Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Persistent Systems Ltd

An agile acquisition

IT & ITES	Sharekhan code: PERSISTENT
Reco/View: Buy ↔	CMP: **Rs. 4,321** / Price Target: **Rs. 5,550** ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX

	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

\+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

ESG Disclosure Score NEW

ESG RISK RATING 20.80

Updated Oct 08, 2021

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

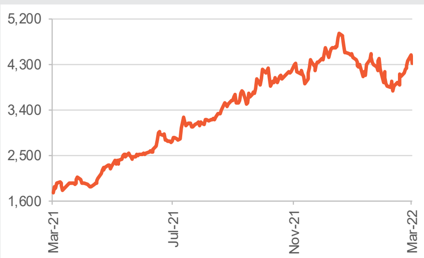
Company details

Market cap:	Rs. 33,024 cr
52-week high/low:	Rs. 4,986 / 1,735
NSE volume: (No of shares)	3.2 lakh
BSE code:	533179
NSE code:	PERSISTENT
Free float: (No of shares)	5.3 cr

Shareholding (%)

Promoters	31.3
FII	21.4
DII	27.6
Others	19.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3.1	-1.9	20.5	144.3
Relative to Sensex	7.1	2.1	24.7	133.6

Sharekhan Research, Bloomberg

Summary

- Persistent Systems announced the acquisition of Google Cloud premium partner MediaAgility for $71.7 million. The transaction is valued at 2.8x EV/revenue on CY2021 basis.
- The acquisition will accelerate and deepen Google Cloud partnership, scale new offerings, expand the company's client footprint and give it access to talent pool. This transaction will help PSL to scale-up its Google cloud practice going ahead.
- Though the acquisition would be EBITDA-margin neutral, intangible amortisation expenses would affect EBIT margins by 45-50 bps in FY2023. Synergies are expected do gradually reduce margin dilution.
- We retain a Buy on PSL with an unchanged PT of Rs. 5,550, given building more growth avenues via tuck-in acquisitions, robust execution and broad-based demand.

Persistent Systems Limited (PSL) announced acquisition of Google cloud premium partner MediaAgility Inc. (MediaAgility) for a total consideration of $71.7 million (including earnouts and retention-based payment). MediaAgility (revenue $25.5 million as on LTM basis - December 2021) is a Gartner-recognised public cloud transformation services provider with a specialisation in the Google Cloud ecosystems. With this acquisition, PSL will launch its Google business unit to accelerate cloud-led digital transformation and cross-sale its vertical and industry solutions to Google Cloud marketplace. PSL aspires to build strong practice across leading Cloud technologies (already have $100 million+ practice for IBM and Salesforce and scaled Microsoft Cloud practice by acquiring Data Glove in February 2022). We believe this transaction will help the company to scale-up its Google cloud practice in coming years.

- **Event: Deal struck to buy:** PSL entered into a stock purchase agreement with MediaAgility Inc. to acquire its assets for a total purchase consideration of $70.71 million. The total purchase consideration includes: 1) an upfront payment of $53.25 million, 2) cumulative earnout of $17.75 million over the next two years, subject to achievement of certain performance thresholds, and 3) retention payment of $0.71 million over the next two years subject to employment continuity. This acquisition is expected to be completed in 6-8 weeks. The acquisition of MediaAgility would strengthen the company's expertise in Google Cloud-based digital transformation and enable the company to capture opportunities in high growth Cloud markets.
- **MediaAgility to enhance presence in Google Cloud:** MediaAgility provides cloud-native application development and modernisation, analytics and AI, cloud engineering, migrations, and managed services to over 35+ enterprise service clients worldwide. Key rationale for deal include, (a) accelerate ad deepen Google Cloud partnership, (b) scale new offerings and bolster industry expertise, and (c) expand client footprint & access talent pool. This acquisition will enhance end-to-end service line offerings with Google cloud, enable the company to capture opportunity from multi-cloud, strengthen data & analytics capability and higher cross-selling as there is no overlapping of customers.
- **EBIT margins to dilute in FY2023, but expect to cover the gap from synergies:** MediaAgility's EBITDA margin is similar to that of PSL's. Though the acquisition would be EBITDA-margin neutral, intangible amortisation expenses would impact EBIT margin by 45-50 bps in FY2023. PSL expects revenue synergies to gradually reduce margin dilution and absorb the EBIT impact in the coming years.

