4iG

Initiation of coverage

Building on a transformational FY19

IT services

4iG is a leading IT services and systems integrator in Hungary, a growing IT services and near-shoring market of choice. Following a change of management in 2018, revenues almost tripled in 2019 to HUF41bn, with EBITDA of HUF4.1bn and EPS of HUF30.1. Management anticipates consolidation-driven growth of over 20% in the medium term. COVID-19 makes forecasting challenging, but we believe 4iG's business remains robust (60%+ of FY19 revenues from the public sector). At an FY20 P/E of 16.3x and offering a yield of 4.3%, the valuation neither reflects 4iG's recent transformation nor its growth prospects and it remains at a substantial discount to its peers and our NPV estimate of HUF1,005/share.

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	16.3	4.3
12/20e	49.1	3.4	31.1	22.0	16.3	4.3
12/21e	58.9	4.8	43.9	31.0	11.6	6.1

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

Transformation targeting market leadership

In FY18, the current management team bought into 4iG, with a five-year plan to transform the business. The initial stage was to reposition the company for growth, introduce efficiency improvements and refocus the sales function on larger and more profitable contracts. The second phase is to diversify the business away from product reselling towards a more solution-oriented approach, based around new technologies to increase margins and revenue visibility. Under this strategy, 4iG has risen from sixth in the market in FY18 to second in FY19 (threefold growth) and management's target is for 4iG to become the number one IT systems integrator in Hungary by the end of FY22, as well as become a significant regional player.

COVID-19: Robust profile, geared to the public sector

With Hungary in lockdown, 4iG has successfully transitioned to remote working. Although forecasting the impact of COVID-19 remains challenging, in the short term, changing work habits including greater remote working are likely to drive clients to invest further in technology. However, while we do see a heightened risk of project deferral and slippage in FY20, 4iG derives over 60% of its revenues from multi-year contracts with the public sector, which should provide a strong degree of revenue protection, even if the risk on corporate contracts is higher (eg Wizz Air).

Valuation: Material discount to peers, 4.3% yield

After a period of super-normal growth in FY18–19, despite the impact of COVID-19 management anticipates sustainable revenue growth of c 20% in the period to FY22 as 4iG consolidates its market leadership in Hungary. At an FY20 P/E of 16.3x, 4iG's valuation neither reflects the transformation the business has already achieved nor its future growth prospects and the stock remains at a substantial discount to regional peers. 4iG also trades at a substantial 50% discount to our NPV estimate of HUF1,005 per share (WACC of 10.2%).

13 May 2020

Price	**HUF507**
Market cap	**HUF47bn**
	HUF352.2/€
Net cash (HUFbn) at 31 December 2019	4.04
Shares in issue	91.7m
Free float	35.82%
Code	4iG
Primary exchange	Budapest
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	9.9	(15.9)	(40.4)
Rel (local)	5.5	6.5	(30.3)
52-week high/low		HUF1148	HUF296

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

Q120 results	22 May 2020
H120 results	28 August 2020

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Investment summary

High-growth market leader

Following a transformational year in FY19 (194% organic revenue growth FY18–19), despite the impact of COVID-19, management anticipates sustained revenue growth of c 20% in the period to FY22. The Hungarian market is a relative digital laggard in Europe and has therefore attracted EU funds over the past five years to help transition the economy online. EU funding is expected to continue until 2027 as part of the latest round of budget negotiations concluding this year. A reinvigorated 4iG is now clearly one of the market leaders in the IT services sector in Hungary with an ambition to become the market leader by FY22. Management expects continued organic growth to be supplemented by market share gains, with COVID-19 potentially accelerating market consolidation.

Diversified business, investing in higher-margin services

4iG has a broad footprint in Hungary, with a 600+ strong sales and engineering team serving both corporate and public sector clients across multiple sectors, making it the second largest player in the market. As part of its ongoing transformation, 4iG intends to deliver sustained double-digit revenue growth by diversifying away from lower value-added business, such as hardware/software reselling, offering near-shoring and increasingly moving into higher value-added IT services and SaaS-based solutions.

Substantial discount to peers, underpinned by 4.3% yield

Despite its ongoing transformation and growth prospects, at an FY20 P/E of 16.3x, 4iG's valuation neither reflects the transformation the business has already achieved nor its future growth prospects with the stock remaining at a substantial discount to European and regional peers. If 4iG successfully executes its growth strategy, its ratings should start to align with its more established peers. Looking ahead, improving profitability should drive cash generation and support an attractive dividend yield (FY19: 4.3%). Our assumptions, which are based on the guided c 20% revenue CAGR in FY19-22 imply a DCF value of HUF1,005 per share using a 10.2% WACC. The current share price of HUF507 represents a c 50% discount to this valuation.

Company description

4iG is a public limited company listed on the Budapest Stock Exchange, offering IT services and IT software implementation in Hungary and regionally. The 4iG group has been operating for more than 30 years, offering high-quality IT solutions and service levels and now, following a change of leadership, has become one of the largest domestic IT services businesses both in terms of revenue and engineering headcount.

In its latest financial year, to 31 December 2019, 4iG delivered almost three-fold organic top-line growth, reporting HUF41bn of revenue (€117m) from HUF14bn (€40m) in FY18 (both include value of goods resold). At 31 December 2019, 4iG employed more than 600 highly skilled professionals, including over 420 qualified engineers based in Budapest, Hungary.

4iG acts as the main contractor on large-scale IT projects for both public sector and private clients across multiple sectors, but with special expertise in healthcare and education in the public sector, energy and utilities, industry and manufacturing, retail and wholesale and IT, telco and business services. In terms of IT outsourcing, 4iG provides services to more than 100 enterprises including

Lego, Unilever and Wizz Air, as well as numerous other corporates and SMEs. The company manages more than 1,000 servers on behalf of clients as well as 17,000 computers and handles more than 12,000 IT tickets a month. 4iG has been the distributor of the world's leading computer manufacturer DELL since 1991. The company now is one of the largest DELL partners in Hungary and holds the Dell Certified Solution Partner title.

Outlook: 20% organic growth guided for FY20–22

Following a stellar performance in FY19 (194% organic revenue growth), expectations for FY20 remain robust with HUF23bn (€65m) of contracted revenue for January and February 2020, compared to HUF11bn (€31m) for the first two months of 2019. As is common in the sector, the group's revenue profile tends to be back-end loaded, with Q4 the busiest quarter of the year as clients commit remaining budgets ahead of the new financial year. COVID-19 may further accentuate this trend in FY20.

Many of the easy wins identified by the new strategy in FY18 have already shown through in FY19 and, as such, management expects to achieve sustainable top-line growth of c 20% through a combination of organic growth as the company focuses on higher value-added segments of the market, together with leveraging its scale and efficiencies to gain market share. Organic growth could be supplemented by selective M&A.

The company reported EBITDA margins of 9.9% in FY19 (FY18: 6.0%) and is targeting EBITDA margins in an 8–10% range over the medium term (two to three years). These relatively modest margins reflect the high levels of hardware and software reselling in 4iG's current revenue mix, where pure IT services companies can achieve gross margins in excess of 30% and double-digit EBITDA margins. We would expect margins to improve as 4iG builds its services revenues and gradually reduces its reliance on reselling.

COVID-19: Over 60% revenues from the public sector

In common with many other countries, Hungary is in lockdown with restrictions on movement implemented on 28 March until further notice. The COVID-19 outbreak makes forecasting challenging. The business has already successfully transitioned to remote working with minimal disruption. In the short term, changing work patterns including greater remote working for clients is likely to drive the need for further technology investment. In the medium term, reassuringly, 4iG derives over 60% of its revenues through multi-year contracts with the public sector, which should provide some degree of revenue protection even if the risk on corporate contracts is higher (eg Wizz Air). 4iG also has a strong footprint in the pharmaceutical sector, which is likely to benefit from additional funding post COVID-19.

To date, supply constraints have been minimal, so we have not factored in any project delays at this stage. However, we have some concerns that in the medium term, there may be delays on significant IT infrastructure projects if the current uncertainty persists. In the longer term, we feel more confident that the need for digital transformation and migration to the cloud will continue to drive technology investment domestically and regionally.

In summary, although we see a potential impact on 4iG in FY20, as COVID-19 affects specific sectors (eg aviation, automotive), clients (eg Wizz Air) and projects, we believe the medium- to long-term impact may be neutral to positive for 4iG as it is likely to accelerate the need for further IT investment and digital transformation as businesses gear up for more effective remote working. We also highlight a potential impact on 4iG's hardware reselling business, with hardware supply chains being elongated due to supply shortages in China and the Far East. We believe this risk is now receding as the Far East has started to emerge from lockdown ahead of the West. Consequently, our base scenario is for a re-weighting of revenues to H220. However, if the slowdown persists, there could be a degree of revenue deferral from FY20 into FY21 (although this is not currently in our model).

Looking for potential upside, management has already seen a slight freeing up in 2020 of Budapest's tight labour market and have completed a number of recent hires. Any COVID-19-led downturn is also likely to lead to a reduction in competition in the market as smaller, less well-capitalised businesses struggle. 4iG remains well capitalised (FY19 net cash of HUF4bn (€11.3m)) and is actively exploring opportunities for further market consolidation if the opportunity presents. We intend to try to quantify COVID-19's impact on 4iG and the IT services market in Hungary as the situation becomes clearer.

Peer and NPV valuations suggest meaningful upside

4iG trades at a material discount to its regional IT services and software peers, with FY20–22 EV/sales multiples at a 29–42% discount to the peer group average. On an EV/EBITDA basis, the discount widens from 2% for FY20 to 36% for FY22, showing a similar trend for the P/E multiple where the discount widens from 25% in FY20 to 47% in FY22. Looking at an NPV valuation, we have derived a core value of HUF1,005 per share, approximately 98% above the current share price of HUF507.

4iG's shares traded at a high of HUF1,184 around the time the T-Systems Hungary deal was announced, but traded steadily down in H219, reaching a low of HUF285.5 in mid-March. At HUF507, the shares have now recovered some of the ground lost to COVID-19. Key catalysts for future share price progression would be increasing investor familiarity with the business, proof of its growth story and successful market consolidation through M&A. As 4iG builds investor credibility and establishes itself regionally, rather than as just a domestic story, we would expect the peer group discount to narrow and ultimately close.

