

Persistent Systems

Refer to important disclosures at the end of this report

Acquisitions to strengthen payment/BFSI and cloud capabilities

CMP	Target Price
Rs 3,716 as of (September 30, 2021)	Rs 3,700 (■) 12 months
Rating	Upside
BUY (■)	(0.4) %

- Persistent Systems has entered into an agreement to acquire Software Corporation International (SCI) and its affiliate Fusion360 LLC for a cash consideration of USD53mn (~3.1x EV/S on CY20 basis). It has also signed an agreement to buy certain assets from Shree Partners LLC USA and business from its Indian subsidiary Shree Infosoft Pvt. Ltd. for a cash consideration of USD6.87mn (~0.9x EV/S on FY21 basis).
- **Deal rationale:** SCI brings domain consulting capabilities and specializes in payments solutions, integration and support services for leading US banks. SCI enhances PSYS's capabilities and serves as the foundation of a dedicated payments business unit. SCI expands PSYS's BFSI client footprint with ~10 marquee customers from top banks in North America and over 90 employees in the region. PSYS has announced a dedicated payment business unit, which will be headed by D. Keith Sides, President and CEO of SCI. The Shree acquisition expands PSYS's BFSI capabilities in the cloud, data and infrastructure domains. It also enables PSYS to deliver critical services to a strategic client, which is a leader in the global claims management industry. Shree adds over 200 employees, largely in NCR, India, and clients across US and Europe in BFSI and Travel & Hospitality. Additionally, SCI expands PSYS's presence in Charlotte, a key hub for the US BFSI industry. Shree Infosoft adds a new delivery location in NCR.
- **Deal structure, consideration and timeline:** Persistent Systems Inc., a wholly-owned subsidiary of PSYS, has entered into a stock purchase agreement to acquire US-based SCI and its affiliate Fusion360 LLC. The total consideration payable for the acquisition of SCI and Fusion360 is USD53mn. The total consideration includes: 1) an upfront payment of USD34.45mn, 2) earnout of maximum USD5.96mn per annum in next two years subject to achievement of certain performance thresholds, and 3) a retention payment of USD2.21mn per annum to key employees and consultants at the year-end for the next three years. PSYS has signed an agreement with Shree Infosoft to buy its business and inked a pact with its parent entity, Shree Partners LLC USA, to purchase certain assets for an aggregate cash consideration of USD6.87mn. The total deal amount includes: 1) an upfront payment of USD2.37mn in USA and USD1mn in India, 2) earnout of maximum USD1.5mn per annum in next two years subject to achievement of certain performance thresholds, and 3) a retention payment of total USD0.5mn to key employees in the next three years. The SCI deal is expected to be completed within two weeks. The acquisition of certain assets and business of Shree is likely to be completed within 3-5 weeks.
- **Financial implications:** The combined revenue run rate of the two target entities was ~USD25mn in the last fiscal year. Combined revenue grew at a ~13% CAGR in last two years. Management said that the deals are likely to be gross margin accretive. However, retention payment and intangible amortization expenses would impact EBITM by 50-75bps in FY22. PSYS expects revenue synergies would gradually reduce margin dilution, and the absence of retention payment after the third year should further improve margins.
- **Our view:** The deals should strengthen PSYS's BFSI/Payment and cloud capabilities. The payments IT services market is expected to grow by 12.5% in CY21 to reach USD16.8bn. The acquisition of SCI and Fusion360 will help PSYS take advantage of the acceleration in demand for payments modernization. Cross-selling opportunities among the existing clients and access to marquee logos augur well for revenue growth in the medium term. Given the size of the deals (~4% revenue accretion/low-single digit EPS dilution due to amortization charges and lower other income in Year-1), we do not expect any meaningful revision to our earnings estimates. We have a Buy rating on the stock with a TP of Rs3,700 at 33x Sep'23E EPS.

This report is solely produced by Emkay Global. The following person(s) are responsible for the production of the recommendation:

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Brief profile of SCI: Software Corporation was incorporated in 1990, while Fusion360 was incorporated in 2011 in the US. Software Corporation provides consulting services in the payment ecosystem with respect to products such as ACH, Check Processing Systems, Corporate Payments, SWIFT, SEPA, digital payments, including Zelle and The Clearing House RTP network in the US. It leverages payment platforms such as Financial Transaction Manager (FTM) to provide payment consulting services. Fusion360 supports consulting services of Software Corporation with application development, maintenance, and support services for leading payment platforms. SCI reported consolidated revenues of USD13.32mn/USD15.18mn/USD17.08mn in CY18/CY19/CY20.

Brief profile of Shree Partners: Incorporated in 2005, Shree Partners LLC, along with Shree Infosoft Pvt. Ltd., provides data management and analytics, IT infrastructure management and support services to companies based predominantly out of the US. Shree reported revenues of USD6.0mn/USD8.7mn/USD7.6mn in FY19/FY20/FY21.

Emkay Rating Distribution

Ratings	Expected Return within the next 12-18 months.
BUY	Over 15%
HOLD	Between -5% to 15%
SELL	Below -5%

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