4iG

Q320 update

Strong Q320 results, estimates raised

IT services

In its Q320 update, 4iG reported nine-month (9m) net revenues of HUF33.5bn, a 34% y-o-y increase. EBITDA increased 13% to HUF2.8bn, with EBITDA margins climbing to 10.8% in Q320 from 6.7% in H120. Net income for the 9m rose 11% y-o-y to HUF1.9bn. 4iG reported a continuing robust operational performance, with a limited effect from COVID-19, announcing two acquisitions and a satellite joint venture during the period and a third acquisition after period-end. Management reiterated its confidence in achieving its 20% revenue growth guidance for FY20 ahead of its seasonally strongest quarter, with a HUF18.2bn order book for 2020 (19 November) on top of 9M20 revenues of HUF33.5bn (total HUF51.7bn). We have raised our revenue estimate for FY20 by 10% and FY21 by 5%.

Year end	Revenue (HUFbn)	PBT* (HUFbn)	Adjusted EPS* (HUF)	DPS (HUF)	P/E (x)	Yield (%)
12/18	14.0	0.2	1.1	0.0	N/A	N/A
12/19	41.1	3.3	31.1	22.0	20.6	3.4
12/20e	54.0	3.6	33.3	24.0	19.3	3.7
12/21e	62.1	4.7	43.2	31.0	14.9	4.8

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Q320: Acquisitions support continued momentum

4iG has weathered COVID-19 well and delivered strong 9M20 results, with y-o-y revenue growth of 34% and y-o-y EBITDA growth of 13%. EBITDA margins have picked up from 6.7% for H120 to 8.4% for 9M20, versus management's medium-term target of 8–10% and our prior estimates for FY20 of 8.5%. Including the acquisitions of TRC and INNObyte, the company has continued to increase headcount, reaching 735 staff by November. Software development and outsourcing have continued to be the drivers of group revenue growth, with 9M20 revenues ex reselling growing 143% y-o-y.

FY20 revenue estimate raised by 10%

With reported 9M20 revenue and the latest identified FY20 order book together exceeding our prior FY20 revenue estimate and the blended YTD EBITDA margin approaching our prior FY20 estimate, we believe it is appropriate to revise our FY20 estimates upwards. We have increased our FY20 revenue estimate by 10% to HUF54.0bn and raised our EBITDA forecast by 6% to HUF4.4bn, implying an FY20 EBITDA margin of 8.1%. As a result of the higher base revenues, we have also raised our FY21 revenue estimate by 5%. Our model does not currently reflect an estimated c HUF5bn of revenues/HUF0.5bn EBITDA from FY20 M&A, as we await more details on these acquisitions.

Valuation: FY21 discount to peers, 4.8% yield

Our new estimates reflect FY20e revenue growth above 30%, with management guidance of 10%+ revenue growth in the medium term as 4iG consolidates market leadership in Hungary. Our estimates indicate an FY21 P/E of 14.9x and an attractive 4.8% dividend yield. The stock remains at a meaningful discount to its European and regional peers with further upside potential.

1 December 2020

Price	**HUF642**
Market cap	**HUF58.4bn**
	HUF355/€
Net debt (HUFbn) at 30 September 2020	1.2
Shares in issue	91.0m
Free float	36.1%
Code	4iG
Primary exchange	Budapest
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	18.5	(1.9)	(27.8)
Rel (local)	(1.4)	(11.8)	(18.6)
52-week high/low		HUF978.0	HUF296.0

Business description

4iG is one of the leading IT services and systems integrators in Hungary, working with public sector clients, large corporates and SMEs. Management is focused on becoming the market leader in Hungary by FY22 as well as targeting expansion in Central and Eastern Europe.

