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Transcript from broadcast of Asseco's Q1 2023 earnings conference call

Artur Wiza – Vice President of the Management Board of Asseco Poland (AW)

We would like to warmly welcome you to the Asseco Group's Q1 2023 results conference, during which we will present our business and financial performance during this period. Present at today's meeting are: Karolina Rzońca-Bajorek – CFO of the Asseco Group and Marek Panek – Vice President responsible for the Group's development. In the first part of the conference we will present the Group's activities, in the second part we will focus on the financial results, and at the end we invite you to ask questions. I will now give the floor to Marek.

Marek Panek – Vice President of the Management Board of Asseco Poland (MP)

I would like to welcome you very warmly. I would like to tell you what happened in the first quarter of 2023 in the Asseco Group. We met together a month ago and business-wise we will not surprise you with anything new. We come with positive information, because past Q1 was a very good period for our Group. This is confirmed by the numbers you see on the slide presented here: revenue growth to PLN 4.3 billion, that's 7% year-on-year, operating profit close to PLN 500 million, non-IFRS net profit of PLN 120 million and reported profit of PLN 108 million. The profits achieved are at a similar level to Q1 2022.

Our business is very well diversified. We operate in different markets, countries, sectors. This diversified business has allowed us to achieve such good results. Our strength is also our long-term relationships with customers, long-term maintenance contracts that provide us with recurring revenues from maintaining our systems. All of this makes us optimistic about the next quarters of this year – at the same time we have been experiencing continued demand for IT solutions, although there are reports in the press that a slight cooling of the market is observed, a lower dynamics of spending on IT solutions. This has not affected us yet, but we are well prepared.

Let me give you some more details on our business in Q1: revenues at PLN 4.3 billion - up by 7%. In our core software and proprietary services business, we grew at the rate of 8% and reached over PLN 3.4 billion. Non-IFRS EBITDA and EBIT went up at a similar pace - by 3% and reached PLN 644 million and close to PLN 500 million, respectively. Non-IFRS net profit was at PLN 120 million.

A brief commentary on what has been happening in the various geographic areas in which the Asseco Group has been operating. I will start with Poland. Before that, however, I would like to comment on the increases presented – you see a 7% increase regarding the Group's total sales. As you remember, last year, the increases were more dynamic, amounting to over 20%, while at that time we talked about the large impact of exchange rate differences on these increases. In turn, this past quarter, exchange rate differences were acting in a negative way, so these increases were less dynamic. This effect is visible in the Formula System and Asseco International segments, which are exposed to exchange rate differences. On the other hand, if we compared organic increases in fixed exchange rates they would remain at the same percentage level as in in Q1 2022, which means that, in fact, business-wise we have been growing at a similar rate.

In the Polish market, sales growth reached 12%. It was not affected by exchange rate differences. This is fully organic growth, as there were no acquisitions in Poland at the time. We highlight the areas that grew the fastest: banking and finance, healthcare, energy and telecommunications. We are pleased with what has been happening in the public sector, as we have been signaling for many quarters that this part of Asseco in Poland has been doing very well thanks to the large, multi-year projects we have been executing for the public sector. We are also pleased with the double-digit sales growth in Asseco Data Systems and Asseco Cloud.

As for Formula Systems, we achieved a 7% increase in sales. Here the impact of exchange rate differences can be seen the most, because last year, about 50% of the growth shown was thanks to exchange rate differences. Now it works the other way and this 7% growth should be considered a very good result. The comment is one – all the companies in Formula Systems have been doing very well. This is all supported by the acquisitions that took place last year. The share of recurring revenues is also high. We are very satisfied with this part of the Asseco Group.

In the Asseco International segment, we have a 5% increase in sales. This is thanks, among other things, to the ERP area, which has been performing very well for many quarters, namely the Asseco Enterprise Solutions Group, and Asseco South Eastern Europe, which operates in the Balkans and has increased its scale of operations in all segments in which it operates.

On this slide, we are showing you the sector diversification – there is not much change here: in Q1, 44% of revenues came from the general business sector, 33% from banking and finance, the remaining 23% from public institutions. The chart is showing solid growth in all sectors over the past 5 years.

