This analysis was prepared by mBank at the request of the WSE as part of the Exchange's Analytical Coverage Support Programme

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Wednesday, 3 March 2022 | update

Sygnity: buy (reiterated)

SGN PW; SGN.WA | IT, Poland

Decent Q1 but FY Growth Unlikely in FY2021/22

Shares in Sygnity have retreated nearly 13% over the last five months as investors most likely lost confidence in the Company's ability to grow revenues.

In calendar fourth quarter of Q4 2021, which represented the first quarter of fiscal FY2021/2022 for Sygnity, the stock registered a rebound despite of a lack of immediately noticeable improvement in the quarterly results.

Stunting revenue growth in the period was a one-time contract provision that, presumably, once stripped would reveal a year-on-year rebound in both the quarterly core gross profit and the adjusted EBITDA.

When it comes to future sales prospects, Sygnity has an order pipeline for 2022 worth PLN 187m, 5% less than this time last year. Given that it is planning to hire more employees in coming months, to us this suggests unlikely growth in FY2021/22 earnings.

After updating our models for Sygnity, including by cutting the FY2022/23 EBITDA forecast by 6%, we lower our target price from PLN 11.70 to PLN 10.70. The new target indicates 20% upside potential from the current level, and so we maintain a buy recommendation for the Software Developer.

SGN is currently trading at 5.9x EV/EBITDA'22 and 8.9x P/E'22, and after completing a difficult restructuring and refinancing push the Company reports relatively low debt ratios.

Finally, an ongoing review of strategic options can prove an attractive opportunity for potential investors.

A Good First Quarter

The three months ended 31 December 2021 (Q1'21/22) marked the first quarter in a long time of Sygnity experiencing revenue growth, with the topline figure showing a year-on-year increase of nearly 4% at PLN 54.4m.

The gross margin decreased by 3.5pp y/y to 28.6% due to a one-time contract charge. That same charge also put a dent in EBITDA of roughly PLN 2m, and when stripped EBITDA would show a small increase from Q1 2020/21 – a major step forward from the previous year, when annual recurring EBITDA fell 12%.

Reviewing Strategic Options

A year ago, Sygnity announced it was beginning a review of strategic options. The Company has not given updates since then on how the review process is going, but in our opinion a strategic reassessment offers an opportunity.

After a successful restructuring, Sygnity has fairly low debt levels, generates stable cash flow, and trades at low ratios. As such, it represents an opportunity for a strategic investor with a vision on how to harness the Company's resources and maximize sales.

(PLN m)	19/20	20/21	21/22E	22/23E	23/24E
revenue	230.0	204.1	212.1	218.4	225.1
EBITDA	53.0	61.0	43.8	42.7	42.6
EBITDA margin	23.1%	29.9%	20.7%	19.6%	18.9%
EBIT	36.9	49.2	31.7	30.3	29.9
net profit	29.2	46.6	23.4	22.7	22.1
P/E	7.2	4.5	8.9	9.2	9.5
P/CE	4.6	3.6	5.9	6.0	6.0
P/B	2.2	1.5	1.3	1.1	1.0
EV/EBITDA	5.0	4.0	5.1	4.8	4.4
DPS	0.00	0.00	0.00	0.00	0.00
DYield	0.00%	0.00%	0.00%	0.00%	0.00%

current price	PLN 9.18
target price	PLN 10.70
mCap	PLN 203m
free float	PLN 203m
ADTV (3M)	PLN 0.2m

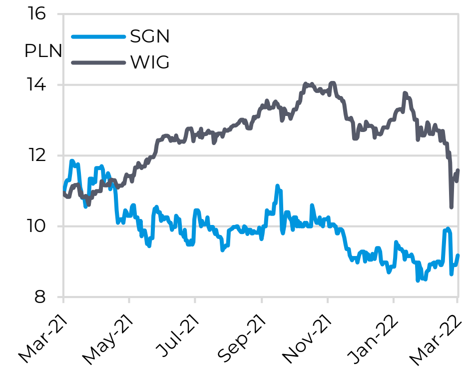
Shareholders

Value FIZ	28.39%
Cron sp. z o.o.	24.20%
NN PTE	11.48%
Others	35.93%

About

Sygnity creates IT solutions and offers advisory services to customers across many different industries. The Company generates approximately PLN 210m in annual sales. Headquartered in Warsaw, Sygnity earns more than 95% its revenues in Poland.