Next events

Summary FY20 results	February 2021
Full FY20 results	April 2021
AGM	April 2021

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Edison profile page

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Q320 results update

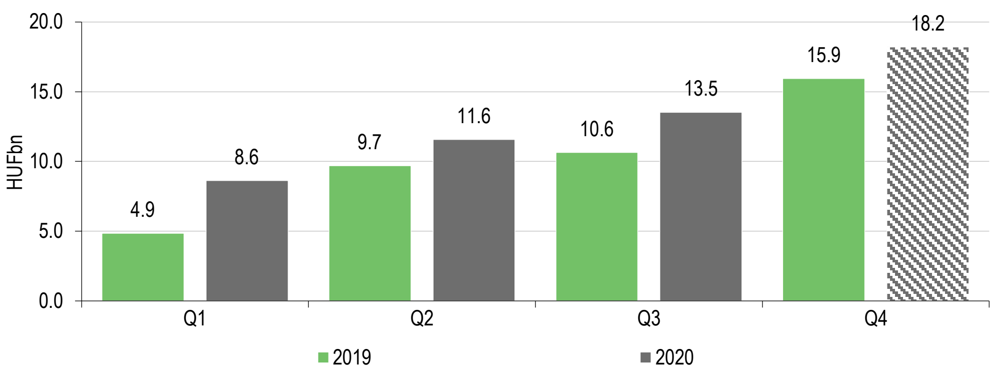
Operational momentum continues

The momentum that 4iG demonstrated in its H120 results continued in Q320. In its Q320 results, 4iG reported net revenues of HUF33.5bn for the first 9m of 2020, representing growth of 34% y-o-y (Q1 to Q319: HUF25.0bn). EBITDA rose 13% to HUF2.8bn (Q1 to Q319: HUF2.5bn), with EBITDA margins climbing to 10.8% in Q320 from 6.7% in H120 meaning the blended margin for Q1 to Q320 rose to 8.4% (4iG's medium-term target of 8–10%). Net income grew 11% y-o-y to HUF1.9bn (Q1 to Q319: HUF1.7bn). Net debt rose to HUF1.2bn at end-Q320, from HUF0.0bn at end-H120.

Operationally, COVID-19 has only had a marginal impact, with clients in certain sectors hit hard (eg retail, travel) but technology sales amongst both domestic and international companies has proven to be resilient. The COVID-19 pandemic has also provided a catalyst for increased spending on IT segments, accelerating the digitalisation of businesses and driving growth in SaaS, remote maintenance, blockchain and artificial intelligence, in particular.

The forward order book for FY20 reached HUF18.2bn on 19 November 2020. As an indicator, total revenue including actual Q1–Q320 revenue, together with the identified forward order book, adds up to HUF51.7bn (26% ahead of FY19 revenues), with the potential for additional orders to be received during the remainder of Q4, historically 4iG's strongest quarter.

Exhibit 1: Quarterly revenues FY20 vs FY19 (Q420 based on forward order book)



Source: 4iG

4iG's headcount has grown significantly, reaching almost 700 staff by 30 September 2020 (735 in November 2020), including more than 500 technical engineers. Including contractors, the group has almost reached a headcount of 1,000.

M&A: A busy period for acquisitions

In Q320, 4iG announced two acquisitions together with a geostationary satellite joint venture, with a further acquisition completed post period end in November. 4iG is looking to lead market consolidation, targeting smaller players with an attractive client base or sector focus and a proven track record to support the company's growth and build out its capabilities.

- **TR Consult (TRC), announced July 2020**, a specialist IT consultancy focused on the cybersecurity sector. Based in Budapest, TRC serves a Central Eastern European (CEE) corporate client base, as well as companies in Hungary. 4iG had previously worked with TRC for the last 10 years. In FY18, TRC had revenues of HUF0.7bn (c €2m). The purchase price was not disclosed.
- **Hungarian Space Telecommunications Corporation (CarpathiaSat), announced August 2020**, a joint venture to launch and operate Hungary's first geostationary satellite for

commercial, public sector and scientific research. CarpathiaSat will have the right to operate geostationary satellites for a period of 20 years from 2024, following expiry of the current 20-year lease. 4iG owns 51% of CarpathiaSat, with Antenna Hungária, the state-owned telecoms and broadcasting company, owning 44% and New Space Industries, an investment vehicle, holding the remaining 5%. The launch and operation of Hungary's first satellite for broadcasting, internet and telephone services and data transmission is a strategic initiative that will broaden 4iG's footprint and progress its strategy to become the leading IT services company in Hungary and CEE.

- **INNObyte and Innoware Kft (INNObyte Group), announced September 2020**, the acquisition of a 70% majority shareholding in INNObyte Group. INNObyte Group's FY19 turnover was HUF3.3bn (€9.1m) with EBITDA of HUF447m (€1.2m). INNObyte, founded in 2014, with offices in Budapest and Pécs, is a software development company, specialising in contact centre services, business intelligence, test automation, AI development and database solutions, with c 200 employees. The acquisition helps broaden 4iG's development capabilities, contributing to 4iG's drive for market leadership in fintech, Industry 4.0, AI development and blockchain. The purchase price was not disclosed.

