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# Asseco Business Solutions (ABS)

Sector: IT  
Fundamental rating: Buy (↑)  
Market relative: Overweight (↑)  
Price: PLN 12.50  
12M EFV: PLN 14.6 (↑)

Market Cap.: US\$ 190 m  
Reuters code: ABSUWA  
Av. daily turnover: US\$ 0.02 m  
Free float: 46%  
12M range: PLN 11.00-13.75

## Investment story

Asseco Business Solutions (ABS) commands a unique position among local ERP players in terms of the combination of (i) the scope of ERP-complementary products/services, (ii) data base technologies' coverage, (iii) width of target customer spectrum, (iv) ability to keep the customers via migrating them from one proprietary application to another and (v) profound R&D synergies potential stemming from the Asseco Poland Group membership. Given that (i) the mid-term outlook for strong local ERP players seems favorable, (ii) we are pleased to see that the Company will not incorporate Asseco Systems (low-margin, low value-added system integrator - ultimately decided to be contributed into ABG (much better fit, in our view)) which removes the risk of the market pricing the Company's equities at much lower forward multiples than the ones typical for software houses, and (iii) with risk to our current financial forecast for ABS rather on the upside than downside (1Q08 profits visibly stronger than we had expected), our sentiment towards the shares of ABS clearly improves (LT fundamental rating upgraded to a Buy).

## Quarterly results corner; 1Q08 review

On May 9 (before the session) ABS released its 1Q08 financial results, which showed stronger than expected profits (please refer to *Figure 1* on the next page regarding the details). We remind that comparing the Company's 1Q08 reported results in yoy terms is pointless, as in 1Q07 ABS encompassed only the outsourcing & e-learning business of Incenti, with three ERP software houses (Wa-Pro, SoftLab and Safo) as well as SFA provider Anica acquired later during the year. Nonetheless, the apple-to-apple comparison (based on pro-forma results of the parent company for the base period) shows a robust financial performance, with sales, operating profit and net income advancing yoy by impressive 40%, 79% and 104%, respectively.

While the Company's 1Q08 consolidated top line only slightly exceeded our forecast – due to parent company's ERP business, as Anica's and the outsourcing & e-learning practice's revenues were actually somewhat weaker than expected – ABS reported stronger than envisaged margins, due to four main reasons. First, the Company enjoyed more favorable than assumed quarterly sales mix, with subdued share of lower-margin outsourcing & e-learning revenues (the margin of this business line declined yoy (from 16.1% in 1Q07 to 14.4% in 1Q08 at the EBITDA level)). Second, following last year's merger of the three ERP companies, ABS was able to implement larger ERP projects with embedded higher margins. Third, the aforementioned merger resulted in lowering of the software development and SG&A costs (per unit of sales). Fourth, ABS was able to increase the per hour fees of its

## Guide to adjusted profits

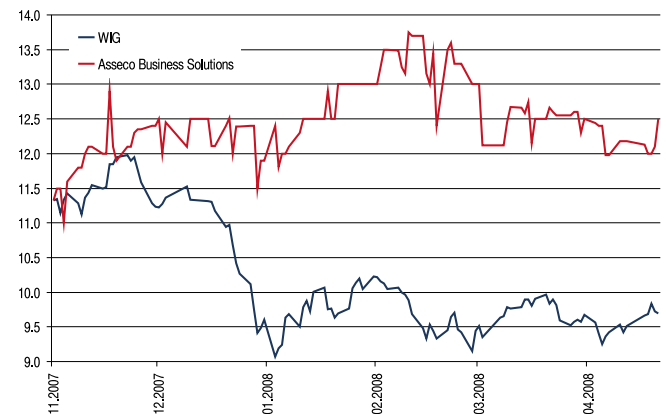
No factors necessitating adjustments of reported numbers.