Our Call

Valuation – Strong growth momentum: PSL is well-poised to deliver industry-leading growth in FY2023, led by its strong digital competencies, robust ACVs, and broad-based demand. The acquisition will strengthen its partnership with Google and enable it to capture opportunities in high-growth markets. We believe that revenues from MediaAgility would add around 3% to PSL's top-line and the transaction is valued at 2.8x of CY2021 revenues. EBIDTA margins of MediaAgility is similar to PSL. At the CMP, the stock trades at a valuation of 38x/31x its FY2023E/FY2024E earnings, justified considering the strong revenue growth potential, robust deal wins and strong demand. We expect USD revenue/earnings to report a CAGR of 24%/25% over FY2022-FY2024E. Given healthy operating cash flow generation and strong balance sheet, we retain our Buy rating on the stock with an unchanged price target (PT) of Rs. 5,550.

Key Risks

Slowdown in non-Internet of Things (IoT) revenue/delay in product launches/stronger rupee and/or adverse cross-currency movements could affect earnings.

Valuation Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Revenue	4,187.9	5,689.4	7,556.2	9,058.2
OPM (%)	16.3	16.5	16.8	16.7
Adjusted PAT	450.7	668.5	878.2	1,051.3
% YoY growth	*32.4*	*48.3*	*31.4*	*19.7*
Adjusted EPS (Rs.)	59.0	87.5	114.9	137.6
P/E (x)	73.3	49.4	37.6	31.4
P/B (x)	11.8	10.3	8.8	7.5
EV/EBITDA (x)	49.3	35.2	25.6	20.9
RoNW (%)	17.4	22.3	25.3	25.9
RoCE (%)	22.7	28.8	33.0	33.9

Source: Company; Sharekhan estimates

Stock Update

Event Update

Event: Entered into an agreement to acquire MediaAgility

On March 14, 2022, PSL entered into a stock purchase agreement with MediaAgility Inc. to acquire its assets for a total purchase consideration of $70.71 million (~2.8x its EV/revenue on CY2021 basis). Persistent will acquire 100% shareholding of MediaAgility upon closing. MediaAgility has been positioned by Gartner as a niche player in the 2021 Magic Quadrant for Public Cloud IT Transformation Services.

Deal structure, consideration and timeline: PSL will acquire shares of MediaAgility Inc. along with its subsidiaries in Mexico, UK and Singapore. Additionally, the company will acquire MediaAgility's Indian arm. The total purchase consideration is $71.71 million. The total purchase consideration includes: 1) an upfront payment of $53.25 million, subject to customary adjustments for working capital, debt and cash on closing, 2) cumulative earnouts of $17.75 million over the next two years subject to achievement of certain performance thresholds and 3) retention payment of $0.71 million over the next two years subject to employment continuity. This acquisition is expected to be completed within 6‑8 weeks.

MediaAgility – A bird's eye view

Founded in October 2009, MediaAgility Inc. is a global cloud transformation services provider with deep expertise in building scalable cloud-based solutions as a Google Cloud Premier Partner. The company is a Gartner recognised Public Cloud Transformation Services provider with a specialisation in the Google Cloud ecosystems. MediaAgility provides cloud-native application development and modernisation, analytics and AI, Cloud engineering, migrations, and managed services to its 35+ enterprise service clients across the globe. MediaAgility has a presence in US, India, UK, Mexico and Singapore. With 500+ employees worldwide, MediaAgility has 31 Google Cloud Partner Expertise designations, 330+ Google Cloud certifications, and seven Google Cloud partner specialisations. At MediaAgility is focused on building end-to-end cloud-native engineering capabilities on the Google Cloud Platform. With the growing demand for its services, it has been focusing on rapidly growing its business globally. MediaAgility had a consolidated revenue of $25.50M as on LTM December 2021. Of this, MediaAgility generated $20.59 million from services and $4.91 million from reselling. Further, MediaAgility generates 80% of revenue from long-term clients with more than a three-year relationship.