SGN vs. WIG



company	target price		recommendation	
	new	old	new	old
Sygnity	10.70	11.70	buy	buy

company	current price	target price	upside
Sygnity	9.18	10.70	+16.6%

forecast revision	2022E	2023E	2024E
revenue	-0.8%	-1.7%	-2.4%
EBITDA	-3.2%	-6.4%	-7.3%
net profit	-7.9%	-11.1%	-9.2%

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Key Risks

Goodwill Impairment

Sygnity recorded goodwill in the amount of PLN 157.2m as of 31 December 2021, representing more than half of the balance sheet total. A deterioration in the Company's financial standing could lead to impairment of that goodwill which in turn could lead to a violation of debt covenants.

No Dividends

Sygnity's net debt is relatively low, ending FY2021/22 at a IFRS 16 net amount of PLN 16m, equivalent to 0.4x adjusted EBITDA. However, at the same time the Company has a relatively small asset base after several years of curbed capital expenditures. Once it increases investment and expenses on customer acquisition, this could result in negative changes in working capital, leading to curbed medium-term dividend payments despite good cash flow generation.

Supplier Risk

Sygnity serves as a local partner to global technology companies, integrating their solutions into customer systems and providing a range of services from training to maintenance, upgrades, and extensions. If global software providers were to change the terms of their partner policies, for example by limiting the number of local partners or by bringing implementation services in different markets in house, this could have a negative effect on revenues.

Increase in Labor Costs

Payroll accounts for a major part of Sygnity's operating expenses. The average salary offered in the Polish IT industry has been on a steady rise for the last several years, including 2021, when the average pay is estimated to have increased in the high single digits. Sygnity has to offer competitive salaries if it wants to attract top talent and skilled specialists for its teams.

Liquidated Damages

Sygnity is always at risk of claims under liquidated damages- and warranty clauses contained in its many contracts with customers and business partners. As of 31 December 2021 the Company reported having conditional off-balance-sheet obligations under performance and warranty clauses in the amount of PLN 13.8m.

Public Contracts

Sygnity competes in government tenders for IT services which are typically awarded to the lowest bidder. Meanwhile, the biggest contracts usually require the onboarding of subcontractors, which heightens the risk of nonperformance. Another risk are cost overruns on underestimated projects (Sygnity's 2013 e-Taxes contract is one example of an underrated budget).

Long-Term Contracts

The valuation and successful delivery a long-term contract hinges on many factors, some of which are beyond the control of the supplier. For example, the actual figures at the end of the contract might miss the initial revenue, cost, and profit targets, leading to provisions, adjustments, and write-offs (cost overruns are the most common issue), and in the worst case to events of default.

Exchange Rate Risk

Sygnity's revenues and costs are affected by changes in the zloty's exchange rates relative to the euro and the US dollar. On the balance sheet, assets and liabilities denominated in foreign currencies consist exclusively of trade receivables and trade payables.

Loss of Business Due to COVID-19

So far Sygnity's business has not been affected by the Covid-19 pandemic, but the uncertainty is still there as to the virus's future spread and long-term consequences for customers and partners alike.

Tax Rulings

After tax auditors found that Sygnity had owed back income tax for the years 2007 and 2008, the Company made payments to its local tax authorities in the amount of approx. PLN 1.7m for 2007 and PLN 2.4m in 2008. As of this writing the case has been referred back to the body of first instance.

Corruption Probe

In 2019, Sygnity became involved in an investigation into allegations of corruption in the award of contracts by the Polish Post Office brought against its employees, including the CEO and the Supervisory Board Chairman. The Company cooperated with the authorities and turned over all requested records and items. Since we do not have insight into the current status of the case, we cannot tell whether or not it might affect the Company's business in the future.

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Valuation

Using DCF analysis and relative valuation, we set our nine-month per-share price target for Sygnity at PLN 10.70.

Valuation Summary

(PLN)	weight	price
relative valuation	15%	13.73
DCF analysis	85%	9.41
	valuation	10.06
	9M target price	**10.70**

Source: mBank

Multiples Comparison

We compared Sygnity with its peer group based on forward P/E and EV/EBITDA multiples.

Each of the forecast years, calendar 2022, 2023, and 2024, is assigned an equal weight. For Sygnity we made equal the fiscal years of FY2021/22, 2022/23, and 2023/24, with the corresponding calendar years.

We assigned a 20% discount to the final valuation outcome to reflect Sygnity's slow earnings growth.

