

Systems Ltd

Multiple avenues will continue stellar growth momentum

- **We upgrade our estimates for SYS and incorporate new acquisitions and geographies. Our new TP is PKR660/sh vs. PKR490/sh earlier, and we maintain our Buy rating. SYS has delivered higher-than-expected revenues/profits in 1HCY22 to warrant the upgrade.**
- **Our new CY22/23f consolidated EPS are PKR24.5/34.0, where key drivers are the robust demand for software implementation, cloud-based and AI related services. Continuous expansion in new markets and inorganic growth will help SYS to continue its hyper growth momentum, in our view.**
- **On core earnings, SYS trades at a CY23f P/E of 13.0x, which does not justify the 5-year forward EPS CAGR of 35%. Current valuations are at a 40% discount to the average valuations of comparable global companies. SYS has gained less than 5%CYTD in PKR terms, giving it ample room to now kick on and reach all-time high market capitalization.**

Several factors lead to better valuations

We raise our TP for SYS by 35% to PKR660/share, up from PKR 490/share previously. This has come about due to (i) better-than-expected 1HCY22 performance, (ii) entry into geographies with healthy growth potential, (iii) continued swift growth in existing markets, and (iv) consolidation of recent synergy-enabling acquisitions of NdcTech and TreeHouse in 2HFY22. We see massive earnings growth of 58%/39% YoY in CY22/23f, while our CY22-24f EPS estimates are now higher by 10% on average. Our new TP of PKR660/sh is based on PKR610/sh assigned to core valuation (blend of DCF & 20x P/E), and PKR50/sh attributable to the aforementioned recent acquisitions. SYS arguably justifies a higher terminal growth rate than the 5% we are currently employing, given more than 80% of the revenue is USD-denominated and we expect the PKR alone to depreciate by 5%pa versus the USD. This can significantly propel valuations – for instance our TP would rise to PKR750/sh in case we employ terminal growth rate of 8%.

Middle East performance has been excellent

Bellwether business in North America has continued to be robust, with revenue lines such as software implementation, Cloud, Data and AI-based services all performing well. With this background, the Middle East performance has been phenomenal, where consolidated revenue from the Middle East exceeded that of the North American market for the first time (in 1HCY22). Specifically, ME has posted revenue of USD25mn, up 100% YoY in 1HCY22, whereas North America has grown by 30% YoY to USD23.3mn. The NdcTech acquisition, recent partnership with SAP and greater focus on the Middle East (incorporation of Systems Arabia, and service centers in Egypt) will help deliver a 5-year dollarized CAGR of c 30% in the region. SYS has also established presence in Singapore and South Africa, which will help keep it on its hyper growth trajectory (dollarized revenues were up 48% YoY in 1HCY22).

New synergies will kick in

SYS has fully acquired two new tech companies. NdcTech implements core and digital banking transformation services in Pakistan, Asia Pacific, Middle East and Africa. This 20+ year old company has partnered with Temenos to provide its SaaS based services. SYS already had strong presence in BFS (Banking and Financial Services), providing support services such as enterprise solutions, automation and business process management services. This acquisition completes its product suite in this space, and it will now provide Temenos SaaS based services to its clientele. This increases the potential to add new customers, unlocks synergies and unleashes growth earlier than would have arisen before the acquisition.

Buy

SYS PA

TP: PKR660.0/sh

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Systems Limited

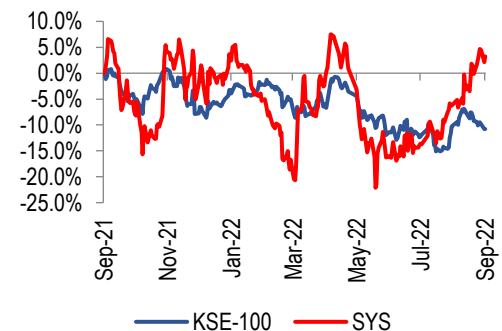
Price (PKR)	393.91
Bloomberg / Reuters	SYS PA/SYSE.KA
Mkt Cap (USDmn)	498
Upside	68%
Fwd D/Y	1.8%
Total Return	69.8%
12m Hi-Low (PKR/sh)	412.79/299.01
6m Avg. D. Vol ('000 shrs)	421
6m Avg. Td Val (USDmn)	0.83

SYS - Valuation Snapshot

	CY21	CY22f	CY23f	CY24f
EPS (PKR)	15.44	24.45	34.03	42.50
EPS Growth	99%	58%	39%	25%
P/E (x)	18.9	16.1	11.6	9.3
P/B (x)	9.1	5.8	4.2	3.1
ROE	43%	44%	42%	38%
DPS (PKR)	2.50	5.00	7.00	8.50
DY	0.6%	1.3%	1.8%	2.2%
Gross margins	33%	32%	32%	32%
Net margins	28%	26%	25%	24%