Now, let's move on to the presentation of our various sectors of activity – I will start with banking and finance. As far as the whole Group is concerned, we have a 7% increase in sales - we exceeded PLN 1.4 billion. The Polish segment recorded the fastest growth, Formula Systems - the slowest. Formula has the largest share in each sector, it always used to have the fastest growth. However, this quarter, due to exchange rate differences, this dynamics is slightly lower - in banking and finance it recorded a 3% increase. We are pleased with Sapiens's strengthening position as a leading global software developer for the insurance sector. Sapiens has returned to growth in the US market – it has acquired more than a dozen customers. It has also been growing very well in Europe – 52% of Sapiens's sales come from the European market, which is also a very large share from this part of the world.

In the case of Asseco International, we have the largest increase - 19%. Here we would like to emphasize the role of the holding company Asseco South Eastern Europe and all the companies that operate in the region. Asseco PST, our Portuguese company, which operates mainly in Portuguese-speaking African countries, also recorded very good sales results.

In the banking and finance sector in Poland, we exceeded PLN 125 million in sales. This was a 14%, pure, organic growth that was not affected by FX rate differences. In banking, we are executing 3 major core system implementations in commercial banks. We continue to implement a cloud solution for smaller banks, mainly for the cooperative sector. Our division dealing with solutions for the capital market, that is, mainly for brokerage firms, has been doing very well. We have been also making a lot of efforts to sell our solutions in foreign markets as well.

In the general business sector, we have a 5% increase across the Group, close to PLN 1.9 billion in sales. As for Formula, we had a 6% increase and exceeded PLN 1.3 billion in sales. Formula's main players in the general business market are Matrix IT and Magic Software, as well as the slightly smaller Insync Staffing, which deals mainly with body leasing. All of these companies had a very good quarter.

At Asseco International, sales are at similar levels to last year. We are pleased with the double-digit revenue growth rate at the Asseco Enterprise Solutions Group, which sells ERP solutions. In Asseco South Eastern Europe, the part that works for enterprises also did well. We are signaling a lack of revenues from Danish companies here, as we sold our Danish businesses in the fourth quarter of last year, at the very end of the year. We are no longer consolidating these revenues at the moment - it was PLN 13 million in the general business sector. If we added this to revenues, we could show growth on the entire Asseco International segment.

At Asseco Poland, we recorded a very dynamic, almost 30% increase in sales, which stood at PLN 112 million. We would like to emphasize here primarily the energy sector, as we had about 40% growth in sales there. The high dynamics is mainly thanks to projects related to changes in energy market regulations, such as the so called solidarity shield. The telecommunications division of Asseco Poland and the aforementioned Asseco Data Systems have been also doing well.

Now let’s move to the last of the sectors – the public institutions sector, where we have 10% growth across the Group and more than PLN 1 billion in sales. Formula recorded the fastest growth, mainly thanks to Matrix. Matrix IT is a major player in Israel when it comes to government and healthcare projects. Magic Software is also present in this sector. Its share is much smaller, but it has been recording dynamic sales growth.

At Asseco International, we have a 5% decline in revenues, which amounted to PLN 148 million. The effect of sales of Danish companies here is even greater than in the general business sector, as these companies had sales of PLN 26 million in Q1 2022. If we took this into account, we would even have double-digit increases. Also, there is nothing wrong here. All companies operating in the public sector are doing well, although all the time the situation in the Czech and Slovak Republic is not stable, as we also discussed in previous quarters. Certainly things could be better in this sector, but unfortunately we have no influence on the political situation in these countries.

We had a very good quarter at Asseco Poland, 4% growth. Let's keep in mind the high base here, because for many quarters the public sector in Poland has been growing very well, and these results have been at a very high level for some time, so it's getting increasingly more harder to have spectacular growth here. The amount of PLN 220 million we generated in Q1 was a very good result, driven primarily by projects for the central administration. Our healthcare division also recorded a very good quarter.

In terms of acquisitions, we were joined in Q1 by one company from Israel called Zebra Technologies, bought by Matrix. This is a distribution company, but one that also has value-added services related to cyber security, network management, consulting and training. We bought a 70% stake in this company. We paid approx. PLN 100 million (after conversion, since we paid in another currency, of course). This is another factor that will be supporting Matrix's growth. Matrix is a very active company when it comes to acquisitions. Usually, there were even more of them during the quarter. This year, just one was finalized, but there are sure to be others in the coming quarters.