Factors influencing growth and profitability

As well as the usual risk factors relating to competition and regulation, we have already highlighted the impact of COVID-19 as a significant but, as yet, unquantifiable risk. As the group targets growth, management recognises that 4iG's most important assets are its staff. With the Hungarian employment market having been very tight for a number of years, staff recruitment and retention are critical. 4iG will also be reliant on acquisitions to achieve market leadership, needing to complete, by our high-level estimate, c HUF20bn (€57m) of M&A over the coming years.

Finally, we would note there is a degree of political exposure for the group, with market commentary closely linking Lőrinc Mészáros, an indirect shareholder in 4iG, with the Hungarian prime minister, Viktor Orbán. Mr. Mészáros holds a 21.6% stake in the company through his controlling interests in the financial investors, Konzum PE and Opus. Public sector contracts represent c 62% of FY19 turnover.

History of the group

4iG was founded in 1995 as FreeSoft and listed on the Budapest Stock Exchange in 2004 before making a series of acquisitions between 2004–2008 to build its market presence, including HumanSoft, Axis and BankSoft. Over the following 10 years, FreeSoft consolidated its acquisitions, rebranded to 4iG but abstained from further M&A, although we would note that growth was minimal between 2014–18, as the company stagnated under its previous management. In 2018, Gellért Jászai bought into 4iG, supplementing the company's existing management team with new hires to turn around the business and help implement the group's new strategy.

Exhibit 1: Company history

Source: 4iG

2018 management buy-in, transformation programme

Gellért Jászai became chairman of 4iG in July 2018 before becoming CEO in March 2019, shortly before increasing his equity stake in the business to 40.2% in July 2019. Having strengthened the existing management team, Mr Jászai (now chairman and CEO) led a transformation programme that has delivered a material improvement in FY19 (FY19 revenues c 3x FY18 revenues), but is not expected to deliver its full benefits until FY23, five years from the start of the programme.

The initial stage of that strategy has been to reposition the business for growth, as well as to introduce efficiency improvements, including changes in the organisational structure, consolidation of duplicated activities, a thorough review of contracts and strengthening of project control. This tighter management of the business and better cost control have led to a refocus of the sales function on larger and more profitable contracts in both the public and private sector. In terms of client delivery, improved process management has been introduced to manage the increasing number of large clients and projects.

As 4iG was created from the integration of five separate businesses, there is also an ongoing major project to update and integrate the IT infrastructure to create a common IT platform across the group. This integration project is not likely to complete before FY21.

The second phase of the strategy is to diversify the business away from product reselling (hardware and software) towards a more solution-oriented approach, by understanding client needs in more detail and introducing corporate account management, with a pro-active sales function target aligned to a number of sector verticals to meet and drive customer demand. 4iG is also looking to position itself for future market growth, broadening its capabilities to ensure it can offer a comprehensive suite of solutions across the entire market.

Future market leader

In FY18, 4iG was ranked the sixth information and communication technologies (ICT) business in Hungary (by revenues), but by the end of FY19 it had grown to become the second largest, behind T-Systems Hungary. Management estimates that T-Systems Hungary has c HUF100bn of revenues and, with an estimated 1,500–2,000 employees, 3x the number of staff. Management's strategic goal is for 4iG to become the leading company in the ICT space in Hungary by FY22 (through a combination of organic growth and M&A), expanding opportunistically in Central and Eastern Europe (CEE).

Organisation, culture and staffing

As well as its strength in the public sector, 4iG is well positioned within the corporate sector due to its broad footprint, making it the second largest IT services provider in Hungary with a range of blue-chip accounts (eg Wizz Air). 4iG offers a comparable depth and breadth of capability the market leader, T-Sytems Hungary, but is smaller and nimbler, with a more streamlined management structure.

At 31 December 2019, 4iG employed c 600 employees including over 400 technical employees (consultants and highly qualified engineers and technicians).

With its goal to become the number one IT systems integrator by the end of FY22, management recognises that 4iG's most important assets are its staff. To supplement its existing talent pool, 4iG is looking to recruit new staff with a focus on flagship technologies, relevant to the future development of the market. However, Hungary remains a tight employment market and employing suitably qualified staff in Hungary (and across the CEE) remains challenging.

Accordingly, 4iG is taking a differentiated strategy from many of its peers and recently hired a new HR director to oversee the necessary changes. This strategy will focus on developing an attractive workplace culture based around a matrix structure (by service line and sector). Unusually, the vast majority of 4iG's staff (c 90%) are full-time employees who know and understand the business culture, where its competitors rely on a large cohort of part-time consultants.

Consultants offer flexibility, both for the individual but also for the corporate cost base. However, relying on consultants does have a significant downside in terms of higher staff turnover and in establishing a corporate culture. Being based around a permanent team allows 4iG to build a differentiated workplace culture to attract, motivate and retain key staff. Management has highlighted its employment structure as one of the major factors behind its relative cost-efficiency against its competition, allowing it to bid competitively for contracts and deliver them on time and within budget.

4iG's full-time employee base also allows it to avoid any potential tax risk from consultants being deemed de facto employees in the future.

Strategic outlook: Three pillars of growth

Management's medium-term goal is for 4iG to become the number one IT systems integrator in Hungary and a significant player in the CEE region. To fulfil this vision, the company has identified three pillars of future growth:

- Future-proofing the business by offering new technologies relevant to its client base – these will include blockchain, artificial intelligence (AI), industry 4.0, cyber security, digitalisation and fintech.
- Expansion of 4iG's sectoral presence to include transportation, banking and healthcare.
- Developing its product strategy, diversifying away from product sales towards selling client-relevant solutions on an annualised recurring basis: developing a suite of 'x-as-a-service' products.

4iG is developing new technologies and products, but where the skillset does not exist internally it expects to hire or acquire expertise through acquisitions. Broadening the company's sector footprint is also expected to be M&A driven, with clients, contracts and a sector track record to be acquired through complementary acquisitions.

Together with ongoing investment to develop and integrate a group-wide IT platform and systems, management expects these pillars of growth to continue to drive growth well above local market levels for the foreseeable future.

M&A strategy: Domestic and regional focus

Management expects organic growth to be complemented by acquisitions. By our calculations, to become the market leader in Hungary 4iG will need to reach HUF100bn of revenues by FY22, which would imply c HUF20bn of acquired revenues to supplement organic growth and market share gains in FY20/21.

4iG's M&A strategy remains aligned with its growth strategy, where management expects continued robust organic growth to be complemented by acquisitions in coming years. Management also remains open to considering strategic partnerships and joint ventures – long-term cooperation with European or other international groups with complementary resources.

In terms of funding, 4iG had net cash of c HUF4bn at 31 December 2019 and the ability to issue new equity to supplement its cash resources for larger deals. Additionally, 4iG sought a credit rating in Q419 to allow the group to access debt finance.

Management's M&A goals are to consolidate 4iG's position in the Hungarian market and support the growth objectives set out above. 4iG has no tightly defined acquisition criteria but, nevertheless, domestically 4iG is looking to lead market consolidation, targeting smaller players with an attractive client base or sector focus and a proven track record (over five years) at typical multiples of up to c 8x EBITDA. The company will also consider acqui-hires (acquiring a company primarily to recruit its employees) and the acquisition of other specialist capabilities where opportunities allow. 4iG continues to review potential acquisitions and expects opportunities to emerge in FY20 as a result of financial pressure following the COVID-19 pandemic.

In CEE, 4iG will follow a low-risk opportunistic expansion strategy, building on client contracts to land and expand in nearby or adjacent markets. 4iG's expansion will be opportunistic; however, management has indicated that neighbouring CEE countries including Serbia, Bulgaria, Croatia and Romania are likely to present attractive opportunities over the next 10 years.

T-Systems deal aborted in FY19

In terms of M&A, it is worth noting that 4iG came very close to completing a transformational deal in FY19, announcing that it had signed a non-binding heads of terms to acquire T-Systems Hungary from Magyar Telekom Group for an undisclosed amount on 9 July 2019.

T-Systems is the Hungarian market leader in the ICT space, a far larger company with an estimated 1,500–2,000 employees (4iG had c 600 staff at the end of 2019). The deal was reportedly expected to boost 4iG's revenues to HUF200–250bn within a two- to three-year timeframe.

The deal was terminated by mutual agreement in December 2019 (reasons not disclosed), although in a joint statement 4iG reported that 'Magyar Telekom and 4iG intend to continue exploring cooperation opportunities with the aim of partnering in the field of services sold to the public and enterprise segments'. 'We made a difficult, but careful decision', said 4iG chairman and CEO Gellért Jászai, adding that '[4iG] remains on the look-out for acquisition targets and will engage on negotiations on a future partnership with T-Systems' (source: https://emerging-europe.com/).

The deal would have allowed Magyar Telekom Group to streamline its operations and focus on its core telecoms business, while for 4iG the acquisition would have been a quick way to deliver scale and market leadership in the Hungarian market. However, 4iG's underlying performance in FY19 has highlighted the considerable organic growth opportunity in the market.

Credit rating: 4iG rated BB- by Scope Ratings

As part of its planned funding for the aborted acquisition of T-Systems Hungary, 4iG received a BB- issuer rating from Scope Ratings in October 2019, allowing it to qualify for the National Bank of Hungary's Bond Funding for Growth Scheme.

This scheme was put in place in July 2019 to support the development of a corporate bond market in Hungary and allows the central bank to underwrite up to HUF20bn of a corporate bond issue (or 70%, whichever is lower) for a qualifying corporate group.

4iG received shareholder approval to issue up to HUF30bn of corporate bonds in September 2019.