Our model takes into account the NPV of the deferred tax asset arising from prior year losses.

Multiples Comparison

		P/E			EV/EBITDA	
	2022E	2023E	2024E	2022E	2023E	2024E
Sap	14.2	12.6	11.4	19.0	17.2	15.4
Oracle	12.2	11.7	11.2	15.8	14.5	13.3
Cap Gemini	11.7	10.7	9.8	19.1	16.9	14.7
Sage Group	16.3	14.7	13.3	26.9	23.7	21.3
Atos	5.1	4.4	3.8	8.0	6.8	5.8
Software AG	10.6	8.9	7.6	19.6	16.0	13.4
Indra Sistemas	6.3	5.9	5.5	10.6	9.5	8.4
Computacenter	12.0	11.1	9.9	15.2	13.2	11.6
Asseco Poland	9.0	8.7	7.9	17.3	16.9	16.2
Comarch	4.5	4.4	-	12.3	11.6	-
maximum	4.7	4.6	4.8	11.9	11.8	10.4
minimum	4.5	4.4	3.8	8.0	6.8	5.8
median	11.2	9.8	9.8	16.5	15.2	13.4
Sygnity**	5.0	4.7	4.3	8.7	8.9	9.2
premium / discount	-55.3%	-52.1%	-56.4%	-47.5%	-41.5%	-31.7%
Implied Valuation						
value per share (PLN)	20%	20%	20%	20%	20%	20%
multiple weight		50%			50%	
year weight	33%	33%	33%	33%	33%	33%
equity value per share (PLN)* **13.73**						

Source: mBank, *after a 20% discount; ** FY2021/22, 2022/23, 2023/24, respectively

DCF Valuation

Assumptions:
- The forecast period spans FY2021/21 - 2030/31.
- The risk-free rate in the forecast period is 3.50%.
- We assume FCF after the forecast period will grow at a rate of 0.0%.
- Net debt is ex IFRS 16 as of 30 September 2021.
- D&A expenses in the terminal period are equal to CAPEX.

DCF Model

(PLN m)	21/22E	22/23E	23/24E	24/25E	25/26E	26/27E	27/28E	28/29E	29/30E	30/31E	29/30+
EBIT	**31.7**	**30.3**	**29.9**	**29.4**	**29.1**	**28.8**	**28.7**	**28.6**	**28.6**	**28.6**	
EBIT margin	14.9%	13.9%	13.3%	12.7%	12.1%	11.6%	11.1%	10.6%	10.2%	9.8%	
tax on EBIT	6.0	5.8	5.7	5.6	5.5	5.5	5.4	5.4	5.4	5.4	
effective tax rate	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	
NOPLAT	**25.7**	**24.6**	**24.2**	**23.9**	**23.6**	**23.4**	**23.2**	**23.2**	**23.2**	**23.2**	
D&A	3.5	3.7	4.0	4.4	4.8	5.4	6.3	7.3	8.6	9.0	
CAPEX	-5.7	-6.7	-6.9	-7.1	-7.3	-7.6	-7.9	-8.2	-8.6	-9.0	
working capital & other	-2.2	-1.1	-1.5	-1.6	-1.8	-2.0	-2.2	-2.4	-2.7	-3.0	
FCF	21.2	20.5	19.9	19.5	19.2	19.2	19.5	19.9	20.2	20.2	20.2
WACC	8.1%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	
discount factor	0.95	0.87	0.81	0.74	0.68	0.63	0.58	0.54	0.46	0.42	
PV FCF	20.1	18.0	16.0	14.5	13.1	12.1	11.3	10.7	9.2	108.3	
WACC	8.1%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%
cost of debt	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%
risk-free rate	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%
risk premium	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%
effective tax rate	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%
net debt / EV	7.3%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
cost of equity	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%
risk premium	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%
beta	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0

FCF growth after the forecast period	0.0%
Terminal value	237.7
Present value of terminal value	121.9
Present value of FCF in the forecast period	132.6
Enterprise value	243.5
Net debt (eoy FY'20/21)	29.3
Other noncore assets	0.0
Minority interests	0.0
Equity value	214.2
Shares outst. (m)	22.8
Equity value per share (PLN)	**9.41**
9M cost of equity	6.4%
Target price	**10.01**
EV/EBITDA ('22) at target price	6.9
P/E('22) at target price	9.3
TV / EV	44.5%