The last slide of my part of the presentation is showing the order backlog through 2023. I suggest you don't focus on the right part, where we are presenting the variable rates, because this gap between last year's Q1 rates and this year's rates is really very large, and someone might say that the backlog is flat, very comparable to what we showed a year ago.

Let's focus, please, on the left side of the slide, where we are showing the backlog in fixed rates. This is broken down by segments. In Asseco Poland, we have a very solid, 13%, increase in the backlog. In Asseco International, we have a 9% increase compared to the backlog we presented a year ago. Formula Systems needs to be commented on, as someone might say it's only 2%. However, let's keep in mind two effects: first, Matrix IT sold one of its companies and it was contributing close to PLN 50 million to revenues in Q1 2022, so that's not there now, and second (as we already signaled during the 2022 conference call), we've had a new CFO at Matrix for some time, and he has slightly changed the methodology for determining the backlog. He looks at it more conservatively. At Matrix, we have framework agreements that have only frameworks, rates and are executed on a time & material basis. Historically looking, a lot of revenues were generated from these contracts. Matrix's CFO doesn't consider it a backlog, because for him it's not signed. It is simply a change in methodology to a more conservative one. Nothing bad is happening in the Israeli market. All the companies are doing very well and we are hoping that this trend will continue. The backlog presented allows us to look at the rest of the year with optimism, although of course we are observing the changing business environment and are aware of many risks. We must take them into account and monitor them.

That's all from my side. Thank you very much and I give the floor to Karolina.

Karolina Rzońca-Bajorek – Vice President, CFO Asseco Poland (KR-B)

Good day to you all. In the profit and loss statement, we have, as Marek has already mentioned, a 7% revenue growth. If we were to break down that growth by sources, 116% of that growth this year is organic, another 13% is from acquisitions, while the negative effect that Marek has mentioned is 29% on the downside from foreign exchange differences. This comes mainly from the Formula Systems segment and is due to the fact that there were negative effects on the NIS/USD currency pair. Speaking of what's below revenues, operating profit of PLN 398 million, which marks a 3% increase - these are the results we expected and are close to consensus. Profitability was 9.2% vs. 9.6% in the comparable period - this is also in line with our expectations for the year. I am expecting that Q1 2023 illustrates a lot in terms of how the full year will look, and as I mentioned, this is consistent with our expectations. In fact, we see stabilization in terms of cost growth and dynamics that are definitely lower than in comparable periods. Therefore, it seems that these "scissors" seem to be no longer as wide as in the previous year. This can be seen especially in more developed markets, i.e. the United States, Israel – there is definitely a deceleration there in terms of wage cost growth and a stabilization or even a gentle decline in terms of average wages in constant exchange rates. These are good predictors when it comes to managing the cost side, which was a challenge throughout last year. We continue to see more dynamic cost growth at the level of Asseco International and in Asseco Poland, while, as we expected, Central Europe and Southeast Europe are places where the labor market is not slowing down as much as overseas or in Israel.

Actually, there is no impact of one-off events above EBIT in this quarter. It can be said that these numbers are strongly typical. As for the impact of one-off events below EBIT, actually the only one that can be pointed out is the effect of hyperinflation. This is a topic related to the Asseco South Eastern Europe Group and the Group's operations in Turkey. Here, there is a positive effect of nearly PLN 10 million. However, it should be remembered that in Asseco South Eastern Europe this positive effect is offset by what has been happening to the Turkish lira. We have negative effects there on foreign exchange transactions, hence - if you look at the year-on-year results - we had a significant positive effect of almost PLN 9 million on these foreign exchange transactions in Q1 last year, while in Q1 2023 there is a negative effect, coming mainly from Asseco South Eastern Europe and Formula, amounting to more than PLN 3 million in minus. On the other hand, it is worth noting that despite the significant debt in Formula, interest costs are under control, at very similar levels in this and the comparable period. Interest expenses at Formula have grown, while as some of the companies in the Group have positive net cash and invest funds in various instruments, there is also a positive result on interest and generally very similar numbers year-on-year. At the Group level, the effective tax rate is also stable - we are slightly above 22% and this is in line with what we budgeted. As Marek has mentioned, we ended the quarter with a flat net profit growth for the parent company's shareholders. At the reported, IFRS level, we have PLN 108.1 million vs. PLN 107.6 million in the comparable quarter last year.