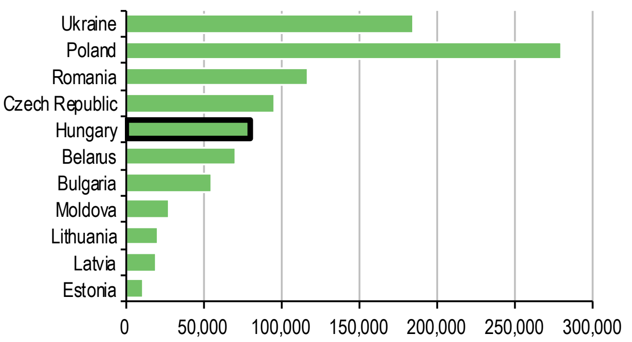
Market background: Hungary and the CEE

Attractive near-shoring destination

The IT market across Eastern Europe has grown strongly in recent years as the CEE has become a preferred choice for global companies looking for a software development partner, attracted by the depth of the talent pool, its strong technology infrastructure and the affordable cost base. In particular, since 2014 there has been a dramatic increase in outsourcing driven by cloud adoption, the flexibility within the region and low costs. Companies are drawn to the CEE region over other countries (eg India) because of the better skillset, fewer cultural differences and easier communication given shorter distances and fewer time zones. IT outsourcing to Eastern Europe is now viewed as a major business enabler of digital transformation.

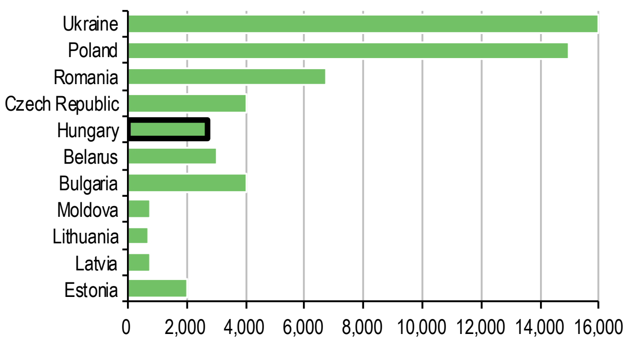
Countries such as Ukraine, Poland and Romania are taking the lead as IT outsourcing destinations. The largest talent pool is in Poland with 279,800 IT specialists. Ukraine remains one of the leading IT outsourcing destinations, with a large pool of around 184,700 IT professionals and estimated IT market growth of 15–20%. Romania has 116,100 IT specialists. The Czech Republic and Hungary have also attained a competitive position among top five Eastern European outsourcing destinations by market capacity, with sector growth rates of 10–15%.

Exhibit 2: Developer numbers by CEE country



Source: www.n-ix.com

Exhibit 3: Numbers of ICT graduates across CEE



Source: www.n-ix.com

Other countries have lagged in terms of adoption of new technologies and overall capacity, such as Moldova, Bulgaria, and Belarus. However, these jurisdictions have introduced incentives to attract foreign investment and encourage the growth of the domestic IT industry.

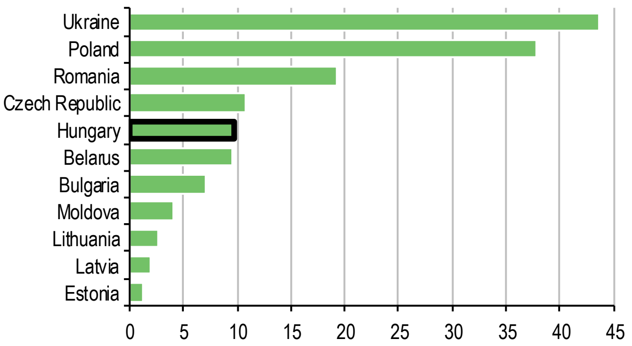
Hungary: Macroeconomic perspective

Following the fall of communism in 1990, Hungary has transitioned to a market-driven economy with a per-capita income now approximately two-thirds of the EU average. Hungary joined the EU in 2004 but has yet to join the eurozone. In recent years the government has become more directly involved in managing the economy, implementing unorthodox economic policies to boost household consumption and relying on EU-funded development projects to generate growth.

Hungary suffered a significant economic contraction from the global economic slowdown in 2008/09 with a drop in export demand and domestic consumption, leading it to accept a package of IMF-EU assistance.

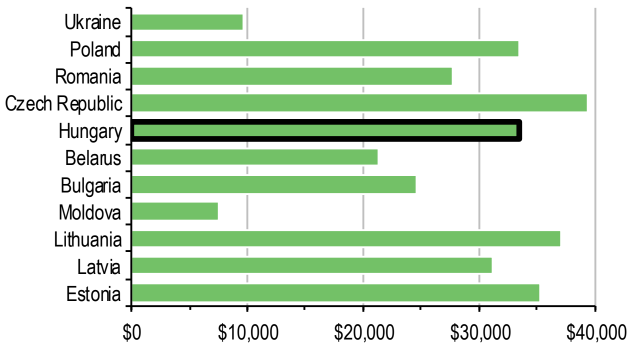
Real GDP growth has been robust in the past few years due to increased EU funding, higher EU demand for Hungarian exports and a rebound in domestic household consumption. According to the OECD's latest real GDP forecasts, Hungary is expected to have delivered the strongest GDP growth in the CEE in 2019, with 4.8% growth – on top of 5.1% growth in 2018. To boost household consumption ahead of the 2018 election, the government embarked on a multi-year phased increase to minimum wages and public-sector salaries, cutting personal income tax from 16% to 15% and implementing a uniform 9% business tax for SMEs and large companies.

Exhibit 4: CEE population estimates (m)



Source: UN World Population Prospects (2019)

Exhibit 5: CEE US$ 2018 GDP per capita (PPP)



Source: The World Bank

Supportive corporate tax regime

Since 2010 the Hungarian government, led by the Fidesz Hungarian Civic Union, has developed the practice of imposing sector-specific special taxes, including in the banking, energy, telecommunications, retail, media and tobacco industries. These often penalise large (mostly foreign-owned) businesses and are most often levied on sales revenue to prevent individuals or companies from evading taxes by moving profits offshore.

Special taxes aside, Hungary's corporate income tax regime remains among the most attractive in the EU, with a 10% rate on the first HUF500m of profits and a rate of 19% above that. This is coupled with tax credits for companies carrying out investments of at least HUF3bn (or as low as HUF100m in areas such as R&D), provided they meet job-creation targets.

Exhibit 6: CEE regional business rankings

	AT Kearney	Bloomberg Innovation	Doing Business	English proficiency
Ukraine	20	53	71	43
Poland	24	22	33	13
Romania	28	29	52	16
Czech Republic	33	25	35	20
Hungary	31	32	53	21
Belarus	-	72	37	38
Bulgaria	17	41	59	25
Moldova	-	42	47	-
Lithuania	16	37	14	26
Latvia	21	42	19	-
Estonia	12	36	16	-

Source: N-iX.com, AT Kearney 2019 Global Services Location Index, Bloomberg Innovation Index 2019, World Bank Group's Doing Business Report

Market context: Hungary and the CEE

Global IT market: Expected impact from COVID-19

IDC forecasts the overall global IT market will grow by 6.2% annually until 2022, with new technologies growing at a CAGR of 18.5%. Growth was anticipated to come from opportunities in fibre-optics connections, virtual mobile connections, big data/analytics, convergent communication, system security, cloud-based services and software-defined networks.

However, recent revisions to IDC's forecasts, taking into account the impact of COVID-19 on the global economy, suggest 2020 annual global IT spending, forecast in January 2020 to grow at 5.1%, will now fall by 2.7%. Hardware spending is often cut early in an economic crisis to preserve cash and profitability but with greater penetration of cloud delivery than in previous global recessions, overall IT spending may be more resilient than in previous downturns.

IDC forecasts that global IT services spending will decline 2% in 2020, with project work likely to be worst hit until business visibility improves. Software services spending is still forecast to grow 1.7%, with growth driven largely by cloud investment and other core software services.

The impact of COVID-19 underlines the need for digital transformation and cloud migration, with companies needing to invest rapidly in remote working and collaboration tools.

Hungarian IT landscape

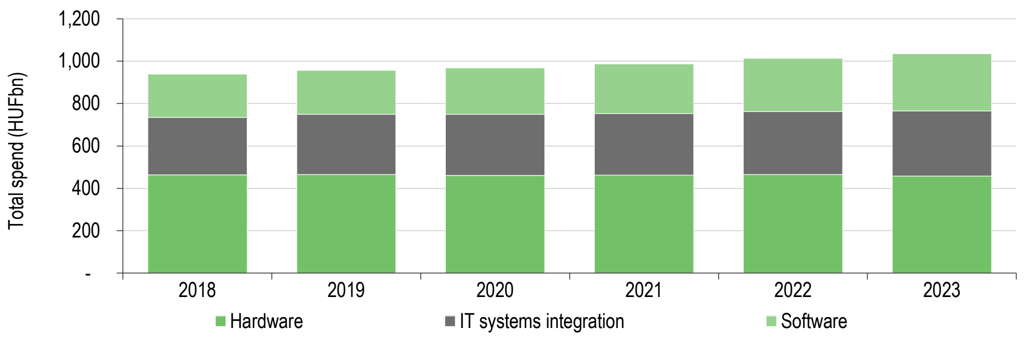
The Hungarian software development industry is a significant contributor to the country's economy, representing about 6% of GDP. Hungary also has a large share of outsourcing within the CEE, with 80,100 specialists employed in the IT sector. Budapest is at the heart of the country's growing IT sector. According to the Hungary Information Technology Report, sales of IT services are expected to grow from $760m (in 2016) to $993m in 2020 (6.9% CAGR).

The Hungarian government has provided financial support for R&D between 2016–20 and has launched a number of incentives to give easy access to technical knowledge through workshops, events and conferences. IT-friendly policies such as these have helped the country attract a number of multinational companies such as Siemens, Microsoft, Deloitte, Ericsson, Nokia and TATA to establish R&D centres to the country.

Although some segments of the market are growing much more strongly, latest figures indicate the Hungarian IT spending is expected to grow at a 2% overall CAGR to 2023 (Exhibit 7 below), driven mainly by increasing public sector software spending. The increase in public sector spending reflects three major drivers:

- **Digital transformation**: investment in future technologies, including Internet of Things in manufacturing, retail, utilities, agriculture and logistics and AI, particularly in customer service and customer-facing deployment.
- **GDPR-related backlog**: regulatory compliance (mainly GDPR) has been a key driver in the Hungarian IT services market during 2018. Continued investment in systems and processes still required to catch up with best practice.
- **Public-sector investment to increase efficiency and reduce overheads**: the public sector in Hungary spent more than HUF50bn on IT services in 2018, 21% of the whole information service market, driven by EU funding through to 2021 (although this is expected to be extended through to at least 2027 when the next five-year EU budget is agreed).