Acquisition to open doors to growth markets; further M&A activity unlikely in near-term

PSL has done four acquisitions (including MediaAgility) in the last seven months for a total purchase consideration of $222 million, where the upfront payment remains at $142 million for the company. These tuck-in acquisitions in the recent past have bolstered its capabilities, enhanced capabilities in adjacent areas, increased customer base, helped to enter into growth markets and expanded talent pool. The company's M&A strategy includes (1) deeper industry vertical (especially in technology, BFSI, healthcare, and life-sciences); (2) capture high-growth markets including cloud, applications, security, data, and analytics among others, and (3) expanding geographical and vertical footprint. For example, the acquisition of SCI strengthened its presence in micro-verticals within BFSI such as payments, while acquisition of Capiot enhanced its capability in the enterprise integration services. Similarly, the acquisition of Data Glove and MediaAgility would strengthen the company's expertise in Azure and Google cloud –based digital transformation and position the company to capture opportunities in high growth cloud markets. The company does not expect any further acquisition in the near-term given the ongoing geo-political tension.

PSL gains a footing in Google Cloud

The MediaAgility acquisition in the cloud area will benefit PSL, as the addressable market for IT service providers is expected to be multi-fold as compared to revenue of hyperscalers. This acquisition would create a strong relationship with Google (including its existing relationship in products), bolster offerings and industry expertise and expand client footprint and talent pool. Further, the company will launch a Google business unit to accelerate cloud-led digital transformation and will introduce its vertical and industry solutions to Google Cloud market place. Further, this acquisition will enhance end-to-end service line offerings with Google Cloud, augment existing IP to support open cloud adoption and strengthen existing vertical expertise in BFSI, HCLS and add new expertise in media, entertainment and gaming. In addition, this transaction will help the company to expand footprint in 35+ new enterprise service clients and strengthen talent with over 220 Google cloud certified architects and cloud engineers in US, Mexico, UK and India. According to Gartner, the public cloud services market is expected to grow at CAGR 20.7% over next five years.

Financial implications

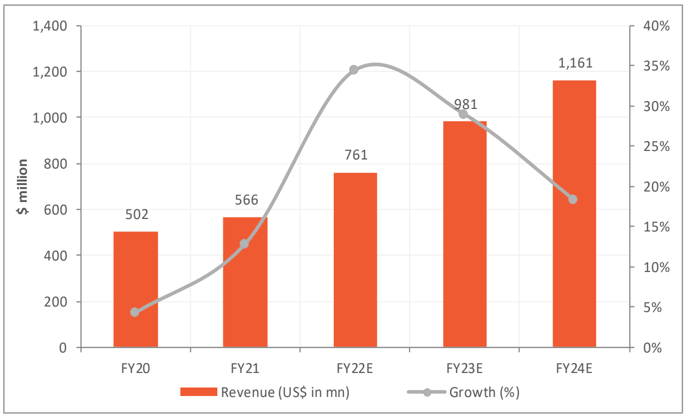
MediaAgility had consolidated revenue of $9.6 million, $14.2 million, and $19.7 million in FY2019, FY2020, and FY2021 (year-ended in March), respectively. Media Agility also reported a consolidated revenue of $25.5 million as on a last twelve month (LTM) basis as of December 2021. Media Agility's revenue grew at a CAGR of 43.3% over FY2019-FY2021. MediaAgility is the premier consulting services partner to Google, which provides cloud-native application development and modernization, analytics and AI, cloud engineering, migrations, and managed services to over 35 enterprise service clients across the globe. The transaction is based on 2.8x its EV/revenue on CY2021 basis. MediaAgility's EBITDA margins are similar to that of PSL. Though the acquisition would be neutral at EBITDA margin level, intangible amortisation expenses would impact EBIT margin by 45-50 bps in FY2023. PSL expects revenue synergies to gradually reduce margin dilution and absorb EBIT impact in the coming years.