We recorded very satisfactory results in individual companies. In Asseco Poland, year-on-year revenues increased mainly thanks to banking, the health area and the energy area, where we are the beneficiary of legal changes. The solidarity shield, for example, gave a significant boost to growth in the energy area. At the non-IFRS operating profit level, there was a slight increase and the contribution was also higher year-on-year. We are pleased with the results of Asseco Poland. Asseco Data Systems looks stable year-on-year in terms of EBIT and very similar in terms of net profit. Here we can see the good performance of the trust services area, i.e. cyclicality in electronic signatures. The 2-year signature renewals that just took place this quarter are starting showing their impact. On the other hand, the "Other companies and consolidation adjustments" item shows that we have a decline at the non-IFRS EBIT level, while I would not extrapolate this to the whole year. Slightly worse-than-expected results were generated by some smaller companies like ComCERT, DahliaMatic, while Asseco Cloud has been doing very decently. We made one consolidation adjustment related to tax topics (VAT). It is recognized above the operating result at PLN 2.5 million, hence the net effect is close to zero on this line.

As far as Formula is concerned, Matrix IT recorded its best quarter ever. Marek has already mentioned that everything has been growing there, the banking situation in the US has been rebuilding, so we are very happy with these numbers. At Magic, the situation looks stable, and I think this is how it will be for the whole year. We have very good results and good forecasts in the case of Sapiens. We see that this company has improved profitability. This is a result of the restructuring measures taken last year, the effects of which we are already seeing. The company has moved even more of its production to off-shore - they have a ratio of over 51% already. They employ workers in regions such as Central Europe (they include Poland here), but primarily in India. With the return of production to India, the average wage at Sapiens has been declining year on year. On the other hand, what we are very pleased about is that Sapiens has managed to contract more than $47 million with new customers (more than $30 million comes from the United States). You probably remember that last year, virtually all of the growth came from Europe, and now it looks like Sapiens is back on track for growth in the United States as well.

In the Asseco International segment, we have very good results in the ERP area, which is consolidated within the Central European market. It is made up of our Asseco Solutions and Asseco Business Solutions companies. The public institutions segment of Asseco Central Europe is still under some pressure due to the changes of governments in Slovakia and the Czech Republic. We have some challenges related to public projects, while we are also optimistic about the future. The Southeast European market, or our Asseco South Eastern Europe Group – there are increases in all three segments. We have slightly lost momentum when it comes to e-commerce in Turkey, which I think Asseco South Eastern Europe commented on during its conference. In the Western European market, the situation is stable. The drop in revenues is a result of the sale of Danish companies and a little worse sales in Asseco Spain when it comes to wholesale operations, which generate a lot of revenues, but do not translate significantly into our profitability. I wouldn't worry about this drop in revenues.

The Group's cash conversion ratio is at a safe level of 73%. Your analytical reports also ran through comments on Asseco Poland's cash generation nature – this segment does indeed have a cash conversion ratio lower than our benchmark, while we reported that the first quarter of this year would still be subject to such trends, and we expected such a ratio. However, it should be remembered that we have very significant amounts recognized as so-called customer contract assets, i.e. long-term contracts at our key customers, mainly in the area of public administration, so very safe receivables, which we will be cashed in Q2 and Q3 of this year. I'm talking about a level of PLN 150-200 million here, which will be subject to invoicing in Q2 and cashing in Q3, so here there is no reason to worry about this cash position of Asseco Poland. The same is true for Asseco Data Systems – several public projects, including infrastructure projects, which are of the nature that cashing takes place at the end of the project. This just goes to show that in order to deliver significant value to the public segment, you need to have so-called capacity. Both Asseco Poland and Asseco Data Systems have this capacity, so there is nothing to worry about. In terms of cash generation in the Asseco International segment, we see the effects coming from Asseco Central Europe, where we also have public contracts, so those are rather safe receivables. In the Formula Systems segment, cash generation is a little bit lower than benchmark, mainly in Matrix IT, that is, those dynamic growths and the effect of paying off a large volume of liabilities in Matrix in the first quarter of this year lowered that cash generation level a bit.