Source: IMS Research

SYS vs. KSE100 index



Source: IMS Research

NdcTech Projections

(PKRmn)	CY22f	CY23f	CY24f	CY25f
Net Sales	2,601	3,541	4,482	5,543
Gross Profit	780	1,080	1,389	1,746
GP Margin	30.0%	30.5%	31.0%	31.5%
EBIT	553	753	975	1,232
EBIT Margins	21.3%	21.3%	21.7%	22.2%
Profit for the period	547	744	963	1,218
EPS (PKR)	1.96	2.67	3.46	4.38
Net Margins	21.0%	21.0%	21.5%	22.0%

Source: IMS Research Estimates

The other recent acquisition is TreeHouse Consultancy, which provides enterprise solutions, digital transformation, automation and CRM-related services in the Middle East. We understand that the services provided by TreeHouse are similar to SYS existing portfolio, but the company can now upsell its other products to the customer base.

TreeHouse Projections

(PKRmn)	CY22f	CY23f	CY24f	CY25f
Net Sales	741	1,017	1,316	1,671
Gross Profit	222	310	408	526
GP Margin	30.0%	30.5%	31.0%	31.5%
EBIT	158	216	286	371
EBIT Margins	21.3%	21.3%	21.7%	22.2%
Profit for the period	156	214	283	367
EPS (PKR)	0.56	0.77	1.02	1.32
Net Margins	21.0%	21.0%	21.5%	22.0%

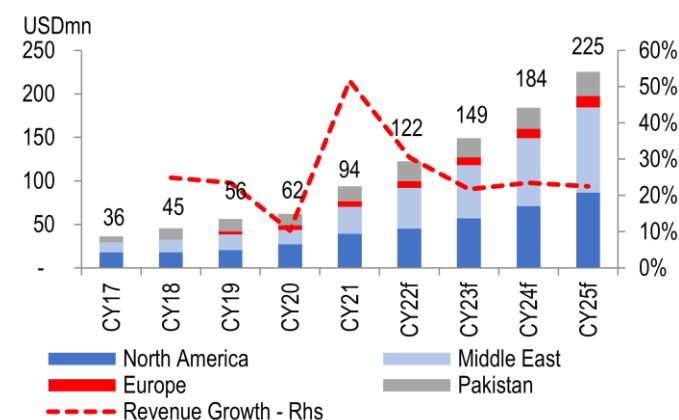
Source: IMS Research Estimates

SYS will continue to focus on new, quality recruitment

To continue growth momentum, SYS is extensively investing in training and development of existing and new employees. To fill the required skill set gap, Systems in collaboration with local institutes, has launched fast-track diploma programs. Apart from this, certain local IT firms, besides Pakistan Software Export Board (PSEB) and Pakistan Software Houses Association (P@SHA), are working on custom-designed curriculums, based on the skill set required by both Systems and Pakistan, to push future growth. This will create a pipeline for growing needs for human resources in Pakistan.

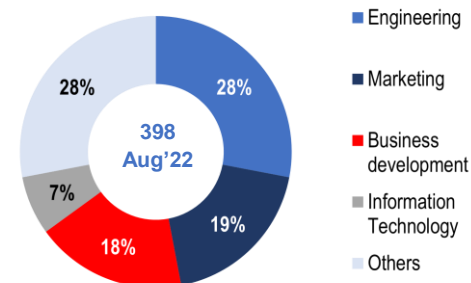
The opening of new geographies will allow SYS to attract top-tier talent, that is required at senior levels, now that the company has expanded significantly. SYS has also opened a resource pool office in Egypt to attract resources with the required skill sets, which will help the company to bridge any language barriers in the Middle East region.

ME region will bring massive growth



Source: IMS Research, Company Accounts

NdcTech Employees Breakup



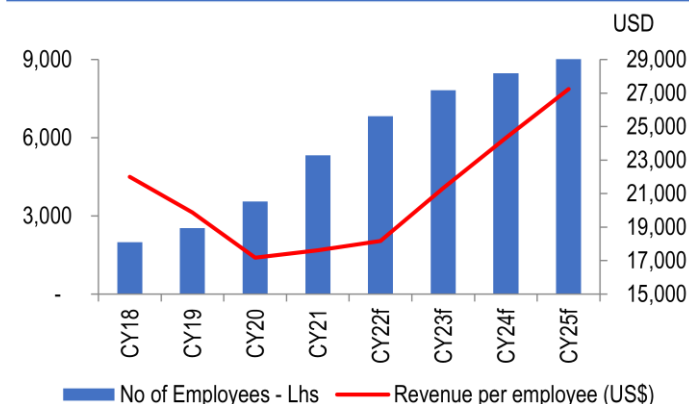
Source: LinkedIn Insights, IMS Research

MENA IT Spending Forecast (Millions of U.S. Dollars)