Other conference call highlights

- MediaAgility's key verticals include financial services and insurance, healthcare and lifesciences, and media, entertainment and gaming. Management indicated that there is no overlapping of customers.
- The company M&A activity is based on three pillars – (1) capturing high growth markets in a service line or industry vertical, (2) bolstering existing capability in industry or service line, and (3) expanding footprint in geographies. The company may not do any acquisition in Europe in near term because of ongoing geo-political tension.
- Industry has moved from Data Centre to Private Cloud to Hybrid Cloud to Multiple Cloud adoption. This makes service providers to build capabilities across different Cloud platforms
- With the acquisition of Data Glove, the company has built nearly $100 million revenue in Microsoft ecosystem from data, cloud and AI perspective.
- The reselling business ($5 million) of MediaAgility has a EBITDA margin of 16-17%.

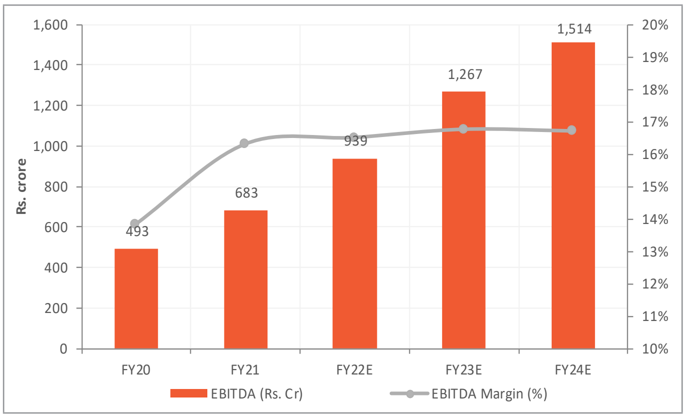
Financials in charts

Revenue in US$ (mn) and growth (%)



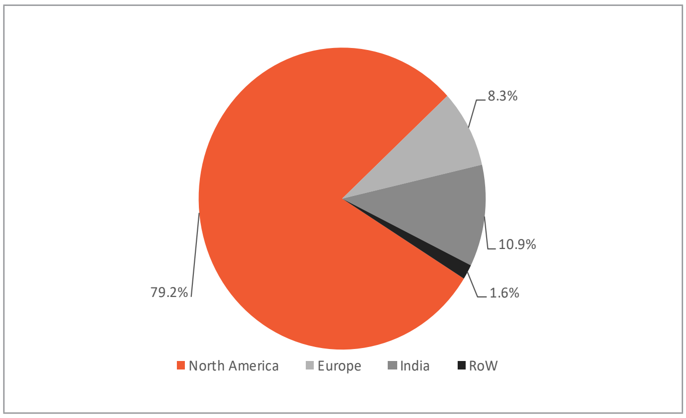
Source: Company, Sharekhan Research

EBITDA (Rs. cr) and EBITDA margin (%)



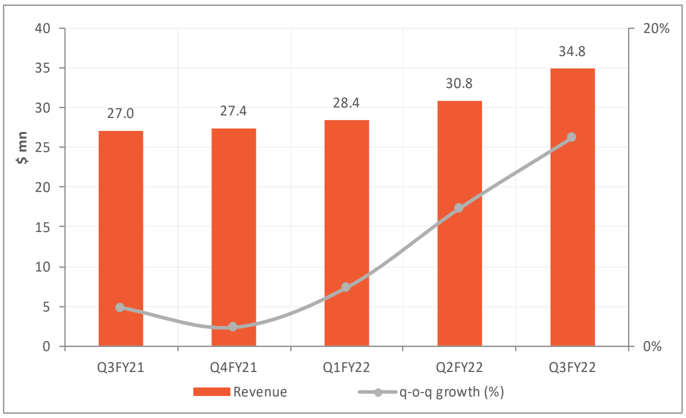
Source: Company, Sharekhan Research

Geography break-up (%)



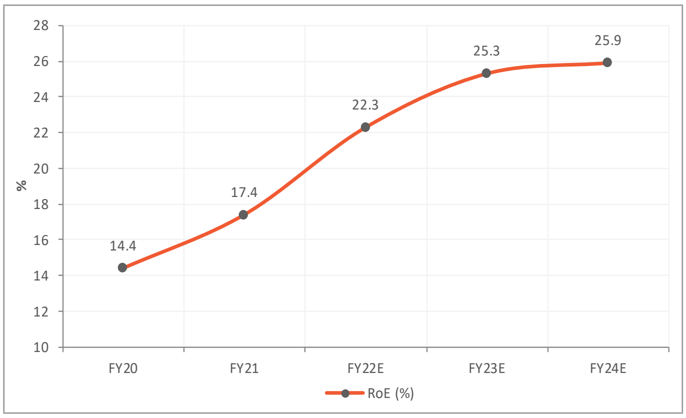
Source: Company, Sharekhan Research

Top account revenue ($ mn) and growth (%)