## Key data

IFRS consolidated		2007	2008E	2009E	2010E
Sales	PLN m	96.0	188.1	215.8	243.1
EBITDA	PLN m	19.8	38.4	43.9	48.8
EBIT	PLN m	15.4	30.7	35.6	40.2
Net income	PLN m	13.6	26.5	30.9	35.0
EPS	PLN	0.47	0.79	0.92	1.05
EPS yoy chng	%	n.m.	68	16	13
Net debt	PLN m	-17.8	-44.4	-67.5	-89.4
P/E	x	26.4	15.7	13.5	11.9
P/CE	x	20.0	12.3	10.7	9.6
EV/EBITDA	x	18.1	10.1	8.0	6.7
EV/EBIT	x	23.5	12.7	9.8	8.2
Dividend yield	%	0.0	0.0	1.6	1.9
No. of shares (eop)	ths.	28,614	33,418	33,418	33,418

Multiples calculated on the basis of proportional consolidation of not wholly-controlled subsidiaries  
Source: Company, DM IDMSA estimates

## Stock performance



Source: www.money.pl

## Upcoming events

- 2Q08 results release: August 6, 2008
- 1H08 results release: September 15, 2008
- 3Q08 results released: November 6, 2008

## Catalysts

- Low penetration of ERP packages among domestic enterprises: a plenty of room to expand (especially in a sound macro environment) for ABS and other strong ERP vendors
- Expected strong organic earnings growth in the coming quarters
- Potential synergies stemming from the co-operation with other ERP members of Asseco Poland capital group
- No acquisition of Asseco Systems (low-margin, low value-added system integrator); ABS should continue to be priced at multiples typical for software houses (rather than lower multiples typical for a mix of software and integration)
- The risk to our current financial forecasts for ABS seems to be rather on the upside

## Risk factors

- Major slowdown of GDP: would cap the new license sales (SMEs' IT demand shows strong cyclicality)
- Global ERP vendors' increasing interest in the SME segment: could heat up the competition in Company's target segments
- Wage pressures in the IT industry: could put a pressure on margins, especially in weaker macro environment
- Pure commercial sector play with no public exposure: means that expected pick up of public sector's IT demand is irrelevant for ABS
- Competitor's (BPSC's) prospective WSE-listing: may attract the investors' attention away from the Company
- M&A-driven shareholder value creation does not constitute a theme, at least for the short- to mid-term

consultants ahead of the payroll rate increases. All these factors enhanced the EBITDA margins of the ERP and SFA business lines by c. 4-9 percentage points yoy, shifting up the EBITDA profitability of the entire organization by over 3pp yoy (from 21.8% for 1Q07 (parent's pro-forma) to 25.4% for 1Q08). At the quarterly bottom line level, stronger than envisaged EBIT was helped by low (c. 10%) effective CIT rate (due to tax-loss-carry-forwards – a factor which we correctly identified); consequently, the Company's 1Q08 consolidated NI beat our forecast in comparable extent (by c. 30%) as the operating profit projection.

Given stronger than expected 1Q08 financial showing at ABS, market's positive reaction during the Friday's session comes as no surprise. While we do expect the Company to post robust results for the upcoming quarters (regarding the rationale, please refer to the *Financial forecast* section), we would like to draw the attention to two issues. First, one should not – in our view – fully extrapolate outstanding 1Q08 financial performance into 2-3Q08, due to the seasonality patterns of the ERP market (especially in its micro- and small-companies' segment; seasonal height in 4-1Q, seasonal trough during 2-3Q). Second, starting from 2Q08 ABS's effective CIT rate should cease to dwell markedly below the 19% statutory level, as the Company's tax-loss-carry-forwards are running dry.

### Financial forecast

Following rather lukewarm market reception of an idea to contribute Asseco Systems (100%-owned low margin system integrator) to ABS, Asseco Poland changed its intentions regarding this subsidiary, and now intends to incorporate it into ABG, a move providing – in our view – much better business fit than the originally conceived plan. Consequently, we remove Asseco Systems' contributions from our forecasts of ABS's consolidated accounts, which decreases our mid-term (2008-2010) forecasts of the Company's revenues, EBIT and NI by, respectively, app. 44-58%, 19-26% and 12-24% (please note that our projections for the parent company are only slightly upped, while for Anica remain basically unaltered; regarding the details, please refer to the *Financial statements* section).

We would, however, like to note that at the moment the risk to our current forecasts for ABS seems to be rather on the upside, given that: (i) stronger than expected 1Q08 financial showing (after 1Q the Company realizes 28% and 27% of our FY2008 EBIT and NI forecasts, a proportion which appears quite robust, in our view), and (ii) the beginning-of-May contract backlog of PLN 92.3 million (PLN 45 million in ERP, PLN 22.7 million in outsourcing & e-learning, PLN 24.6 million in SFA) provides a 49% coverage of our FY2008E target for ABS (49%, 58% and 43% coverage in the ERP, outsourcing & learning and SFA areas, respectively), which seems quite strong for this part of the year. Nonetheless, we'd rather wait for the Company's 2Q08 financial posting (likely, in our view, to be weaker than the 1Q08 showing, due to strong seasonality effect in the ERP area) to see whether 1Q08 favorable profitability tendencies continue, before we contemplate possible more meaningful upgrade to our current financial projections for the Company.