Our liquidity position remains stable. Throughout the Group, we have more than PLN 3 billion in cash and net cash in each segment. In the Asseco Poland segment, this cash level amounts to more than PLN 0.5 billion, and as you can see there is practically no debt, rather accounting effects on the lease item. We are, of course, ahead of the dividend payment, while the situation is very stable, and I am counting on the fact that this cash flow in Asseco Poland will improve in Q2 and Q3, and we will rebuild similar balances after the dividend payment. That's all from my side.

AW:

Thank you, Karolina and Marek. We will now move on to the question and answer (Q&A) session. We have one question in the chat room for now, no questions from the floor for now. I encourage you to ask questions unless we have already explained everything in the presentation.

Investor 1:

Would the current market price be satisfactory to you in a share buyback scenario?

KR-B:

I think it is too early at this point to talk about the price in the case of buybacks. We are only before the decision of the General Meeting of Shareholders, so I am afraid that this is a question that will have to remain unanswered today.

AW:

Keep in mind that we have convened an Extraordinary General Meeting to make a resolution on the possibility of conducting a share buyback. We will see after this meeting what the shareholders' decision will be. For the time being, we are analyzing this topic. We are approaching this solution as an option that is needed to secure the company's development, including in the emergency situations that have occurred recently. We have decided that it is worthwhile to have such a program. If we decide to implement it, we will then see what the price will be. But, as a first step, we need to get approval from our shareholders at the General Meeting to buy back our own shares.

Investor 1:

When you say that "the first quarter shows a lot in terms of the picture for the whole year," do you mean more in terms of nominal results or their year-on-year dynamics?

KR-B:

I think both. As far as dynamics are concerned, they are largely driven by currency fluctuations, so it is naturally more difficult to predict. On the other hand, as Marek said, in terms of organic growth, year-on-year, they are very similar. As a result, today we don't see any signals that would cause us not to think about the whole year in this way.

AW:

Thank you. I don't see any further questions. I don't know if this is because we have exhausted all the topics in our presentation today that would be of interest to our analysts and shareholders. We will wait perhaps a while for additional questions. We will still give you a chance to ask them. For my part, I'd like to raise an issue that we didn't talk about when commenting on Q1 – I'll talk about the sports we support. We would like to boast that this year the team we support, Asseco Resovia, took third place in PlusLiga. Considering the fact that the first two teams won the Europa League, we can say that we are the third team in Europe. We are happy that we are also successful in such areas as supporting sports.

I'm waiting for more questions, but there are none of them. Therefore, we can probably consider that we have exhausted all the topics of interest this quarter. We had our last meeting a month ago and presented a lot of information. It was also attended by President of the Management Board Adam Góral. We talked quite a lot about what was going on, and as a result, we may have exhausted all the topics. However, I now see that we have one more question.

Investor 2:

If Q1 is representative of your expectations for the full year, does that mean we should expect both flat (dynamics) of revenue and net profit, or could the profit rise thanks to declining cost pressures?

KR-B:

I seem to have answered this question before. In fact, cost pressures at places like Formula Systems or partly at Asseco International have decreased. In Poland, on the other hand, the growth is still in the region of 10% year-on-year, so this rate of decline in profitability may slow down over the course of this year. Will results be flat year-on-year? It seems to me today that – ceteris paribus – flat results are the minimum target. We are constantly looking for new acquisition targets, and as a result, I assume that some part of the growth will come from new acquisitions, which we may finalize in Q2, Q3 and Q4. We are dealing with a rather dynamic macroeconomic situation and we do not give forecasts. You can see from our backlogs that these dynamics are actually marginally lower, and as a result, it seems that such a target to achieve – flat year-on-year results – is within our reach. As for increases, we will do our best to make them appear, while – probably also due to the situation on the foreign exchange market – they will not be the same as last year.

AW:

Thank you very much. Karolina has just mentioned acquisitions, which are the subject of the next question. I am glad that it has been asked, because Marek always counts on them.

Investor 3:

What does the M&A pipeline look like?

