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Special comment


IT
 Poland

Sygnity

COMW.WA SGN.PW

Buy

(Reiterated)

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Seasonally Weak First Quarter

Current Price: PLN 14.2; Target price: PLN 18.2

We expect Sygnity's financial performance to pick up after a weak first quarter, with Q2 2010 earnings fully reflecting the positive effects of downsizing and centralized purchasing. Revenues are expected to increase going forward thanks to more successful contract acquisition and comparable base adjustments for divested operations. The second and third quarters will probably still see small operating losses totaling PLN 8m, but the fourth quarter should bring a turnaround in EBIT. Sygnity has been keeping its debt low (PLN 16m at mid-May), and its cash balance high, for an unexpectedly long period of time, easing concerns over liquidity. We are reiterating a buy rating on Sygnity.

Seasonally Weak First Quarter

As expected, Sygnity reported weak earnings results for the first quarter of 2010. We were most disappointed by the weak revenues and gross profit margin. The gross margin was weighed down by a changed approach to accounting for payroll expenses that cannot be attributed to any particular project – recognized before under SG&A expenses, they were charged against the gross margin for the first time in Q1 2010. Adjusted for the PLN 8.9m reclassification from SG&A to COGS, the gross margin figures to 19.3% vs. our forecast of PLN 19.0%.

At PLN 104.2m, first-quarter revenues missed our estimate by 13.5%, and displayed a 25.8% shrinkage vs. the Q109 figure, indicating that the company performed few contracts in the period. Sygnity typically records high sales of proprietary services and products at the beginning of the year, representing 84.7% of Q1 2010 revenues (compared to 87.2% in the same period a year ago). Given that the current order backlog is comparable to last year's (at PLN 366.0m vs. PLN 296m), we expect the company to catch up with deliveries in subsequent quarters.

Reported vs. forecasted Q1 2010 results

(PLN m)	1Q2010	1Q2009	change	1Q2010F	differ.	consensus estimates	differ.
Revenues	104.2	140.4	-25.8%	120.4	-13.5%	110.0	-5.3%
EBITDA	-10.0	-6.3	-	-9.6	-	-8.7	-
margin	-9.6%	-4.5%	-	-8.0%	-	-7.9%	-
EBIT	-17.5	-16.1	-	-17.6	-	-17.6	-
Pre-tax income	-19.3	-18.0	-	-20.6	-	-	-
Net income	-17.1	-17.2	-	-19.6	-	-19.6	-

Source: Sygnity, F - forecasts by BRE Bank Securities, Consensus estimates by PAP

The first-quarter gross margin before adjustment for the reclassified expenses referred to above amounted to 13.0%. SG&A expenses totaled PLN 31.5m, less than our expected PLN 41.0m, (even after adjustment for the PLN 6.5m reclassified to COGS). "Other" operations produced a gain of PLN 3.9m (vs. our estimate of PLN 2m), resulting in an operating profit of PLN 17.5m (we predicted PLN 17.6m). Financial expenses were lower than expected at PLN 1.7m (vs. PLN 3.0m), thanks to lower interest expenses incurred on low net debt. Sygnity received a higher-than-anticipated tax refund (PLN 2.2m vs. PLN 1.0m) in the first quarter, producing a bottom-line loss of PLN 17.1m, lower than our PLN -19.6m forecast.

Order Backlog Status

Sygnity has accumulated an order backlog worth about PLN 500m, slightly more than the PLN 496m reported at the same time a year ago. The value of orders scheduled for delivery in 2010 is PLN 366.6m, marking a decrease from last year's PLN 396.3m, but the value of orders with deadlines in future years is approximately PLN 134m, compared to PLN 100m in May 2009.

2010 Outlook

Sygnity's Management expect 2010 revenues to remain steady at last year's level, and anticipates an EBIT loss not exceeding PLN 15.0m. Between September and December of 2009, the company captured only PLN 83m-worth of new business, and we expect the hit rate to improve this year, and make up for the slight year-on-year decline in the current backlog. These expectations lead us to conclude that Sygnity will beat our cautious revenue estimate for 2010, and report a sales increase by at least several percent.

**Y/Y changes in order backlog (by type of customer)**

	15 May 2009	17 May 2010	change
Banking industry	133.6	110.0	-17.7%
Public sector	114.1	148.3	30.0%
Industrial customers and telecoms	83.0	52.2	-37.1%
Utilities	65.7	56.4	-14.1%
Other	0.0	-0.2	n/a
Total	396.3	366.6	-7.5%

Source: Sygnity



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List of abbreviations and ratios contained in the report.

EV – net debt + market value (EV – economic value)
EBIT – Earnings Before Interest and Taxes
EBITDA – EBIT + Depreciation and Amortisation
PBA – Profit on Banking Activity
P/CE – price to earnings with amortisation
MC/S – market capitalisation to sales
EBIT/EV – operating profit to economic value
P/E – (Price/Earnings) – price divided by annual net profit per share
ROE – (Return on Equity) – annual net profit divided by average equity
P/BV – (Price/Book Value) – price divided by book value per share
Net debt – credits + debt papers + interest bearing loans – cash and cash equivalents
EBITDA margin – EBITDA/Sales

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