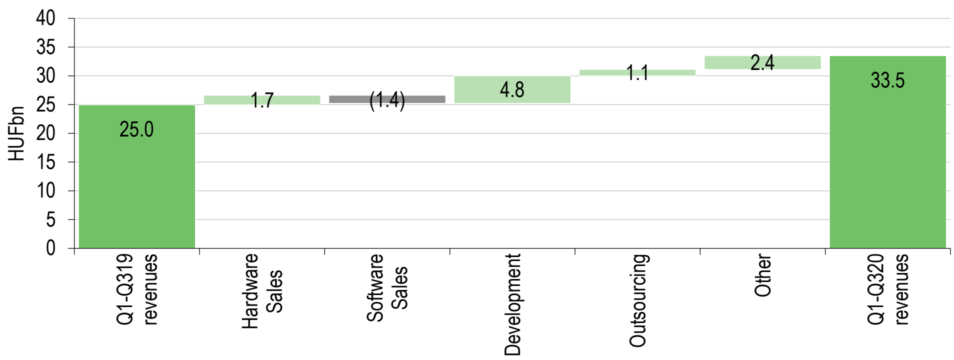
DTSM, announced November 2020 (completion subject to competition clearance). DTSM operates data centres and provides IT services including the installation, operation and integration of IT and telecoms systems and integration of cloud technologies for private customers. DTSM reported FY19 revenues of HUF1.2bn (€3.4m) and has operated as a supplier to 4iG since it was founded in 2018. The acquisition expands 4iG's existing capabilities and moves it towards domestic leadership in the operation of outsourced data centres, as well as in service desk operations. On completion, 4iG will have one of the largest outsourcing teams in the Hungarian market, a capability that it expects to expand in the future.

In aggregate, based on the available information, we provisionally estimate that the four acquisitions mentioned above could constitute some HUF5bn+ of revenue and c 0.5bn of EBITDA. However, with limited details on the financials of the acquired businesses and considerations paid by the company, we have not yet explicitly factored these acquisitions into our financial model and await more details from the company.

With the Hungarian market still very fragmented and with not all IT services companies performing as strongly as 4iG, management continue to review M&A opportunities. As such, the signs are that 4iG will continue to acquire opportunistically in FY21.

Segmental analysis: Strength in outsourcing and development

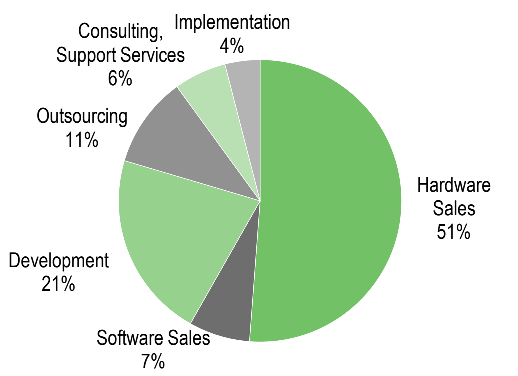
Exhibit 2: Net revenue bridge Q1–Q319 to Q1–Q320



Source: 4iG

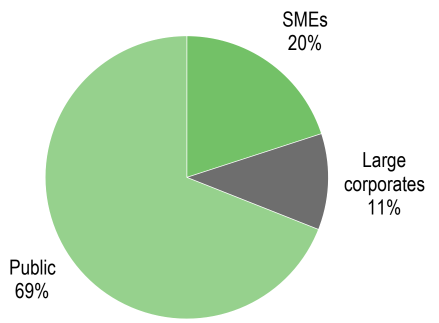
The breakdown of revenue by segment remains very similar to H120, with a slight increase in weighting towards the higher margin segments, development and outsourcing. Supported by the acquisitions of INNObyte and DTSM, we would expect these segments to continue to grow strongly in Q420 and beyond. In terms of recurring revenues, there has been no further increase as a percentage of total revenues, with recurring revenues remaining at 16% of overall revenues, as it was in H120.