Source: mBank

Sensitivity Analysis

	FCF growth in perpetuity				
	-1.0%	**-0.5%**	**0.0%**	**0.5%**	**1.0%**
WACC +1.0 p.p.	8.47	8.68	8.91	9.16	9.44
WACC +0.5 p.p.	8.93	9.16	9.43	9.72	10.05
WACC	9.43	9.71	**10.01**	10.35	10.74
WACC -0.5 p.p.	9.99	10.31	10.67	11.07	11.53
WACC -1.0 p.p.	10.62	10.99	11.41	11.89	12.44

Financial Results for Q1 FY2021/22

Note that the comparability of Q1 2021/22 results with those of the same year-ago quarter is affected by last year's settlement with Fast Enterprises.

Relative to our expectations, the quarterly figures were in line, with revenue showing a 4% y/y rebound at PLN 54.4m.

The gross margin decreased by 3.5pp y/y to 28.6% due to a one-time contract charge.

SG&A expenses amounted to PLN 7.5m in Q1'21/22 vs. PLN 8.3m expected by us and PLN 7.9m posted the year before.

Other operating activity provided an unexpected PLN 0.2m gain.

EBIT came in at PLN 8.2m and EBITDA amounted to PLN 10.9m. **After adjusting for a one-time PLN 2m contract charge, EBITDA showed a small y/y rebound**.

Financing activity produced a net loss of PLN 1.0m in Q1'21/22. The quarterly effective tax rate was 16.5%. After all this, net profit came in at PLN 6.0m.

Financial results for quarter ended 31 December 2021

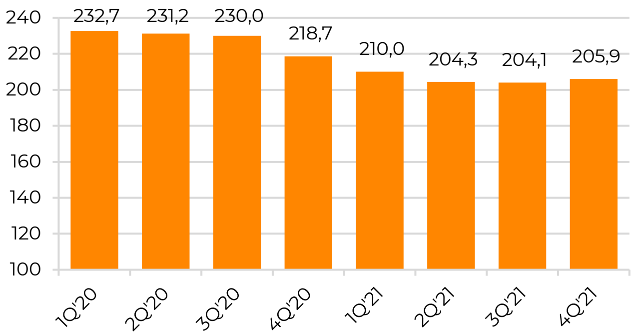
(PLN m)	1Q'21/22	1Q'20/21	y/y	1Q'21/22E	differ.
revenue	54.4	52.5	3.6%	55.0	-1.1%
EBITDA	10.9	26.6	-59.2%	11.1	-2.2%
margin	20.0%	50.7%	-	20.2%	-
EBIT	8.2	23.2	-64.6%	8.3	-1.2%
pre-tax profit	7.2	29.5	-75.5%	7.3	-1.2%
net profit	6.0	26.1	-76.9%	5.9	2.1%

Source: Sygnity, E – mBank estimates

It is worth noting the first sales increase in a long time achieved by Sygnity in Q1 FY2021/22. In the quarters prior, as revenues remained squeezed, quarterly profits remained depressed as well despite high gross margins (ca. 32%) and curbed expenses.

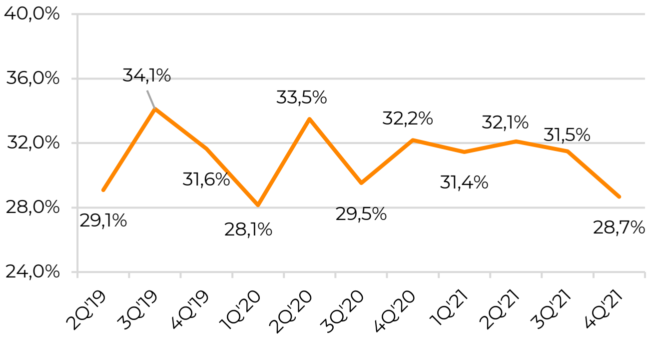
The factor that held profits down in Q1 2021/22 even as revenues rebounded was the aforementioned contract charge; with it stripped off, the quarterly gross profit would be slightly higher than in Q1 2020/21.

