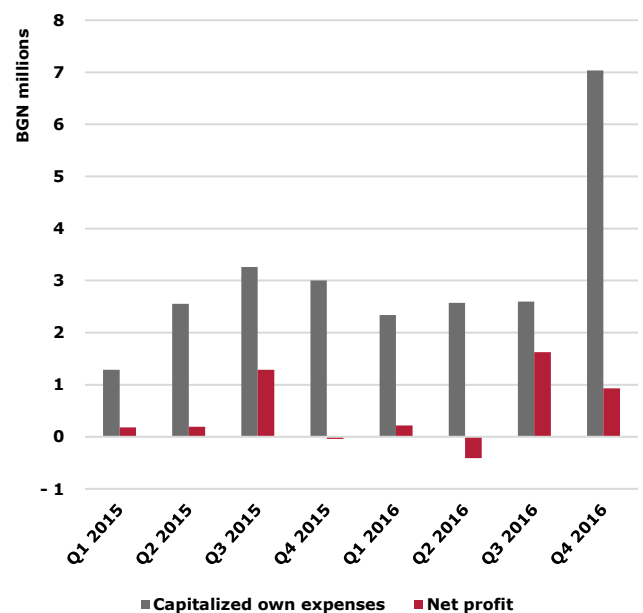
The latter streamlining when approved may be followed by additional funding needs. No concrete details on a potential SPO. Yet, the Company is open for a small dividend distribution, in line with IPO guidance (20%-40% payout of unconsolidated profits).

Exhibit 3: Top line growth stable



Source: Company data

Exhibit 4: ...while the bottom line distorted by capitalized R&D



Source: Company data

FINANCIAL DATA

INCOME STATEMENT ('000 BGN)	2013A	2014A	2015A	2016A	2017F	2018F
Revenues	22 768	27 866	33 977	41 587	51 984	61 341
Materials	-610	-481	-3 167	-4 821	-4 159	-4 907
External services	-4 449	-3 866	-6 910	-8 609	-7 798	-9 201
Salaries & wages	-11 805	-14 890	-16 369	-19 101	-24 432	-28 217
Value of stock and assets sold	-2 276	-5 073	-7 475	-9 766	-9 357	-11 041
Changes in inventories	1 144	-995	499	102	520	613
Capitalized own expenses	4 701	9 587	10 099	14 542	7 798	7 974
Other expenses	-829	-1 147	-990	-1 248	-1 663	-2 576
Total expenses	-14 124	-16 865	-24 313	-28 901	-39 092	-47 355
EBITDA	8 644	11 001	9 664	12 686	12 892	13 986
<i>EBITDA margin</i>	<i>37.97%</i>	<i>39.48%</i>	<i>28.44%</i>	<i>30.50%</i>	<i>24.80%</i>	<i>22.80%</i>
Amortization	-5 285	-5 809	-6 816	-8 239	-7 278	-7 054
EBIT	3 359	5 192	2 848	4 447	5 614	6 932
<i>EBIT margin</i>	<i>14.75%</i>	<i>18.63%</i>	<i>8.38%</i>	<i>10.69%</i>	<i>10.80%</i>	<i>11.30%</i>
Financial income/expense	-431	5 494	-274	-257	-364	-123
Financial expense	-2 124	-427	-693	-579	-780	-613
Financial income	1 693	206	419	322	416	491
Other financial positions		5 715	0		0	0
Part of the profit of the associated companies	263				0	0
EBT	3 191	10 686	2 574	4 190	5 250	6 809
Taxes	-242	-907	-359	-514	-525	-681
Net Profit	2 949	9 779	2 215	3 676	4 725	6 128
<i>Minority Interest</i>	368	2 596	589	1 318	1 694	2 197
Net Profit (non-normalized)	2 581	7 183	1 626	2 358	3 031	3 931
<i>Net profit margin</i>	<i>11.34%</i>	<i>25.78%</i>	<i>4.79%</i>	<i>5.67%</i>	<i>5.83%</i>	<i>6.41%</i>