Exhibit 7: Hungarian IT services spending – growth forecast (2% CAGR 2019–23)



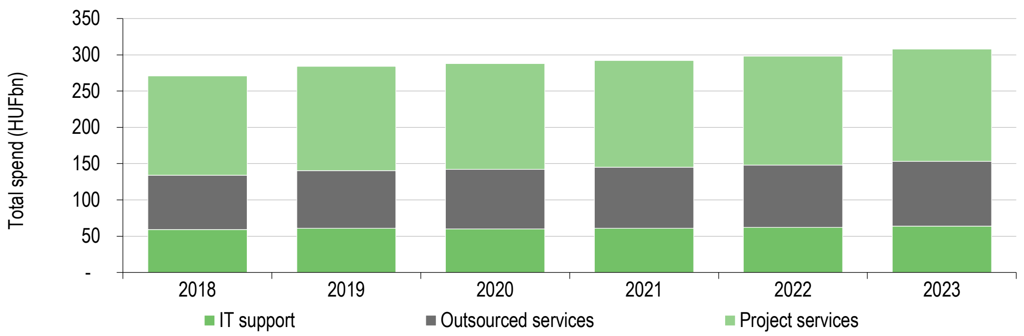
Source: IDC 2019

To ensure continued growth, both absolute as well as increasing market share, 4iG plans to expand into sectors of relative weakness, including transportation, banking and healthcare. The hardware segment is forecast by IDC to be broadly flat over the period 2019–23, with systems integration growing at a CAGR of 2% and software at close to 7%. Bearing these differing growth rates in mind, management intends to position the group for growth, offering high-demand new technologies including digitalisation, blockchain, deep learning, artificial intelligence, industry 4.0, cyber security and fintech. Where possible, management also plans to focus on selling client-relevant solutions on an annualised recurring basis.

Hungarian IT market

The Hungarian IT market is expected to grow by a 3% CAGR to 2023, driven mainly by software-related projects, including development, integration and licensing. Systems integration (SI) and application development represent approximately a quarter of the market, while the public, finance, telecommunications and manufacturing sectors make up around two-thirds of market revenues. The fastest growing segment of the IT/SI market is outsourced services, forecast by IDC to grow at a CAGR of 3.5% 2018–23 (Exhibit 8).

Exhibit 8: Hungarian IT systems integration and outsourcing – growth forecast (3% CAGR 2018–23)



Source: IDC 2018

Competition: Fragmented landscape

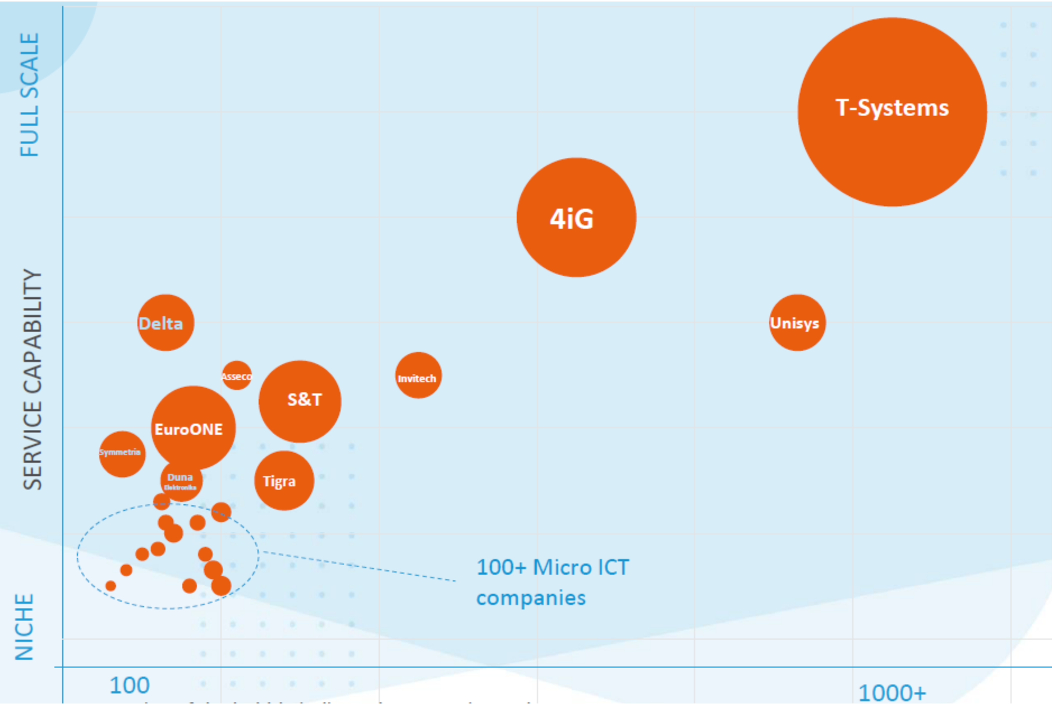
In 2018, the top six players in the Hungarian IT market accounted for c 22% of total market revenues. T-Systems Hungary was the clear market leader, followed by Invitech, Oracle, S&T Consulting, Delta Group and 4iG.

With 4iG's material growth in FY19, 4iG is now the number two in the market, second only to T-Systems Hungary, with management's ambition to overtake it to become the market leader by the end of FY22 (through a combination of organic revenue growth, market share gain and M&A).

Management already considers 4iG to be of a scale in Hungary that means it will be invited to tender for all major contracts. With its (ongoing) investment in IT systems and processes, together with its skilled and motivated full-time workforce, management believes it also has a real competitive advantage over T-Systems Hungary that will mean it can continue to take market share.

As can be seen in Exhibit 9, no other group has the scale and staffing to compete with 4iG and T-Systems across a broad range of sectors.

Exhibit 9: 4iG – number two in the Hungarian market



Source: 4iG, individual company accounts and other public disclosures

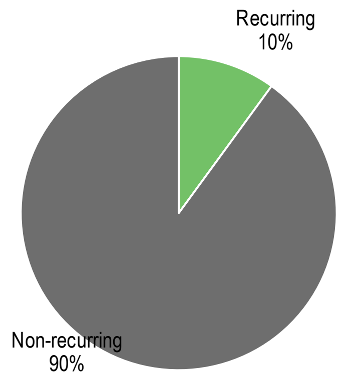
Operational performance: Diversified business

IT spend in Hungary is largely driven by the dominant public sector and, as such, the majority of 4iG's revenues in FY19 were derived from public-sector clients (c 62%), with large corporate accounts making up 22% of revenues and SMEs the remaining 16%. Although we understand 4iG intends to reduce its reliance on public-sector contracts, given the balance of the public versus private sector in Hungary (and across the CEE), we do not envisage public-sector work falling below 50% of overall revenues in the medium term.

4iG is benefiting from market-wide investment in technology in Hungary, with FY19 and FY20 revenues significantly reliant on one-off hardware and software reselling (together almost three-quarters of FY19 revenues) with a relatively low but growing proportion of services sales. Much of this investment is public-sector led, with government spending on digital transformation supported by EU grants until FY21. Grants to support continued IT investment over the next budgetary cycle are expected to be part of the EU's five-year budget to be signed off later this year.

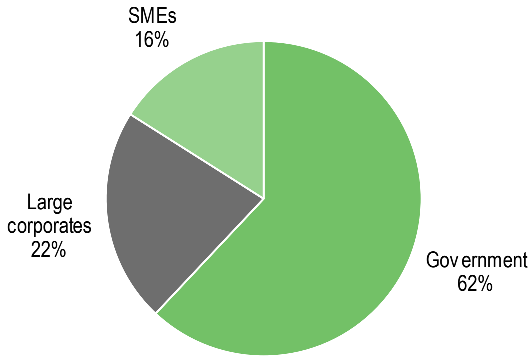
It is also noteworthy that the Hungarian market has been slow to adopt cloud-based revenue models (eg SaaS) and, as such, recurring revenues remained a small proportion (c 10%) of 4iG's overall revenues for FY19. As key areas for future development, management is investing in increasing the share of higher value-added services (software) and recurring revenue business (outsourcing) over the medium term.

Exhibit 10: 2019 turnover by type



Source: 4iG

Exhibit 11: 2019 turnover by client type

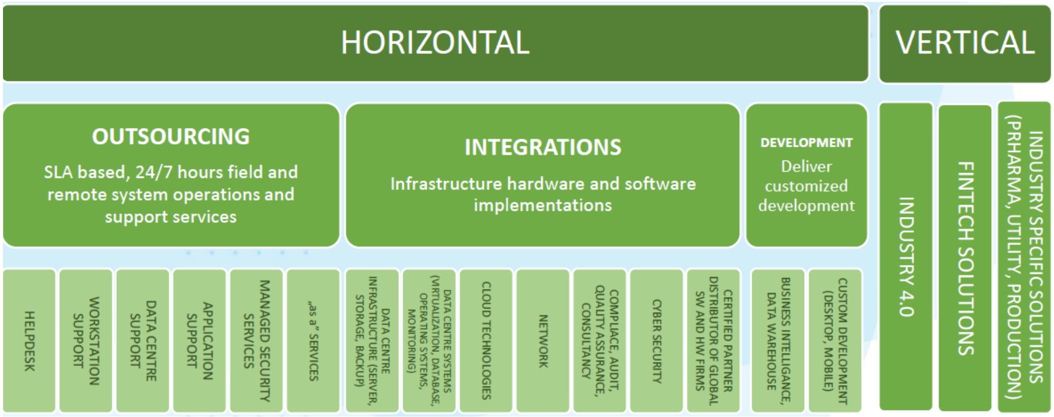


Source: 4iG

Business competency mapping

4iG's revenues in FY19 were dominated by product sales; however, in FY20 and beyond management focus is on investing in and developing higher value-added IT solutions and services. Exhibit 12 sets out 4iG's competency map, outlining the spectrum of services offered by the company. Individual services are increasingly bundled to provide bespoke client solutions and, looking to the future, 4iG is already developing a vertical suite of thematic services around fintech, industry 4.0 and other sector-specific solutions.