Exhibit 3: 9M20 revenues by service line



Source: 4iG

Exhibit 4: 9M20 revenues by client type



Source: 4iG

Hardware reselling remains 51% of total sales, with software reselling an 7% of total sales (although as hardware and software are often sold as a package, there can be some ambiguity as to which segment these sales come under). 4iG has found that a number of hardware projects that had been postponed in H120 due to COVID-19 have started in Q320. The company also had concerns in H120 about the impact of the pandemic on its Far Eastern supply chain; however, those concerns are now receding with delayed deliveries being fulfilled in Q320. Despite COVID-19's impact this year, hardware sales continue to track above 2019, with HUF17.0bn of sales in the first nine months of 2020 versus HUF15.3bn y-o-y in 2019. Software reselling is tracking behind 2019, with HUF2.5bn of sales in the first nine months of 2020 versus HUF3.9bn y-o-y in 2019.

Having established a programme to expand its internal capabilities, 4iG successfully launched a dedicated development unit including 100 programmers, IT architects and testers across 4iG's three regional offices. This focus, together with its wide geographical footprint, significantly enhanced the segment's performance, with service delivery unaffected by COVID-19 through the group's effective use of online delivery and online collaboration tools. Development revenues have increased three-fold, from HUF2.4bn in 9M19 to HUF7.2bn 9M20.

In outsourcing, 4iG secured a number of long-term contracts due to its scalable service structure, that delivered strong revenue growth in the first 9m of 2020. Reassuringly, despite the economic slowdown, demand from 4iG's customers has not scaled back, with revenues of HUF3.4bn in 9M20 versus HUF2.3bn in 9M19.

4iG also received significant additional customer wins in support services, infrastructure development and IT consultancy, generating incremental revenue of HUF3.5bn in 9M20 versus HUF1.1bn in 9M19.

Upward estimate revision

4iG has weathered COVID-19 well and delivered strong Q320 results, with 9M20 revenue growth of 34% and year-on-year EBITDA growth of 13%. EBITDA margins have picked up from 6.7% for H120 to 8.4% in 9M20, versus management's medium-term target of 8–10% and our prior estimate for FY20 of 8.5%. The company has continued to increase headcount, reaching 735 staff by November, including the acquisitions of TRC and INNObyte, and the new IT and CRM systems have delivered the sought for efficiencies. Software development and outsourcing have continued to be the drivers of group revenue growth, with 9M20 revenues ex reselling growing 143% y-o-y.

With reported 9M20 revenue together with the identified forward order book to 19 November 2020 now exceeding our prior FY20 revenue estimate and the blended YTD EBITDA margin approaching our prior FY20 estimate, we believe it is appropriate to revise our FY20 estimates upwards. We have increased our FY20 revenue estimate by 10% to HUF54.0bn and raised our EBITDA forecast by 6% to HUF4.4bn, implying an FY20 EBITDA margin of 8.1%. As a result of the higher base revenues, we have also raised our FY21 revenue estimate by 5%, while pulling back our FY21e EBITDA margin to 9.1% from 9.6% previously, although still above the mid-point of management's guidance of 8–10% EBITDA margins in the medium term.

Exhibit 5: Estimate revisions

HUF'm		2019	2020	2020		2021	2021	
		Actual	Old	New	Change	Old	New	Change
Revenues		41,129	49,083	53,988	10.0%	58,881	62,076	5.4%
Gross profit		11,003	14,761	16,297	10.4%	17,699	18,907	6.8%
Gross margin		*26.8%*	*30.1%*	*30.2%*	*0.1%*	*30.1%*	*30.5%*	*0.4%*
EBITDA		4,075	4,152	4,389	5.7%	5,631	5,669	0.7%
EBITDA margin		*9.9%*	*8.5%*	*8.1%*	*-3.9%*	*9.6%*	*9.1%*	*-4.5%*
Normalised PBT		3,344	3,358	3,594	7.0%	4,794	4,720	-1.5%
Normalised net income		2,922	2,921	3,127	7.0%	4,123	4,059	-1.5%
Normalised basic EPS		31.9	31.8	34.2	7.5%	44.9	44.6	-0.7%
Dividend per share		22.0	22.0	24.0	9.1%	31.0	31.0	0.0%
Net debt/(cash)		(4,039)	(4,445)	1,127		(5,924)	(112)	

Source: 4iG (historicals), Edison Investment Research (forecasts)

As we noted in the M&A section, we have not yet explicitly factored 4iG's acquisitions into our financial model (we estimate at least HUF5bn of revenue and c 0.5bn of EBITDA), which therefore represents additional potential upside to our current forecasts.