Quarterly revenues of Sygnity (LTM, PLN m)



Source: Sygnity

Quarterly gross margins of Sygnity



Source: Sygnity, mBank estimates

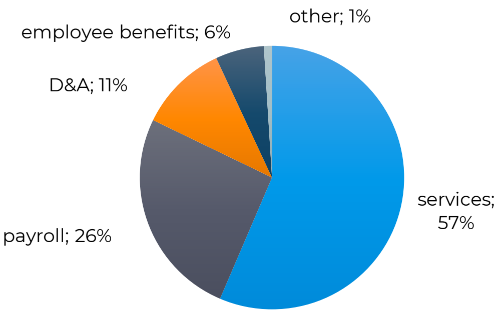
Outlook for the Future

The size of Sygnity's 2022 order backlog is currently PLN 187m, down 5% from this time last year. The Company expects to grow sales to the public sector in the coming months, but sales to the energy sector will probably contract judging by the large declines of 2020/2021.

When it comes to expenses, aside from software development, Sygnity has made its priority to recruit more staff by the end of the year.

Based on the first-quarter results, we are expecting Sygnity to grow revenues by approximately 4% in fiscal FY2021/22.

Breakdown of FY2020/21 operating expenses



Source: Sygnity, *incl. partial payroll costs

Since payroll costs will probably go up, they might knock an estimated 8% off the adjusted EBITDA for the year relative to the year-ago figure (2-3% after adjusting for the Q1 contract provision).

Revision of FY'2021/22 financial forecasts for Sygnity

(PLN m)	Revenue '21/22E	Revenue '21/22E	EBITDA (adj.) '21/22E	EBITDA (adj.) '21/22E
old	212.1	218.4	43.8	42.7
new	213.8	222.1	45.3	45.6
change	-0.8%	-1.7%	-3.2%	-6.4%

Source: mBank

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P&L

(PLN m)	19/20	20/21	21/22E	22/23E	23/24E
Revenue	**230.0**	**204.1**	**212.1**	**218.4**	**225.1**
y/y	-2.0%	-11.3%	4.0%	2.9%	3.1%
COGS	-160.0	-139.3	-149.0	-155.6	-161.7
gross profit	69.9	64.8	63.1	62.8	63.4
other operating income	1.3	15.5	0.0	0.0	0.0
sales and marketing costs	-8.7	-6.7	-6.9	-7.1	-7.3
administrative expenses	-24.7	-23.9	-24.5	-25.3	-26.2
other operating charges	-1.0	-0.6	0.0	0.0	0.0
EBIT	**36.9**	**49.2**	**31.7**	**30.3**	**29.9**
margin	16.0%	24.1%	14.9%	13.9%	13.3%
D&A	16.2	11.8	12.1	12.4	12.7
EBITDA	**53.0**	**61.0**	**43.8**	**42.7**	**42.6**
financing activity	-7.1	3.2	-3.3	-2.7	-2.6
pre-tax profit	29.8	52.3	28.3	27.5	27.2
margin	13.0%	25.6%	13.4%	12.6%	12.1%
Tax	-2.0	-5.8	-5.0	-4.8	-5.2
discontinued ops.	1.4	0.0	0.0	0.0	0.0
net profit	**29.2**	**46.6**	**23.4**	**22.7**	**22.1**

Balance sheet

(PLN m)	19/20	20/21	21/22E	22/23E	23/24E
fixed assets	**515.0**	**496.0**	**492.0**	**484.0**	**485.0**
PP&E	2.4	2.3	2.3	2.3	2.3
intangible assets	6.2	4.2	6.5	9.5	12.3
goodwill	157.2	157.2	157.2	157.2	157.2
current assets	**93.9**	**90.2**	**94.7**	**115.5**	**135.9**
inventory	0.3	0.0	0.0	0.0	0.0
receivables	31.8	39.5	43.2	45.3	48.0
cash	38.5	24.8	25.6	44.3	62.0
equity	**94.3**	**141.6**	**165.0**	**187.7**	**209.8**
minority interest	0.0	0.0	0.0	0.0	1.0
noncurrent liab.	**93.2**	**48.8**	**48.8**	**48.8**	**48.8**
loans	13.5	0.0	0.0	0.0	0.0
bonds	2.1	36.0	36.0	36.0	36.0
current liabilities	**108.9**	**88.7**	**72.0**	**73.1**	**74.2**
loans	9.5	0.0	0.0	0.0	0.0
bonds	6.6	18.1	0.0	0.0	0.0
trade and other payables	66.7	35.3	36.7	37.8	39.0
net debt	**54.0**	**34.9**	**16.1**	**-2.6**	**-20.4**
net debt/EBITDA	1.0	0.6	0.4	-0.1	-0.5