Exhibit 12: Service portfolio structure – competency mapping



Source: 4iG

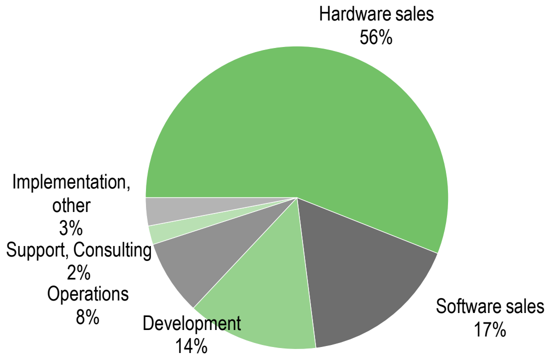
4iG breaks down its business into six separate business lines:

- **Hardware sales (56% of FY19 revenues, HUF23bn, FY18–19 growth of 237%)**: with its partner authorisation, 4iG is a certified reseller for many global hardware brands such as HP, HPe, Dell, DellEMC, Lenovo, NetAPP, Huawei and Cisco. In addition to basic hardware distribution, 4iG also offers a range of higher value-added implementation services, including installation and migration.
- **Software sales (17%, HUF7bn, 920%)**: similar to its hardware accreditation, 4iG holds licence distribution rights to global software developer firms such as SAP, ORACLE, VEEAM, VMWARE, Citrix and ServiceNow.
- **Development (14%, HUF5.4bn, 104%)**: 4iG's development team delivers specialised software products using a range of programming languages (JAVA, .net) on desktop and mobile

platforms. Development scopes encompass front-end, middleware and back-end layers as well as integrated solutions for business intelligence, data warehousing, process automation and bespoke requirements.

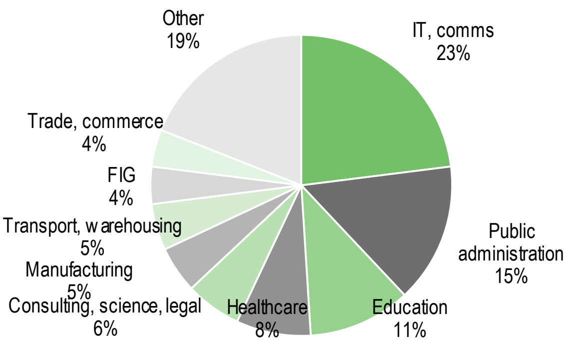
- **Operations (8%, HUF3bn, 67%)**: 4iG offers ITIL- and ISO-compliant, 24/7, onsite and/or remote, service level agreement based maintenance services for both end-user workstation environments and datacentre systems/infrastructure (server, storage, backup, network, operating systems, virtualisation etc) and enterprise business applications. In practice, this includes managing recurring tasks such as security patching, system observation, monitoring, software deployment, install, move, add, change help desk ticketing, as well as higher added value tasks like scheduled database purging.
- **Support/consultancy (2%, HUF1bn, -16%)**: support services are fully connected and integrated into the operations business line as a next level of service, offering deep-level troubleshooting, incident resolution and issue management. Consultancy incorporates infrastructure and security auditing service, project quality assurance and architect/system designing support.
- **Implementation/other (3%, HUF1bn, 47%)**: a systems integration service mainly associated with the hardware and software sales business lines. Certified staff provide cabling, datacentre establishment, installation of high availability infrastructure hardware and software, business applications, databases, network and security solutions. They also offer industry-specific solutions developed in-house for pharma (validation services), manufacturing (industry 4.0), digitalisation and process automation (Workflow etc).

Exhibit 13: 2019 turnover by business line



Source: 4iG

Exhibit 14: 2019 turnover by client sector



Source: 4iG

Client overview

Exhibit 15: Publicly disclosed clients

Source: 4iG

As well as its strength in the public sector, 4iG is well positioned within the corporate sector due to its broad footprint (with a sales and engineering team of 600+), making it the second largest IT services provider in Hungary with a range of blue chip accounts (eg Wizz Air). This broad footprint means 4iG can offer a comparable depth and breadth of capability to the market leader, T-Sytems Hungary, but is smaller and nimbler, with a more streamlined management structure.

Although all government sector contracts and clients are announced publicly, 4iG does not provide a breakdown of its private client exposure. However, of its c 3,500 clients, the group works with c 500 public sector companies and c 3,000 private sector clients (both large corporates and SMEs) across a range of industry sectors.

A summary of recent major public sector client wins can be found in the Appendix.

Management team

When Mr Jászai took control of 4iG in July 2018, he strengthened 4iG's existing management with outside expertise to help drive the required strategic transformation.

Gellért Jászai, chairman and CEO: Mr Jászai is the chairman (since 2018) and CEO (since 2019) of 4iG and leads the company's expansion in Hungary and internationally. Prior to 4iG, he was the chairman of Konzum Nyrt between April 2015 and 2019. Mr Jászai graduated from the Corvinus University of Budapest with a master's in public administration.

Aladin Linczényi, COO: Mr Linczényi is a board member and the COO of 4iG. Prior to joining 4iG, he was a board member of Konzum Nyrt and was the CEO of Konzum Asset Mgmt. Earlier in his career, he spent over 11 years at Raiffeisen Bank in Hungary focusing on diverse corporate finance and financing activities. He has a master's in economics from the Corvinus University of Budapest.

Péter Farkas, CTO: Mr Farkas is the deputy CEO of 4iG and is responsible for client service delivery. In 2001 he joined Humansoft, one of 4iG's subsidiaries, progressing to CTO of Humansoft between 2012–17 before being appointed CTO for 4iG. He has a from the Miskolc University of Engineering. master's in engineering

Csaba Thurzó, CFO: Mr Thurzó is deputy CEO and CFO and is responsible for the accounting, finance, tax, controlling and HR activities of 4iG and its group (DOTO, Veritas, Humansoft Service).

Prior to joining 4iG, he was CFO for Magyar Post for 13 years. He is a graduate from the Budapest Business School and Eötvos Loránd University.

Gábor Radó, CSO is responsible for all sales and commercial activities of the company. He joined Humansoft, a subsidiary of 4iG, in 2004 and worked his way up to Chief Sales Officer. Prior to this, Mr. Radó worked for multinational companies including SAS Institute and Microsoft. He holds a degree in technology from Ort Braude Collage of Technology in Israel, Karmiel.

Peter Fekete, Advisor to the Chairman: Mr. Fekete is the advisor to the Chairman and leads the Company's M&A, capital markets and international activities. Prior to 4iG, he served as the deputy CEO of Konzum Nyrt. between September 2017 and July 2019. Previously, he spent 12 years working in investment banking for UBS, Jefferies and Houlihan Lokey in London. He graduated with a Master's in Economics from the Corvinus University of Budapest.

Financials

As we highlighted above, the current management team took control of 4iG in 2018, taking what was a fairly sizeable IT services business that had stagnated and launched a five-year transformation programme to reinvigorate the group, cutting costs and refocusing the business on profitable contracts and clients. 4iG's FY19 results indicate the success of this approach, with 194% y-o-y organic revenue growth and a return to meaningful bottom-line profitability.

Many of the easy wins identified by the new strategy in FY18 have already shown through in FY19. Accordingly, after this period of hyper-growth, FY20 is expected to be a year of relative consolidation, with the company guiding towards revenue growth of c 20% in FY20–22.

Segmental breakdown

4iG provides a limited segmental breakdown in its accounts, grouping hardware and software reselling into Commerce, while IT Services captures the majority of everything else (development, operations, support and implementation), apart from other IT services, which includes a varying mix of revenue for public procurement costs, R&D subsidies, revenue from the disposal of assets, rebates and other small items.

As is set out in Exhibit 16, Commerce is a relatively low-margin business, with gross margins of 13% in FY19, rising to 17% in FY20–22 on our estimates, as the group leverages its greater scale to improve reselling margins. IT Services margins are relatively steady at c 65% for the forecast period, but the proportion of revenues from these higher-margin service lines is set to increase as the growth rate rises through the forecast period, as new technologies and solutions are developed and rolled-out to clients.

Exhibit 16: Key financials

HUF (bn)	FY18	FY19	FY20e	FY21e	FY22e
Gross revenues*					
IT Services	6.42	11.11	12.78	15.32	18.38
- y-o-y growth	*5.4%*	*73.2%*	*15.0%*	*19.9%*	*20.0%*
Commerce	7.62	29.89	36.16	43.40	49.91
- y-o-y growth	*-29.8%*	*292.0%*	*21.0%*	*20.0%*	*15.0%*
Other	0.45	0.48	0.53	0.58	0.64
- y-o-y growth	*22.1%*	*8.0%*	*10.0%*	*10.0%*	*10.0%*
Total	14.49	41.49	49.47	59.31	68.93
Gross profits					
IT Services	4.22	7.10	8.26	9.92	11.90
Commerce	0.84	3.89	6.33	7.59	8.73
Other	0.01	0.01	0.17	0.19	0.21
Total	5.07	11.00	14.76	17.70	20.84
Gross margins					
IT Services	66%	64%	65%	65%	65%
Commerce	11%	13%	17%	17%	17%
Other	3%	2%	32%	32%	32%
Total	35%	27%	30%	30%	30%
EBITDA	0.84	4.08	4.15	5.63	7.73
- % margin	*6.0%*	*9.9%*	*8.5%*	*9.6%*	*11.3%*
Depreciation	(0.12)	(0.16)	(0.19)	(0.22)	(0.27)
Amortisation	(0.48)	(0.56)	(0.59)	(0.61)	(0.65)
Operating profit (normalised)	0.24	3.36	3.38	4.79	6.81
- % margin	1.7%	8.2%	6.9%	8.1%	9.9%
Effective tax rate (normalised)	53.5%	14.6%	13.0%	14.0%	15.0%
EPS normalised (HUF)	1.1	31.9	31.8	44.9	63.4

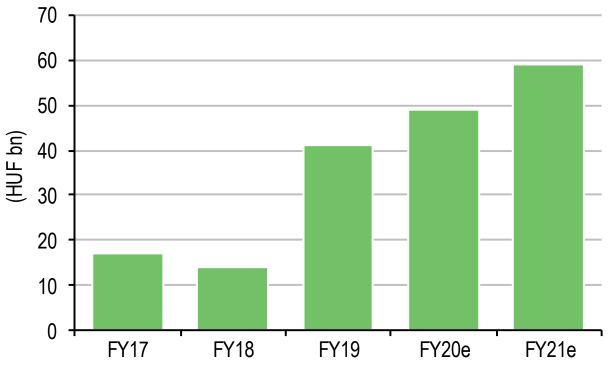
Source: 4iG, Edison Investment Research. Note: *Revenue on a gross basis including value of goods resold.