Exhibit 6: Financial summary

HUFm	2018	2019	2020e	2021e	2022e
31-December	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT					
Revenue	14,007	41,129	53,988	62,076	70,261
Cost of Sales	(8,938)	(30,126)	(37,691)	(43,170)	(48,622)
Gross Profit	5,070	11,003	16,297	18,907	21,638
EBITDA	842	4,075	4,389	5,669	6,990
Normalised operating profit	240	3,362	3,616	4,830	6,075
Amortisation of acquired intangibles	0	0	0	0	0
Exceptionals	0	0	0	0	0
Share-based payments	0	0	0	0	0
Reported operating profit	240	3,362	3,616	4,830	6,075
Net Interest	(21)	(18)	(22)	(110)	(85)
Joint ventures & associates (post tax)	0	0	0	0	0
Exceptionals	0	0	0	0	0
Profit Before Tax (norm)	219	3,344	3,594	4,720	5,990
Profit Before Tax (reported)	219	3,344	3,594	4,720	5,990
Reported tax	(117)	(488)	(467)	(661)	(898)
Profit After Tax (norm)	102	2,857	3,127	4,059	5,091
Profit After Tax (reported)	102	2,857	3,127	4,059	5,091
Minority interests	0	66	0	0	0
Discontinued operations	0	0	0	0	0
Net income (normalised)	102	2,922	3,127	4,059	5,091
Net income (reported)	102	2,922	3,127	4,059	5,091
Basic average number of shares outstanding (m)	91.6	91.7	91.4	91.0	91.0
EPS - basic normalised (HUF)	1.11	31.87	34.23	44.63	55.97
EPS - diluted normalised (HUF)	1.08	31.09	33.26	43.18	54.16
EPS - basic reported (HUF)	1.11	31.87	34.23	44.63	55.97
Dividend (HUF)	0.00	22.00	24.00	31.00	39.00
Revenue growth (%)	(17.2)	193.6	31.3	15.0	13.2
Gross Margin (%)	36.2	26.8	30.2	30.5	30.8
EBITDA Margin (%)	6.0	9.9	8.1	9.1	9.9
Normalised Operating Margin	1.7	8.2	6.7	7.8	8.6
BALANCE SHEET					
Fixed Assets	1,571	1,948	7,620	7,841	8,109
Intangible Assets	1,221	1,525	1,440	1,375	1,335
Tangible Assets	140	322	579	865	1,173
Investments & other	210	101	5,601	5,601	5,601
Current Assets	6,824	22,161	18,923	22,495	26,407
Stocks	242	523	754	863	972
Debtors	4,306	12,892	14,847	17,071	19,322
Cash & cash equivalents	176	6,238	814	2,053	3,605
Other	2,101	2,508	2,508	2,508	2,508
Current Liabilities	(5,652)	(17,861)	(19,186)	(21,103)	(23,012)
Creditors	(3,894)	(16,361)	(17,944)	(19,861)	(21,770)
Tax and social security	0	0	0	0	0
Short term borrowings	(1,758)	(1,500)	(1,242)	(1,242)	(1,242)
Other	0	0	0	0	0
Long Term Liabilities	(18)	(57)	(57)	(57)	(57)
Long term borrowings	0	0	0	0	0
Other long term liabilities	(18)	(57)	(57)	(57)	(57)
Net Assets	2,725	6,192	7,300	9,176	11,448
Minority interests	0	64	64	64	64
Shareholders' equity	2,725	6,255	7,364	9,240	11,512
CASH FLOW					
Op Cash Flow before WC and tax	842	4,075	4,389	5,669	6,990
Working capital	(1,360)	3,231	(603)	(416)	(451)
Exceptional & other	(26)	(5)	0	0	0
Tax	(117)	(415)	(467)	(661)	(898)
Net operating cash flow	(661)	6,886	3,319	4,592	5,640
Capex	(120)	(1,471)	(944)	(1,060)	(1,182)
Acquisitions/disposals	0	3	(5,500)	0	0
Net interest	(11)	(13)	(22)	(110)	(85)
Equity financing	0	185	0	0	0
Dividends	0	0	(2,019)	(2,183)	(2,820)
Other	(3)	36	0	0	0
Net Cash Flow	(795)	5,626	(5,166)	1,239	1,552
Opening net debt/(cash)	792	1,587	(4,039)	1,127	(112)
FX	0	0	0	0	0
Other non-cash movements	0	0	0	0	0
Closing net debt/(cash)	1,587	(4,039)	1,127	(112)	(1,664)

Source: 4iG accounts, Edison Investment Research

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