	2020 Spending	2021 Spending	2022 Spending
Data Center Systems	4,940	5,274	5,423
Enterprise Software	6,922	7,925	8,737
Devices	25,522	27,588	28,129
IT Services	12,566	13,657	14,721
Communications Services	114,031	116,895	120,932
Overall IT	163,982	171,339	177,942

Source: Gartner.com

Company's growth is subject to massive recruitment



Source: IMS Research, Company Accounts

Attractive valuation with massive upside potential

We now value SYS on SoTP basis, using a blended valuation method, assuming 50% PE valuation and 50% DCF valuation. SYS core value is PKR610/sh, where we have applied 20x Price-to-earnings multiple (which is 40% discount to leading global Tech companies), and the other earmarking from 10-yr DCF based valuation. NdcTech and TreeHouse Consultancy together contribute PKR50/sh to our SoTP. Earlier investments in Retailistan (Jugnu) and EP Systems (OneLoad) have not been incorporated yet into our valuations.

PKRmn	CY22f	CY23f	CY24f	CY25f		CY30f	CY31f	CY32f
EBIT(1-T)	4,638	6,687	8,949	11,978	----	32,582	37,011	40,479
Depreciation	345	346	339	333	----	305	300	294
EBITDA	4,983	7,033	9,288	12,311	----	32,887	37,310	40,773
Capital Expenditure	(425)	(346)	(288)	(283)	----	(259)	(255)	(250)
Change in WC	(1,031)	(448)	(599)	(184)	----	(476)	(1,222)	(877)
Free Cash Flow (FCFF)	3,528	6,239	8,402	11,845	----	32,152	35,834	39,646
Present value of FCFF	-	6,239	7,130	8,525	----	10,148	9,590	8,997

Source: IMS Research

We have used same methodology for SYS's two new acquisitions, but have applied 15x P/E multiple and 10-yr DCF method (with terminal growth rate of 5%) to come up with the contribution of PKR50/sh. We maintain our BUY rating of Systems Limited with a Dec'23 based Target Price of PKR660/sh, offering upside of 68%.

(PKRmn)	CY22f	CY23f	CY24f	CY25f		CY30f	CY31f	CY32f
EBIT	744	1,015	1,319	1,676	--	4,232	4,942	5,558
Income on Cash/Bank	-	-	-	-	--	-	-	-
EBIT	744	1,015	1,319	1,676	--	4,232	4,942	5,558
Tax rate	1.2%	1.2%	1.1%	1.1%	--	1.0%	0.9%	0.9%
EBIT(1-T)	735	1,003	1,304	1,657	--	4,191	4,896	5,507
Depreciation	-	-	-	-	--	-	-	-
EBITDA	735	1,003	1,304	1,657	--	4,191	4,896	5,507
Capital Expenditure	(50)	(50)	(50)	(100)	--	(200)	(250)	(250)
Change in WC	(50)	(50)	(50)	(100)	--	(200)	(250)	(250)
Free Cash Flow (FCFF)	635	903	1,204	1,457	--	3,791	4,396	5,007
Present value of FCFF	-	903	1,021	1,049	--	1,197	1,177	1,136

Source: IMS Research

SYSTEM core valuation (PKRmn)	
Sum Of PV FCFF	90,905
PV Of Terminal Value	73,123
Value Of Operating Assets	164,028
- Cash And Cash Equivalents	8,533
Value Of Firm	172,561
- Debt	3,733
Equity Value	168,828
Shares (mn)	278
DCF value (50%) (PKR/sh)	605

Targeted P/E (x)	20
P/E value (50%) (PKR/sh)	610

SYS's core value (PKR/sh)	610
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NdcTech & TH valuation (PKRmn)	
Sum Of PV FCFF	11,325
PV Of Terminal Value	9,236
Value Of Operating Assets	20,561
- Cash And Cash Equivalents	200
Value of Firm	20,761
- Debt	500
Equity Value	20,261
Shares (mn)	278
DCF based value (PKR/sh)	75
Portfolio Discount	35%
DCF value (50%) (PKR/sh)	49

Targeted P/E (x)	15
P/E value (50%) (PKR/sh)	50

NdcTech & TreeHouse value (PKR/sh)	50
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Systems SoTP Valuation

Core business	610
New acquisitions	50
Target Price (PKR/sh)	660

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Ratings Guide*	Criteria
Buy	Total return expectation of $\geq 15\%$ or expected to outperform the KSE-100 index
Neutral	Total return expectation of $> -5\%$ or expected to match the return of KSE-100 index
Sell	Expected downside of more than 5% or expected to underperform the KSE-100 index

*Based on 12 month horizon unless stated otherwise in the report.

Valuation Methodology: We use multiple valuation methodologies in arriving at a Target Price including, but not limited to, Discounted Cash Flow (DCF), Dividend Discount Model (DDM) and relative multiples based valuations.

Risks: (i) Slower than expected growth from existing and new markets, (ii) adverse change in regulatory framework for local IT industry, (iii) difficulty in finding skilled resources.

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