MP:

Even already in anticipation of you questions, I wanted to talk about this issue, although no one asked about it. I expected that you could ask about this area, seeing that only one acquisition took place in the Group in Q1, but it just so happened. This absolutely does not mean that we are slowing down when it comes to acquisitions. Maybe we've become more "picky" – I'll call it this strange way, but the truth is that today we don't have any pressure for acquisitions and we are looking for entities that – on the one hand - fit our strategy very well in terms of product, competence or geography, and on the other hand represent the right price. Very often, we end talks at the stage when we come to a price, because we also don't want to make these acquisitions at any cost. As you have observed in recent years, there have been an average of a dozen acquisitions each year in the Group, and in fact the one in Q1 is below average. However, we are not slowing down in this matter – we are analyzing the market, holding talks. Even now we have several open projects in Poland, we are in talks. I don't know how they will end up, the valuation, which I have already talked about, is very important, but these are potentially interesting projects. It's too early to reveal the names yet. We are working on it all the time. We're trying to encourage people in our Group companies to assist this process as best they can in the sense that they will give us suggestions when it comes to the markets they're operating in, because their expertise there is vital. They know who is good, who is weaker, who is a competitor and who is a partner. This has increased our pipeline – the number of preliminary discussions we are now holding is higher than in the past, historically speaking.

AW:

Thank you very much Marek. We have received another question.

Investor 4:

In the draft resolution for the Extraordinary General Meeting on buy back, there is a procedure for purchasing shares after a public invitation from "interested shareholders" at no lower price. Is Asseco anticipating using the entire pool for buy back at once (including both the public invitation and additional option for the remaining budget)?

AW:

We also have a second question that is worth asking right away.

Investor 5:

Are you anticipating executing buybacks regularly or only when the share price is attractive? Can you assume that some of the shares bought back will be redeemed or will they rather be used in upcoming acquisitions?

KR-B:

As for what mode (if any) the buyback will be implemented, there is no such decision. Therefore, it is difficult to answer this question unequivocally. The draft resolution of the Extraordinary General Meeting is quite broad, for the reason that we are trying to provide ourselves, as a company, with a "just in case" mechanism. Today we are reserving certain tools for ourselves, while we have not made up our minds that this buy-back will take place at all, and certainly under what conditions and in what mode. As a result, I am afraid that these questions are a bit premature. Therefore, only after the decision of the General Meeting – if a scenario materializes that would cause the Management Board to decide that these tools should be used – will we be able to clarify any motivators and parameters. However, today it is a hypothetical scenario.

AW:

Exactly, the word "if" is very important here. We are assuming that if there is such a situation, then we will give more details.

Investor 3:

We see layoffs in IT in Poland and abroad - are you considering such moves to optimize costs?

KR-B:

We are taking a very detailed look at our costs on an ongoing basis, watching the efficiency of our people. However, we don't have for you today the kind of announcement that appears somewhere in the market in the case of other companies, that we will be making, or have already made, decisions today about restructuring measures. It seems that as at today the pipeline in terms of demand for our services is in fact large enough that at some point near the end of last year we had a perfect employment level, although you can see in the quarterly results that it has still increased marginally since then. I think the dynamics of this employment growth will be smaller, while in many places we are still in the mode of recruiting additional people precisely to get those projects we have currently contracted done. We are expecting that some additional topics will come up this year, that this pipeline will still be higher. Therefore, as I said, we monitor costs on an ongoing basis, very closely. We conduct regular monitoring so that we don't miss anything. It seems that today there is no need to take drastic restructuring measures, although we monitor costs, such a general overhead, i.e. the cost of buildings, administration. Looking at the nature of our business and the fact that 80% of our costs, however, are labor costs, this is a key component that we need to pay attention to today, and we try to match these labor costs to what we have in the pipeline so that we potentially have some element of flexibility. Hence, we use, for example, outsourcing services on some insignificant scale today, but these are the kind of elements that make us have tools that can be managed in case there is actually a slowdown on the revenue side. On the other hand, today no drastic moves or any decisions have been made to optimize these costs, except for such actions that were just taken last year at the level of Sapiens. There, a decision was indeed made to restructure and move part of the production back to locations where the resources are just as good, but a bit cheaper.

AW:

Thank you very much Karolina for this answer. I also thank Marek for all his answers. We have no further questions. We would like to invite you to contact us and our investor relations (IR) department. If you need any information, we are always at your disposal. We would like to cordially invite you to our Q2 H1 2023 results conference call. We are looking forward to seeing you and hearing from you.

KR-B, MP:

Thank you very much.