Guided by 4iG's growth targets, our forecasts expect a three-year sales CAGR of 18.5% versus 194% growth in FY18–19. We forecast an overall gross profit margin of c 30% compared to 4iG's historical margins of 26.8% in FY19 and 36.2% in FY18 (based on net revenues, 35.0% based on gross revenues). We forecast FY20 EBITDA margins of 8.5%, a reduction from the 9.9% in FY19 due to a small number of key contracts won at lower margins in FY19, which will have an impact on FY20. Our conservative margin forecasts also leave some scope for increased costs associated with remote-working because of COVID-19. We expect EBITDA margins to recover to 9.6% in FY21 in line with the group's target range of 8–10% for FY20–21, before rising further in FY22 as the group leverages its increasing scale and sees the benefits of the increase in higher-margin services.

Operating profit margins, which were 8.2% in FY19, fall in FY20 to 6.9% due to the lower-margin landmark projects secured in FY19, before stabilising in FY21 and building to 9.9% in FY22.

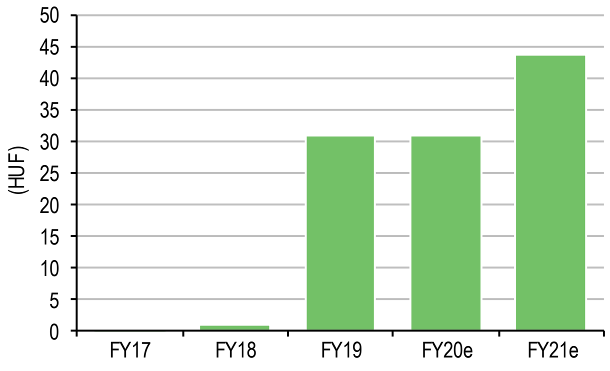
As we have mentioned, Hungary benefits from a low corporate tax rate of 16%, with additional tax breaks. 4iG saw an effective tax rate of 14.6% in FY19, and we forecast that this will fall to 13% in FY20, before converging towards the full tax rate of 16% over the course of FY21–22. Although EPS is fairly flat FY19–FY20 (with revenue growth largely offset by weaker margins), we forecast EPS growth at a 26% CAGR from FY20–22, as 4iG continues to drive cost efficiencies, benefits from greater scale and targets growth of higher-value services including cloud services and annual recurring revenues.

Exhibit 17: Forecast revenues



Source: 4iG, Edison Investment Research

Exhibit 18: Forecast adjusted EPS



Source: 4iG, Edison Investment Research

Cash flow: Strong cash generation, 4.3% dividend yield

4iG is strongly cash-generative, with operating cash flow of HUF6.9bn in FY19 (FY18: an outflow of HUF0.7bn), and HUF3.4bn forecast for FY20, rising to HUF6.2bn in FY22. In FY19, the company had heightened capex of HUF1.47bn (FY18: HUF0.12bn) to cover the investment and integration of its IT systems. From FY20 and for the remainder of the forecast period, we see capex stabilising at 1.8% of revenues. The board of directors declared a dividend of HUF22 per share for FY19, a pay-out ratio of just below 70%, offering a dividend yield of 4.3%. For FY20 and beyond, we have assumed dividends are maintained at a similar level of pay-out, although we would note that cash may be reserved for acquisitions if appropriate opportunities are identified.

Balance sheet: Significant gearing capacity

4iG has an ungeared balance sheet with c HUF4.0bn net cash and no long-term borrowings as at 31 December 2019, against net assets of HUF6.2bn. With EBITDA of HUF4.1bn in FY19, this leaves significant additional debt capacity. As part of its planned funding for T-Systems Hungary, 4iG had sought and received shareholder approval to issue up to HUF30bn of corporate bonds. Although the T-Systems Hungary deal did not proceed, the aborted transaction highlights that 4iG has substantial capacity to gear up its balance sheet for the right acquisition.

Valuation

We have looked at 4iG on the basis of peer valuations, cross-referenced against a more fundamental NPV basis.

Valuation: NPV

Firstly, looking at the net present value (NPV) of future cash flows, we have derived a core value of HUF1,005 per share, 98% above the current share price of HUF507. This valuation is based on an explicit forecast period from 2020–29, before adding a perpetuity calculation, and a WACC of 10.2%. We show the sensitivity to different WACC assumptions in Exhibit 20.

Our key valuation assumptions are set out in the table below:

Exhibit 19: Forecast cash flows (HUFbn)

Valuation (DCF)	FY20e	FY21e	FY22e	FY23e	FY24e	FY25e	FY26e	FY27e	FY28e	FY29e
Net sales	49.08	58.88	68.47	77.94	86.80	94.88	101.73	106.97	110.26	111.36
Net sales y-o-y growth (%)	*19.3%*	*20.0%*	*16.3%*	*13.8%*	*11.4%*	*9.3%*	*7.2%*	*5.2%*	*3.1%*	*1.0%*
EBIT	3.38	4.79	6.81	9.05	11.49	12.37	13.06	13.52	13.71	13.63
EBIT margin (%)	*6.9%*	*8.1%*	*9.9%*	*11.6%*	*13.2%*	*13.0%*	*12.8%*	*12.6%*	*12.4%*	*12.2%*
Depreciation & amortisation	0.19	0.22	0.27	0.32	0.39	0.42	0.45	0.48	0.49	0.50
D&A (as a % of sales)	*0.4%*	*0.4%*	*0.4%*	*0.4%*	*0.4%*	*0.4%*	*0.4%*	*0.4%*	*0.4%*	*0.4%*
Tax paid on EBIT	(0.44)	(0.67)	(1.02)	(1.45)	(1.84)	(1.98)	(2.09)	(2.16)	(2.19)	(2.18)
Tax rate (%)	*13.0%*	*14.0%*	*15.0%*	*16.0%*	*16.0%*	*16.0%*	*16.0%*	*16.0%*	*16.0%*	*16.0%*
Gross cash flow	3.13	4.35	6.06	7.92	10.04	10.81	11.42	11.83	12.01	11.94
Decrease in net working capital	(0.37)	(0.43)	(0.51)	(0.53)	(0.54)	(0.39)	(0.33)	(0.25)	(0.16)	(0.05)
Net working capital	2.17	2.60	3.11	3.65	4.18	4.57	4.90	5.15	5.31	5.37
Net WC (as a % of sales)	*4.4%*	*4.4%*	*4.5%*	*4.7%*	*4.8%*	*4.8%*	*4.8%*	*4.8%*	*4.8%*	*4.8%*
Net capex	(0.90)	(1.03)	(1.17)	(1.31)	(1.45)	(1.35)	(1.20)	(1.00)	(0.76)	(0.50)
Net capex (as a % of sales)	*1.8%*	*1.8%*	*1.7%*	*1.7%*	*1.7%*	*1.4%*	*1.2%*	*0.9%*	*0.7%*	*0.4%*
Free cash flows	1.86	2.88	4.38	6.08	8.06	9.08	9.90	10.58	11.09	11.39

Source: Edison Investment Research

Exhibit 20: NPV sensitivities

		Weighted average cost of capital (WACC)				
		8%	9%	10.2%	11%	12%
Long-term growth rate	0.5%	1,308	1,132	969	883	793
	1.0%	1,378	1,183	1,005	913	816
	1.5%	1,459	1,241	1,045	945	841
	2.0%	1,553	1,307	1,091	981	869

Source: Edison Investment Research

Exhibit 21: WACC assumptions

Risk free rate	2.1%
Beta	1
Market risk premium	10.0%
Marginal tax rate	16.0%
Pre-tax cost of debt	3.0%
Cost of equity	12.1%
Target debt/value ratio	20.0%
Target equity/value ratio	80.0%
WACC	10.2%
Sustainable long-term growth rate	1.0%

Source: Edison Investment Research

Valuation: European and regional peer group

In terms of 4iG's peer group, in the absence of directly comparable domestic peers, we have looked at regional or European companies offering IT services of a similar nature (eg Atos, Tieto, Adesso), international companies with a presence in the Hungarian market (eg S&T) as well as CEE based peers, Comarch and the Asseco Group – considering two separately quoted entities, Asseco Poland and Asseco South Eastern Europe (see Exhibit 22).

Exhibit 22: Peer group comparison

Name	Share price (ccy)	Quoted ccy	Market cap (€m)	Sales growth 1FY (%)	EBITDA margin 1FY (%)	EBIT margin 1FY (%)	EV/ sales 1FY (x)	EV/ sales 2FY (x)	EV/ sales 3FY (x)	EV/ EBITDA 1FY (x)	EV/ EBITDA 2FY (x)	EV/ EBITDA 3FY (x)	P/E 1FY (x)	P/E 2FY (x)	P/E 3FY (x)
Atos SE	66.1	EUR	6,862	(2.2)	13.6	7.7	0.9	0.9	0.9	6.7	6.2	5.6	9.6	8.6	8.1
TietoEVRY Corp	22.0	EUR	2,471	59.9	14.4	9.5	1.3	1.3	1.3	9.1	8.0	7.7	12.7	10.6	10.0
Sopra Steria SA	103.1	EUR	2,012	(2.9)	9.3	5.9	0.7	0.7	0.7	7.5	6.4	5.7	13.7	10.5	9.1
Softcat PLC	1139	GBp	2,463	11.7	8.5	8.2	2.0	1.8	1.7	23.7	22.1	20.5	30.8	29.0	26.9
Asseco Poland	73.0	PLN	1,264	4.7	14.6	9.0	0.8	0.8	0.7	5.4	5.2	4.8	16.5	15.9	12.3
Cancom SE	53.0	EUR	1,941	9.3	8.1	5.2	1.0	0.9	0.8	12.1	10.7	9.5	33.6	26.7	23.2
S&T AG	22.5	EUR	1,415	6.7	9.6	5.3	1.3	1.2	1.1	13.7	11.4	9.5	30.6	21.9	15.9
Datagroup SE	58.8	EUR	467	23.1	14.6	6.7	1.6	1.4	1.4	10.7	9.5	8.9	33.7	25.0	22.2
Adesso AG	51.0	EUR	300	3.9	9.4	4.4	0.9	0.8	0.7	9.1	7.1	6.4	25.2	15.3	12.8
Asseco SEE SA	33.6	PLN	364	14.2	19.6	12.6	1.7	1.6	1.6	8.8	8.8	8.4	17.2	16.6	15.6
Comarch SA	210.0	PLN	356	9.7	15.1	9.6	1.0	1.0	0.9	7.0	6.6	6.2	15.2	14.3	13.4
Mean				**12.6**	**12.4**	**7.6**	**1.2**	**1.1**	**1.1**	**10.3**	**9.3**	**8.5**	**21.7**	**17.7**	**15.4**
Median				**9.3**	**13.6**	**7.7**	**1.0**	**1.0**	**0.9**	**9.1**	**8.0**	**7.7**	**17.2**	**15.9**	**13.4**
4iG Nyrt*	507	HUF	132	19.3	8.5	6.9	0.9	0.7	0.6	10.1	7.4	5.4	16.3	11.6	8.2
Discount/(premium) to mean							29%	37%	42%	2%	20%	36%	25%	35%	47%
Discount/(premium) to median							19%	29%	35%	(11)%	7%	30%	5%	27%	39%