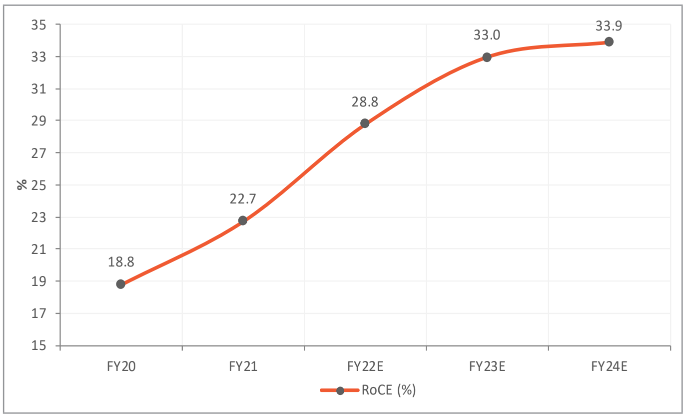
Source: Company, Sharekhan Research

RoE trend (%)



Source: Company, Sharekhan Research

RoCE trend (%)



Source: Company, Sharekhan Research

Outlook and Valuation

■ **Sector view – Expect acceleration in technology spending going forward**

We believe the need for business continuity, operational resilience, and the switch to digital transactions have led to strong demand for IT services post the pandemic. Industry analysts such as Gartner estimate that IT services spending would grow by 8-8.5% in the next four years as compared to the average of 4.3% achieved over 2016-2020. Forecasts indicate higher demand for cloud infrastructure services, a potential increase in specialised software, potential investments in transformation projects by clients, and increased online adoption across verticals.

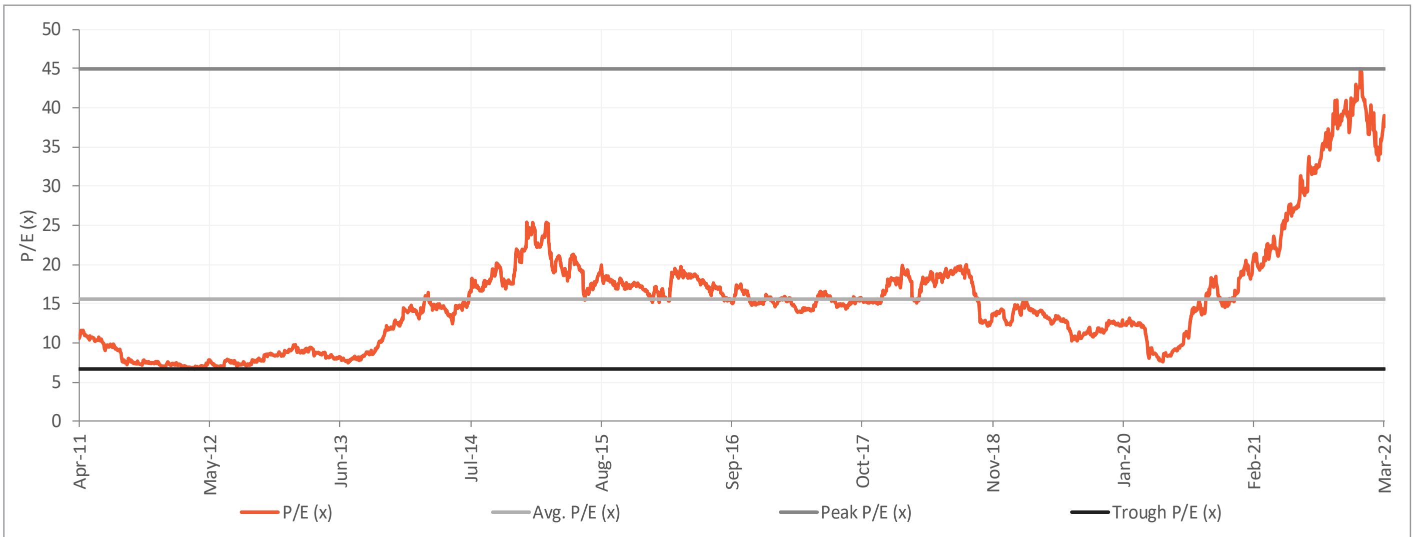
■ **Company outlook – Well positioned to capture immense growth opportunity**