Source: mBank

CF statement

(PLN m)	18/19	19/20	20/21	21/22E	22/23E
operating CF	**52.0**	**20.2**	**36.6**	**36.8**	**35.8**
working capital	3.5	-24.3	-2.2	-1.1	-1.5
investing CF	**-1.9**	**-2.0**	**-5.7**	**-6.7**	**-6.9**
CAPEX	-1.7	-1.3	-5.7	-6.7	-6.9
financing CF	**-30.1**	**-31.9**	**-30.0**	**-11.4**	**-11.2**
change in debt	-11.5	-14.5	-18.1	0.0	0.0
CF	**19.9**	**-13.7**	**0.8**	**18.7**	**17.7**
CFO/EBITDA	98.0%	33.1%	83.5%	86.1%	84.2%
FCFF	41.9	9.6	22.2	21.4	20.3
FCFF/EV	**15.9%**	**3.9%**	**9.9%**	**10.4%**	**10.8%**
FCFE	38.3	8.5	18.9	18.7	17.7
FCFE/MCAP	**18.4%**	**4.1%**	**9.0%**	**8.9%**	**8.5%**
ROIC	24.9%	30.3%	17.7%	16.6%	15.9%
ROCE	7.4%	9.9%	6.4%	5.9%	5.6%
DPS	0.0	0.0	0.0	0.0	0.0
dividend payout ratio	0.0%	0.0%	0.0%	0.0%	0.0%
dividend yield	**0.0%**	**0.0%**	**0.0%**	**0.0%**	**0.0%**

Key Ratios

	19/20	20/21	21/22E	22/23E	23/24E
P/E	**7.2**	**4.5**	**8.9**	**9.2**	**9.5**
P/CE	4.6	3.6	5.9	6.0	6.0
EV/EBITDA	**5.0**	**4.0**	**5.1**	**4.8**	**4.4**
EV/EBIT	7.1	5.0	7.1	6.8	6.3
P/S	0.9	1.0	1.0	1.0	0.9
P/B	2.2	1.5	1.3	1.1	1.0
P/FCFE	5.4	24.6	11.1	11.2	11.8
EBITDA margin	**23.1%**	**29.9%**	**20.7%**	**19.6%**	**18.9%**
y/y % EBITDA change	41.8%	15.0%	-28.1%	-2.5%	-0.4%
net margin	12.7%	22.8%	11.0%	10.4%	9.8%
y/y net change		**59.4%**	**-49.8%**	**-2.8%**	**-2.8%**
price (PLN)	9.18	9.18	9.18	9.18	9.18
shares outst. (millions)	22.8	22.8	22.8	22.8	22.8
mCap	209	209	209	209	209
EV	263	244	225	206	189

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List of abbreviations and ratios used by mBank:
EV (Enterprise Value) – Equity Value + Net Debt; **EBIT** – Earnings Before Interest and Taxes; **EBITDA** – EBIT + Depreciation & Amortisation; **Net Debt** – Borrowings + Debt Securities + Interest-Bearing Loans - Cash and Cash Equivalents; **P/E** (Price/Earnings) – Price Per Share Divided by Earnings Per Share; **P/CE** (Price to Cash Earnings) – Price Per Share Divided by Earnings + Depreciation & Amortisation; **P/B** (Price to Book Value) – Price Per Share Divided by Book Value Per Share; **P/CF** (Price to Cash Flow) – Price Divided by Cash Flow from Operations; **ROE** (Return on Equity) – Earnings Divided by Shareholders' Equity; **ROCE** (Return on Capital Employed) – EBIT x (Average Assets - Current Liabilities); **ROIC** (Return on Invested Capital) – EBIT x (1-Tax Rate) / (Average Equity + Minority Interest + Net Debt); **FCFF** (Free Cash Flow to Firm) – Cash Flow from Operations - CAPEX - Lease Payments; **FCFE** (Free Cash Flow to Equity) – Free Cash Flow to Firm - Net Interest Expense (incl. Debt + Leases) - Lease Payments
EBITDA margin – EBITDA/Sales

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ACCUMULATE – we expect that the rate of return from an investment will range from 5% to 15%
HOLD – we expect that the rate of return from an investment will range from -5% to +5%
REDUCE – we expect that the rate of return from an investment will range from -5% to -15%
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mBank issued the following recommendations for Sygnity in the 12 months prior to this publication:

Sygnity

recommendation	buy	hold
date issued	2021-09-03	2021-03-18
target price (PLN)	11.70	11.60
price on rating day	9.78	11.10

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