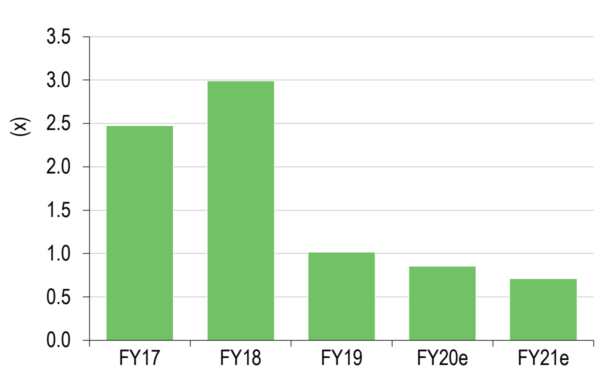
Source: Refinitiv data (9 April 2020), Edison Investment Research. Note: *4iG forecasts are Edison forecasts

The peer table indicates a fairly consistent set of multiples, with an average current financial year EV/sales multiple of 1.2x, against 0.9x for 4iG. The peer group average current year EV/EBITDA is 10.3x with an average P/E multiple of 21.7x. 4iG trades at a discount to these metrics, with the discount ranging from 25% to 47% based on sales and P/E multiples, with current year EV/EBITDA multiples close to parity with the peer group average, but with the discount widening in FY2 (20%) and FY3 (36%). These multiples highlight 4iG's improving operating margins as well as the relative tax-efficiency of the Hungarian market.

Factors behind 4iG's low relative valuation may include the group's: 1) low market capitalisation; 2) singular exposure to the Hungarian market, with a lack of direct peers; 3) lack of trading track record under the new management; 4) reliance on M&A to supplement market growth; and 5) perceived political and governance risk. We would expect key catalysts for share price progression to include increasing investor familiarity with the business, proof of its growth story and successful market consolidation through M&A.

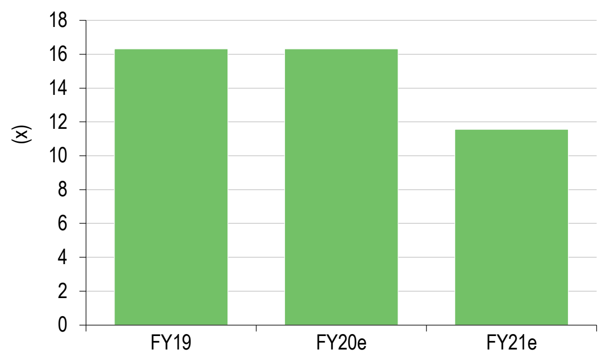
As 4iG builds investor credibility and establishes itself regionally, rather than as just a domestic story, we would expect the peer group discount to narrow and ultimately close.

Exhibit 23: EV/sales multiples



Source: 4iG, Edison Investment Research

Exhibit 24: P/E multiples



Source: 4iG, Edison Investment Research

Focusing in on 4iG's EV/sales and P/E multiples (Exhibits 23 and 24), both sets of multiples have normalised in FY19 as the new management team has driven through sales and cost efficiencies. Having achieved a step change in FY19, looking ahead, the multiples decline steadily (sales based:

0.9–0.7x, P/E: 16.3–11.6x) with little recognition from investors for continued strong growth, augmented by M&A, or the potential for future cost savings.

Sensitivities

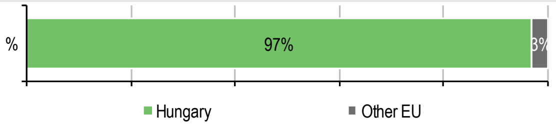
There are a number of factors that investors should bear in mind when considering investing in 4iG:

- **Limited free float:** Gellért Jászai (chairman and CEO) is a major shareholder in 4iG, currently holding c 40.2% of the equity. Together with the Konzum and Opus Global shareholdings controlled by Lőrinc Mészáros, a related party, these two shareholders control 61.8% of the equity. The free float is 35.8%, with the remainder held as Treasury shares.
- **Foreign exchange risk:** 4iG deals with customers and suppliers of different nationalities. However, we understand that there is little foreign exchange exposure to the group as contracts are typically denominated in a currency to provide a natural hedge to costs and liabilities.
- **Key person exposure:** we believe that 4iG's share price and potentially its operations could be affected by the loss of key management, particularly Gellért Jászai, CEO.
- **Political exposure:** we note market commentary that closely links Lőrinc Mészáros, an indirect 21.6% shareholder in 4iG (through Konzum PE and Opus), with Hungarian Prime Minister Viktor Orbán. Were there to be a change of government, prime minister or other political event, this could affect the company's performance. Public sector contracts represented c 62% of FY19 turnover.
- **COVID-19**: the COVID-19 virus represents an evolving scenario and with Hungary currently in lockdown, this makes forecasting the next 12 months challenging. The business itself has already successfully transitioned to remote working and derives over 60% of its revenues from multi-year contracts with the public sector, which provides a strong revenue base. Conversely, the impact of COVID-19 may lead to a consolidation of the Hungarian IT market, with 4iG well-placed to benefit.
- **Recruitment and retention**: management recognises that 4iG's most important assets are its staff. With its goal to become the number one IT system integrator by the end of FY22, 4iG needs to hire new staff with a focus on flagship technologies, relevant to the future development of the market. However, the recruitment market remains tight and finding suitably qualified staff in Hungary (and across the CEE) remains challenging.
- **IT infrastructure**: as part of its transformation programme, 4iG is unifying its fragmented IT systems and processes (CRM, HR, payroll) to deliver further group efficiencies. This project is due to complete in FY21, but if it is delayed then envisaged costs savings may also be delayed.
- **M&A**: 4iG is targeting 20% top-line growth in the medium term through organic growth and market share gains, further supplemented by selective M&A to deliver market leadership. Although 4iG continues to actively review M&A opportunities, the success of a buy-and-build strategy hinges on the company's ability to select the right acquisitions, maintain price discipline and retain its reputation as an attractive acquirer and employer.
- **Interest rates and stock market rating**: the macroeconomic environment has been very supportive for 4iG, with low interest rates and volatile stock market valuations. The environment would become more challenging if interest rates were to rise materially or were 4iG's shares to be de-rated or lose their attraction as an acquisition currency.