### Valuation

Our absolute-value-based 12M EFV for ABS (encompassing already the estimated incremental per share impact of the acquisition of the remaining 39% stake in Anica) increases slightly to PLN 14.6 (from PLN 14.0 previously), due to removal from our exercise of the net impact of Asseco Systems abandoned takeover, minor forecast upgrade for the parent company and valuation horizon forward shift. We would like to note that following the abandonment of the idea to incorporate Asseco Systems (an integrator), ABS should be benchmarked against software houses (and not blends encompassing both software houses and integrators).

### Recommendation

Given (i) favorable outlook for the ERP sector, (ii) the Company's strong market position, (iii) robust mid-term earnings outlook (1Q08 positive surprise), (iv) some upside risk to our current financial forecast, (v) evaporation of the risk that following the takeover of Asseco Systems the market will penalize the Company with lower forward valuation multiples than prior the incorporation and (vi) decent (c. 17%) upside to our 12M EFV, we upgrade our ratings for ABS's shares to a Buy from Hold (LT fundamental) and to an Overweight from a Neutral (ST market-relative).

## BASIC DEFINITIONS

**A/R turnover** (in days) = 365/(sales/average A/R)  
**Inventory turnover** (in days) = 365/(COGS/average inventory)  
**A/P turnover** (in days) = 365/(COGS/average A/P)  
**Current ratio** = (current assets – ST deferred assets)/current liabilities)  
**Quick ratio** = ((current assets – ST deferred assets – inventory)/current liabilities)  
**Interest coverage** = (pre-tax profit before extraordinary items + interest payable/interest payable)  
**Gross margin** = gross profit on sales/sales  
**EBITDA margin** = EBITDA/sales  
**EBIT margin** = EBIT/sales  
**Pre-tax margin** = pre-tax profit/sales  
**Net margin** = net profit/sales  
**ROE** = net profit/average equity  
**ROA** = (net income + interest payable)/average assets  
**EV** = market capitalization + interest bearing debt – cash and equivalents  
**EPS** = net profit/ no. of shares outstanding  
**CE** = net profit + depreciation  
**Dividend yield** (gross) = pre-tax DPS/stock market price  
**Cash sales** = accrual sales corrected for the change in A/R  
**Cash operating expenses** = accrual operating expenses corrected for the changes in inventories and A/P, depreciation, cash taxes and changes in the deferred taxes

DM IDM S.A. generally values the covered non bank companies via two methods: comparative method and DCF method (discounted cash flows). The advantage of the former is the fact that it incorporates the current market assessment of the value of the company's peers. The weakness of the comparative method is the risk that the valuation benchmark may be mispriced. The advantage of the DCF method is its independence from the current market valuation of the comparable companies. The weakness of this method is its high sensitivity to undertaken assumptions, especially those related to the residual value calculation. Please note that we also resort to other valuation techniques (e.g. NAV-, DDM- or SOTP-based), should it prove appropriate in a given case.

## KEY TO INVESTMENT RANKINGS

This is a guide to expected price performance in absolute terms over the next 12 months:

**Buy** – fundamentally undervalued (upside to 12M EFV in excess of the cost of equity) + catalysts which should close the valuation gap identified;  
**Hold** – either (i) fairly priced, or (ii) fundamentally undervalued/overvalued but lacks catalysts which could close the valuation gap;  
**Sell** – fundamentally overvalued (12M EFV < current share price + 1-year cost of equity) + catalysts which should close the valuation gap identified.

This is a guide to expected relative price performance:

**Overweight** – expected to perform better than the benchmark (WIG) over the next quarter in relative terms  
**Neutral** – expected to perform in line with the benchmark (WIG) over the next quarter in relative terms  
**Underweight** – expected to perform worse than the benchmark (WIG) over the next quarter in relative terms

The recommendation tracker presents the performance of DM IDMSA's recommendations. A recommendation expires on the day it is altered or on the day 12 months after its issuance, whichever comes first. Relative performance compares the rate of return on a given recommended stock in the period of the recommendation's validity (i.e. from the date of issuance to the date of alteration or – in case of maintained recommendations – from the date of issuance to the current date) in a relation to the rate of return on the benchmark in this time period. The WIG index constitutes the benchmark. For recommendations that expire by an alteration or are maintained, the ending values used to calculate their absolute and relative performance are: the stock closing price on the day the recommendation expires/ is maintained and the closing value of the benchmark on that date. For recommendations that expire via a passage of time, the ending values used to calculate their absolute and relative performance are: the average of the stock closing prices for the day the recommendation elapses and four directly preceding sessions and the average of the benchmark's closing values for the day the recommendation expires and four directly preceding sessions.