As PSL is an early identifier of digital trends and has strong product development capabilities, we believe the company is well placed to capture a significant chunk of spends in digital technologies by clients going ahead. Management remains optimistic to deliver strong revenue growth q-o-q given strong demand and strong momentum in deal signings. We believe the company's leadership position in the outsourced product development (OPD), strong client relationships, and being an end-to-end service provider would help PSL to make the most of the opportunity.

■ **Valuation – Strong growth momentum**

PSL is well-poised to deliver industry-leading growth in FY2023, led by its strong digital competencies, robust ACVs, and broad-based demand. The acquisition will strengthen its partnership with Google and enable it to capture opportunities in high-growth markets. We believe that revenues from MediaAgility would add around 3% to PSL's top-line and the transaction is valued at 2.8x of CY2021 revenues. EBIDTA margins of MediaAgility is similar to PSL. At the CMP, the stock trades at a valuation of 38x/31x its FY2023E/FY2024E earnings, justified considering the strong revenue growth potential, robust deal wins and strong demand. We expect USD revenue/earnings to report a CAGR of 24%/25% over FY2022-FY2024E. Given healthy operating cash flow generation and strong balance sheet, we retain our Buy rating on the stock with an unchanged price target (PT) of Rs. 5,550.

One-year forward P/E (x) band



Source: Company; Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)		EV/EBIDTA (x)		P/BV (x)		RoE (%)	
				FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
Birlasoft	437	28	12,225	27.6	22.7	18.9	15.0	5.3	4.7	19.4	20.6
L&T Infotech	6,040	18	1,05,855	45.5	36.5	34.0	27.8	10.8	8.3	28.8	32.7
Persistent Systems	4,321	8	33,024	49.4	37.6	35.2	25.6	10.3	8.8	22.3	25.3

Source: Company; Sharekhan Research

About company

Incorporated in 1990, PSL is a global software company specialising in product and technology services. The company has proven expertise, strong presence in newer technologies, and strength to improve its IP base. PSL focuses on developing IoT products and platforms, as it sees significant traction from industrial machinery, SmartCity, healthcare, and smart agriculture verticals. PSL has been focusing on product development, establishing processes to build distributed agile teams, and partnering with the world's leading product companies to build software contributing across the entire product lifecycle. The company derives revenue from North America, Europe, and rest of the world (RoW).

Investment theme

Large corporates have been allocating higher budgets towards digital transformation initiatives and IT spends are moving from ISV to the enterprise model. PSL has restructured its business and aligned its sales resources to capitalise the benefits from clients' digital transformation journey. The alliance with IBM, tuck-in acquisitions in the high growth markets and investments in new-age technologies (IoT, Blockchain, artificial learning, and machine learning) are expected to help the company capture opportunities from these spends.

Key Risks

1) Any slowdown in non-IoT revenue; 2) hostile regulatory development against current VISA regime; 3) delay in product launches; 4) stronger Indian Rupee and/or adverse cross-currency movements; 5) margin dilution from M&A activity; and 6) high client concentration could affect revenue growth.

Additional Data

Key management personnel

Dr. Anand Deshpande	Founder, Chairman and MD
Sandeep Kalra	President: Technology Services
Sunil Sapre	Chief Financial Officer (CFO)
Mark Simpson	President, IBM Alliance

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Kotak Mahindra Asset Management Company Limited	4.94
2	HDFC Asset Management Company Limited	4.78
3	Axis Asset Management Company Limited	2.41
4	Vanguard Group	2.11
5	Nippon Life India Asset Management	1.93
6	L&T Mutual Fund Trustee Limited	1.44
7	Dimensional Fund Advisors	1.42
8	ICICI Prudential Asset Management	1.23
9	PGIM India Asset Management	1.01
10	BlockRock Inc.	0.97

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

Sharekhan

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