Exhibit 25: Financial summary

HUFm	2016	2017	2018	2019	2020e	2021e	2022e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT							
Revenue	15,686	16,915	14,007	41,129	49,083	58,881	68,467
Cost of Sales	(10,913)	(12,046)	(8,938)	(30,126)	(34,322)	(41,183)	(47,625)
Gross Profit	4,773	4,868	5,070	11,003	14,761	17,699	20,842
EBITDA	604	273	842	4,075	4,152	5,631	7,726
Normalised operating profit	98	(333)	240	3,362	3,380	4,792	6,811
Amortisation of acquired intangibles	0	0	0	0	0	0	0
Exceptionals	0	0	0	0	0	0	0
Share-based payments	0	0	0	0	0	0	0
Reported operating profit	98	(333)	240	3,362	3,380	4,792	6,811
Net Interest	(128)	(32)	(21)	(18)	(22)	2	31
Joint ventures & associates (post tax)	0	0	0	0	0	0	0
Exceptionals	0	0	0	0	0	0	0
Profit Before Tax (norm)	(29)	(364)	219	3,344	3,358	4,794	6,843
Profit Before Tax (reported)	(29)	(364)	219	3,344	3,358	4,794	6,843
Reported tax	(81)	(87)	(117)	(488)	(437)	(671)	(1,026)
Profit After Tax (norm)	(111)	(452)	102	2,857	2,921	4,123	5,816
Profit After Tax (reported)	(111)	(452)	102	2,857	2,921	4,123	5,816
Minority interests	0	0	0	66	0	0	0
Discontinued operations	0	0	0	0	0	0	0
Net income (normalised)	(111)	(452)	102	2,922	2,921	4,123	5,816
Net income (reported)	(111)	(452)	102	2,922	2,921	4,123	5,816
Basic average number of shares outstanding (m)	92.8	92.8	91.6	91.6	91.7	91.8	91.8
EPS – basic normalised (HUF)	(1.19)	(4.93)	1.11	31.87	31.84	44.93	63.39
EPS – diluted normalised (HUF)	(1.19)	(4.93)	1.08	31.09	31.08	43.86	61.87
EPS – basic reported (HUF)	(1.19)	(4.93)	1.11	31.87	31.84	44.93	63.39
Dividend (HUF)	0.00	0.00	0.00	22.00	22.00	31.00	44.00
Revenue growth (%)	(4.9)	7.8	(17.2)	193.6	19.3	20.0	16.3
Gross Margin (%)	30.4	28.8	36.2	26.8	30.1	30.1	30.4
EBITDA Margin (%)	3.8	1.6	6.0	9.9	8.5	9.6	11.3
Normalised Operating Margin	0.6	-2.0	1.7	8.2	6.9	8.1	9.9
BALANCE SHEET							
Fixed Assets	2,506	2,049	1,571	1,948	2,079	2,274	2,527
Intangible Assets	1,954	1,655	1,221	1,525	1,440	1,375	1,335
Tangible Assets	374	187	140	322	539	798	1,092
Investments & other	178	207	210	101	101	101	101
Current Assets	7,166	6,352	6,824	22,161	23,078	27,389	32,362
Stocks	461	274	242	523	686	824	953
Debtors	5,801	4,472	4,306	12,892	13,498	16,192	18,829
Cash & cash equivalents	187	323	176	6,238	6,386	7,865	10,073
Other	717	1,283	2,101	2,508	2,508	2,508	2,508
Current Liabilities	(6,544)	(5,756)	(5,652)	(17,861)	(18,006)	(20,408)	(22,662)
Creditors	(4,696)	(4,660)	(3,894)	(16,361)	(16,765)	(19,166)	(21,421)
Tax and social security	0	0	0	0	0	0	0
Short term borrowings	(1,848)	(1,096)	(1,758)	(1,500)	(1,242)	(1,242)	(1,242)
Other	0	0	0	0	0	0	0
Long Term Liabilities	(5)	(8)	(18)	(57)	(57)	(57)	(57)
Long term borrowings	0	0	0	0	0	0	0
Other long term liabilities	(5)	(8)	(18)	(57)	(57)	(57)	(57)
Net Assets	3,123	2,637	2,725	6,192	7,095	9,199	12,171
Minority interests	0	0	0	64	64	64	64
Shareholders' equity	3,123	2,637	2,725	6,255	7,158	9,262	12,234
CASH FLOW							
Op Cash Flow before WC and tax	604	273	842	4,075	4,152	5,631	7,726
Working capital	(1,020)	904	(1,360)	3,231	(366)	(430)	(510)
Exceptional & other	28	(0)	(26)	(5)	0	0	0
Tax	(100)	(104)	(117)	(415)	(437)	(671)	(1,026)
Net operating cash flow	(488)	1,072	(661)	6,886	3,350	4,530	6,190
Capex	(387)	(120)	(120)	(1,471)	(903)	(1,034)	(1,168)
Acquisitions/disposals	(89)	(11)	0	3	0	0	0
Net interest	0	(18)	(11)	(13)	(22)	2	31
Equity financing	(94)	(8)	0	185	0	0	0
Dividends	(183)	0	0	0	(2,019)	(2,019)	(2,844)
Other	(131)	(2)	(3)	36	0	0	0
Net Cash Flow	(1,373)	915	(795)	5,626	406	1,479	2,209
Opening net debt/(cash)	333	1,707	792	1,587	(4,039)	(4,445)	(5,924)
FX	0	0	0	0	0	0	0
Other non-cash movements	0	0	0	0	0	0	0
Closing net debt/(cash)	1,707	792	1,587	(4,039)	(4,445)	(5,924)	(8,133)

Source: 4iG accounts, Edison Investment Research

Contact details	Revenue by geography
H-1037 Budapest Montevideo St. 8. Hungary +36 1 270 7600 www.4ig.hu/en/Home.html	

Management team

Chairman and CEO: Gellért Jászai	COO: Aladin Linczényi
Mr Jászai was appointed chairman of 4iG in July 2018 then CEO in March 2019, leading the company's transformation programme, as well as expansion in Hungary and internationally. Prior to 4iG, he served as the chairman of Konzum Nyrt from 2015–19. Mr Jászai graduated from the Corvinus University of Budapest with a master's in public administration.	Prior to joining 4iG, Mr Linczényi was a board member of Konzum Nyrt. and served as the CEO of Konzum Asset Mgmt. Prior to this, he spent 11 years at Raiffeisen Bank in Hungary focusing on corporate finance and broader financing activities. He has a master's in economics from the Corvinus University of Budapest.
CFO: Csaba Thurzó	**CTO: Péter Farkas**
Mr Thurzó is responsible for accounting, finance, tax, controlling and HR activities of 4iG and its subsidiaries (DOTO Ltd., Veritas Ltd., Humánsoft Service Ltd.). Prior to joining 4iG, he worked as CFO for Magyar Post for 13 years. He is a graduate from the Budapest Business School and Eötvos Loránd University.	Mr Farkas is responsible for all the technical delivery activities of the company. He has worked for 4iG since joining Humansoft Ltd, a subsidiary of 4iG, in 2001. Between 2012 and 2017 he was responsible for the technical directorate at Humansoft, before being promoted to CTO. He has a master's in engineering from the Miskolc University of Engineering.

Principal shareholders	(%)
Investment vehicles controlled by Gellért Jászai (Chairman) (KZF, Manhattan)	40.21
Investment vehicles controlled by Lőrinc Mészáros (Konzum, Opus)	21.58
4iG treasury shares	2.39
Free float	35.82

Companies named in this report

Magyar Telekom, T-Systems Hungary, Unisys, Invitech, Delta Group, Tigra

Appendices

Technology partners, certifications and qualifications

Exhibit 26: 4iG's technology partners

Source: 4iG

Exhibit 27: 4iG's security technology partners

Source: 4iG

4iG is a certified reseller for many global hardware brands like HP, HPe, Dell, DellEMC, Lenovo, NetAPP, Huawei and Cisco. In addition to basic hardware distribution, 4iG also offers a range of higher value-added implementation services, including installation and migration. 4iG has been a distributor of the world's leading computer manufacturer, Dell, since 1991. As a Dell Certified Solution Partner, the company is one of the largest Dell partners in Hungary.

4iG has received a range of certifications, covering different aspects of its business. These include:

- ISO 9001:2015 – Quality management systems
- ISO 27001:2013 – Information security management systems
- ISO 20000-1:2011 – IT service management
- ISO 14001:2015 – Environmental management systems
- Certified supplier for Hungarian public procurement
- Registered NATO supplier
- Member of the Global Outsourcing Association

Recent newsflow and major contract wins

We include below a number of recent major contract wins, although we note that these are skewed to public tenders where announcements are required and exclude private sectors contracts, where public announcements are rare for reasons of confidentiality.

March 2020 – HUF1.1bn, three-year contract extension for National Tax and Customs Administration of Hungary (NAV). A three-year extension to the service management agreement used by the National Tax and Customs Administration of Hungary, supported by HP Managed Services.

February 2020 – HUF0.75bn public contract for the National Healthcare Services Centre (NHSC): Replacement of Routers for institutions participating in the Healthy Budapest Program. 4iG will update and manage data link and router tools, the integration of new network tools to existing systems, as well as their testing and commissioning for institutions across the capital region and Pest county (11 national hospitals, 13 co-hospitals and 32 clinics) until 2026 as part of the Healthy Budapest Program.

December 2019 – termination of discussions on merger with T-Systems Hungary. Magyar Telekom and 4iG terminated negotiations regarding the sale of T-Systems Hungary at '4iG's initiative'. As a result, T-Systems Hungary will continue to be a part of the Magyar Telekom group, although 'Magyar Telekom and 4iG intend to continue exploring cooperation opportunities.'

July 2019 – builds on an existing relationship with Océ Holding, a subsidiary of Canon. Thirty technical specialists were transferred to 4iG from the Hungarian operation of Océ Holding, a subsidiary of Canon, a leading manufacturer of printers and photo cameras. 4iG provides technical services to Canon Europe's digital services team.

July 2019 – HUF3.8bn 5+5-year framework agreement. 4iG, acting as a subcontractor for SYS IT Services, was awarded a public contract by Budapest Metropolitan City Council for 'Information technology operation and development'. The framework agreement was concluded for a fixed period of five plus five years.

July 2019 – 4iG established DOTO Systems ("do together"), a joint venture in which 4iG will hold 60% of the equity, with the founder, László Galambos holding the remaining 40% stake. The JV was established to acquire a unique, business process automation software framework to enhance 4iG's capability to create value-added products. László Galambos was appointed CEO.

July 2019 – Heads of terms agreed for T-Systems Hungary (subject to due diligence). 4iG agreed heads of terms with Magyar Telekom for the purchase of T-Systems Magyarország Zrt (T-Systems Hungary), excluding its SME business, subject to final due diligence. On close, the parties will conclude a long-term strategic cooperation agreement, whereby T-Systems Hungary will continue to sell the telecommunication services provided by Magyar Telekom to the large corporate and public sectors. 4iG will be entitled to use the brand name T-Systems in Hungary for a period of three years. The transaction was expected to close in 2019 but was terminated by mutual agreement in December 2019 (see above).

July 2019 – HUF1.9bn public contract for the 'Purchase of remote training licences' by the Hungarian Bureau of Specialised and Adult Education. The project is to purchase licences for the closed-chain remote training management and teaching material editing system, allowing the use of the system by two groups of users: 1) the provision of licences for 500 internal users (system administrators, training administrators, teaching material editors, proof-readers) allowing for 150 concurrent users; and 2) the provision of 500 external users licences (for teachers and students) with unlimited training time and 10,000 concurrent user authorisations.

July 2019 – **HUF0.9bn public contract (three years + 12m extension) awarded by MÁV (Hungarian State Railways)** for a 'Framework agreement for the installation, operation, maintenance and repair of MÁV Zrt's property protection systems'. The scope envisages the establishment of technologically secure surveillance, intruder alarm and access systems and the regular periodic maintenance and troubleshooting of existing systems. The project involves the installation of card access systems at specified access points, to configure and integrate other systems in the existing onsite, regional and central systems to facilitate uniform card access.

July 2019 – HUF11.2bn public contract award to a consortium comprising 4iG and T-Systems Hungary for the 'Implementation of an Information System for Long-Distance Public Transport (ISLT) as a framework services contract' by the Institute of Transport Sciences. The purpose of the project is to deliver elements for the central and background infrastructure, the system components facilitating the operation of the Main Dispatcher system and the Contact Centre, and the automatic ticket vending machines, road toll vending machines (including a ticket vending function), validators, controller devices and software licences; provision of the related system design, system integration and software design services; as well as the provision of software development and system design services.

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