## LT fundamental recommendation tracker

Recommendation	Issue date	Reiteration date	Expiry date	Performance	Relative performance	Price at issue/reiteration (PLN)	12M EFV (PLN)
<b>Asseco Business Solutions (ABS)</b>							
Hold	–	07.02.2008	-	11.05.2008	0%	1%	12.5
-	→	-	21.02.2008	-	-	-	13.5
-	→	-	13.03.2008	-	-	-	13.3
-	→	-	30.03.2008	-	-	-	12.67
-	→	-	08.04.2008	-	-	-	12.66
Buy	↑	11.05.2008	-	Not later than 11.05.2009	-	-	12.50

## Market-relative recommendation tracker

Relative recommendation	Issue date	Reiteration date	Expiry date	Price at issue/reiteration (PLN)	Relative performance
<b>Asseco Business Solutions (ABS)</b>					
Overweight	–	07.02.2008	-	21.02.2008	4%
Neutral	↓	21.02.2008	-	11.05.2008	-3%
-	→	-	13.03.2008	-	-
-	→	-	30.03.2008	-	-
-	→	-	08.04.2008	-	-
Overweight	↑	11.05.2008	-	Not later than 11.05.2009	-

## Distribution of IDM's current recommendations

	Buy	Hold	Sell	Suspended	Under revision
Numbers	24	13	4	0	0
Percentage	59%	32%	10%	0%	0%

## Distribution of IDM's current market relative recommended weightings

	Overweight	Neutral	Underweight	Suspended	Under revision
Numbers	19	11	11	0	0
Percentage	46%	27%	27%	0%	0%

## Banks

**Net Interest Margin (NIM)** = net interest income/average assets  
**NIM Adjusted** = (net interest income adjusted for SWAPs)/average assets  
**Net interest income** = fees&commissions + result on financial operations (trading gains) + FX gains  
**Interest Spread** = (interest income/average interest earning assets)/ (interest cost/average interest bearing liabilities)  
**Cost/Income** = (general costs + depreciation + other operating costs)/ (profit on banking activity + other operating income)  
**ROE** = net profit/average equity  
**ROA** = net income/average assets  
**Non performing loans (NPL)** = loans in 'substandard', 'doubtful' and 'lost' categories  
**NPL coverage ratio** = loan loss provisions/NPL  
**Net provision charge** = provisions created – provisions released

DM IDM S.A. generally values the covered banks via two methods: comparative method and fundamental target fair P/E and target fair P/BV multiples method. The advantage of the former is the fact that it incorporates the current market assessment of the value of the company's peers. The weakness of the comparative method is the risk that the valuation benchmark may be mispriced. The advantage of the fundamental target fair P/E and target fair P/BV multiples method is its independence of the current market valuation of the comparable companies. The weakness of this method is its high sensitivity to undertaken assumptions, especially those related to the residual value calculation.

Assumptions used in valuation can change, influencing thereby the level of the valuation. Among the most important assumptions are: GDP growth, forecasted level of inflation, changes in interest rates and currency prices, employment level and change in wages, demand on the analysed company products, raw material prices, competition, standing of the main customers and suppliers, legislation changes, etc.

Changes in the environment of the analysed company are monitored by analysts involved in the preparation of the recommendation, estimated, incorporated in valuation and published in the recommendation whenever needed.

## Distribution of IDM's current recommendations for companies that were within the last 12M IDM customers in investment banking

	Buy	Hold	Sell	Suspended	Under revision
Numbers	2	3	0	0	0
Percentage	40%	60%	0%	0%	0%

## Distribution of IDM's current market relative recommended weightings for the companies that were within the last 12M IDM customers in investment banking

	Overweight	Neutral	Underweight	Suspended	Under revision
Numbers	4	1	0	0	0
Percentage	80%	20%	0%	0%	0%

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