Source: Company IFRS Financial Statements; Elana Trading Estimates

BALANCE SHEET ('000 BGN)	2013A	2014A	2015A	2016A	2017F	2018F
Intangible assets	31 692	30 023	36 800	47 565	48 085	49 005
Real estate, machinery and equipment	3 198	4 801	3 588	3 409	3 119	3 680
Investments in daughter companies	0	7	40	7	52	52
Investments in associated companies	8 263	429	301	295	364	364
Long-term financial assets	0	442	0		0	0
Deferred taxes	214	27	188	215	208	208
Capitalized own expenses (products in development)	27 031	11 527	14 984	18 436	19 540	20 242
Goodwill	13 744	19 398	19 489	19 540	19 234	19 261
Total long-term assets	84 142	66 654	75 390	89 467	90 602	92 813
Inventories	1 143	463	892	761	780	920
Trade receivables	4 430	7 377	7 144	6 510	7 798	9 201
Receivables from connected companies	0	1 060	1 649	2 314	780	920
Tax receivables	0	44	167	380	0	0
Other receivables and prepaid expenses	321	288	669	1 150	624	736
Cash and cash equivalents	2 460	3 003	11 176	6 075	6 440	7 361
Total short-term assets	8 354	12 235	21 697	17 190	16 421	19 138
Assets held for sales	0	15 265	15 188	11 843	11 436	11 655
Total assets	92 496	94 154	112 275	118 500	118 459	123 606
Share capital	73 341	49 837	59 361	59 361	59 361	59 361
Treasury stock					262	262
Unpaid capital & other		-25			0	0
Reserves	2 940	2 222	7 146	8 202	10 397	12 268
Retained earnings (accumulated loss)	-1 048	2 197	6 100	8 698	8 317	8 588
Current profit/loss	2 950	9 778	2 169	3 676	3 031	3 931
Non-controlling stakes	8 150	18 320	23 228	23 650	23 913	24 536
Total equity	86 333	82 329	98 004	103 587	105 281	108 946
Provisions	63	86	141	197	260	307
Liabilities to financial institutions	595	860	510	437	572	552
Financial leasing	34	97	278	285	546	552
Trade and other liabilities	279	867	1 139	1 417	1 040	1 227
incl. Other liabilities	0	0	8		0	0
incl. Deferred taxes	135	867	1 131	1 122	0	0
Financing	137	0	89	295	364	429
Total long-term liabilities	1 243	1 910	2 157	2 336	2 781	3 067
Short-term part of the long-term liabilities	0	0	1 588	3 072	2 079	1 779
Pension and other liabilities to the personnel		929	1 043	1 732	1 456	1 718
Provisions	732	728	708	711	364	429
Liabilities to financial institutions	2 107	3 920	66		0	0
Liabilities to related companies	0	185	54	117	260	307
Financial leasing	0	26		41	0	0
Trade and other liabilities	2 081	4 127	8 655	6 904	6 238	7 361
Total short-term liabilities	4 920	9 915	12 114	12 577	10 397	11 593
Total liabilities	6 163	11 825	14 271	14 913	13 178	14 660
Total Equity & Liabilities	92 496	94 154	112 275	118 500	118 459	123 606

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

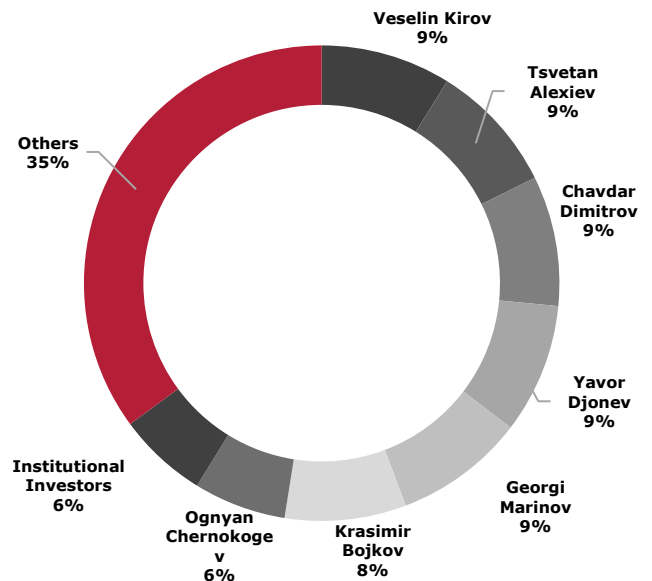
A well-diversified IT group tapping on numerous fast growing areas from software engineering to e-government. Works well both with private and public entities with a customer list including Oracle, Microsoft, IBM, HP, US Government; Canada Government, the BBC, the FT, National Gallery of Art (Washington);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

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

STRENGTHS & OPPORTUNITIES

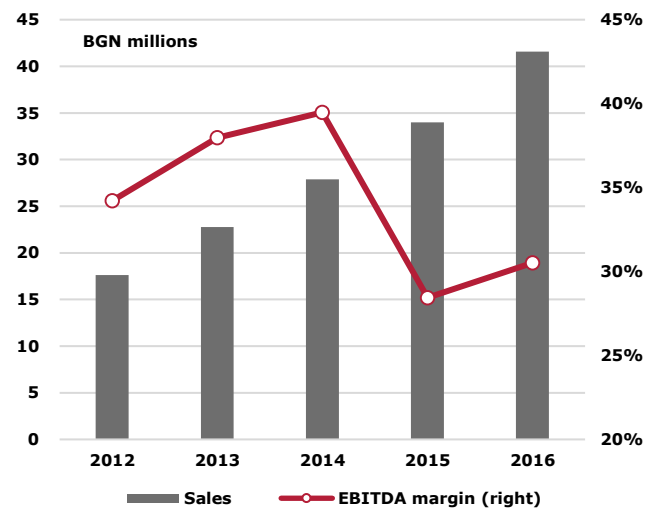
- Well diversified IT company
- Operates in a fastest growing industry in the country
- Good balance between local and international clients

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 2016 Recommendation Review			Market Maker Services
Recommendation	#	Share	
BUY	7	37%	SKK BU
HOLD	9	47%	
SELL	0	0%	
Under review	3	16%	

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