Company Note Overseas
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Perficient Inc. (PRFT.US)

N/R

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International Stock Market Weekly

Information Technology: IT Services / Small cap blend

Perficient Inc. (PRFT.US)

The Covid crisis has brought an acceleration in change in the way companies in all sectors and regions do business. According to a report by McKinsey, companies have accelerated the digitization and automation of their customer and supply-chain interactions and of their internal operations by three to four years And the share of digital or digitally enabled products in their portfolios has accelerated by seven years. Moreover, they expect most of the changes to endure and in fact are now investing to ensure they remain in place. Indeed, in terms of the impact of the pandemic, funding for digital initiatives has increased more than anything else. To remain competitive in this new environment necessitates new strategies and practices, and most companies understand technology's strategic importance as a key part of business, not simply a way to reduce costs.

For digital transformation, smartphones, Covid, and explosion in the adoption of cloud storage solutions are driving organizations to digitalize services to serve customers on online platforms. Worldwide spending on digital transformation products and services will reach an estimated USD2.3tn in 2023, growing at a CAGR of 17.1% from 2019-23, according to IDC. More organizations are now focusing on their digital customer experience and are utilizing big data to generate insights that lead to greater customer understanding, improved engagement, and loyalty. Digital transformation is achieved through the installation of onsite infrastructure or via SaaS based cloud services. The evolution of technology is also contributing to the growing popularity of digitization, with AI, blockchain, IoT, and machine learning simplifying the process of digital transformation.

Among names leading the charge in this swelling digital transformation wave is a Perficient, Inc. (PRFT), a steadily growing small-cap. The company is a digital consultancy services and solutions provider for a wide range of industries such as automotive, energy and utility services, financial services, healthcare, life sciences, manufacturing, and more. The company has outperformed during the pandemic and is racing ahead to become one of the world's leading digital consultancy firm. The reasons behind our bullish view include the company's swelling prospects in digital transformation, its highly differentiated service offering, its key role for a growing list of companies in the ongoing pandemic, expanding global operations, extensive partnerships, and considerable lead on the competition. In short, Perficient's market opportunity is massive, and its addressable market is growing. As such, we recommend growth-focused investors to add Perficient to their portfolios.

Stock pick for the second week of August

Perficient Inc. (PRFT.US)

About Perficient Inc.

Perficient (PRFT), Inc. is a St. Louis, MO US-based digital transformation consulting firm. Its solutions include business intelligence and analytics, commerce, content management, custom applications, platform implementations, portals and collaboration, business integration and application program interfaces, management consulting, business process management, and CRM, and others. It provides services to the healthcare, financial services, retail and consumer goods, automotive and transport products, electronics and computer hardware, telecommunications, manufacturing, business services, and leisure, and media and entertainment markets, and others.

Rationale

The proliferation of the Covid virus was akin to pouring gasoline on a fire in the implementation of automation and digitalization solutions. It compelled organizations to find digital solutions in order to continue functioning remotely.

When Covid-19 struck, it forced rapid societal changes around the globe and accelerated many digitalization processes which were already in play. Governments issued orders that restricted in-person business operations, limited large gatherings, and encouraged people to telecommute. As such, businesses, government offices, and educational institutions started to search and implement web-based solutions to continue their operations remotely. And they made use of collaboration platforms and video conferencing systems to work remotely. However, technology was already becoming increasingly important even before the onset of the pandemic. Prior to the Covid crisis, organizations were already looking at technology solutions as a way to better engage with customers, provide workplace flexibility, and introduce automation and digitalization However, the proliferation of the virus was akin to pouring gasoline on a fire in the implementation of automation and digitalization solutions. It compelled organizations to find digital solutions in order to continue functioning remotely.

This move towards digital operations were both a front-end and back-end endeavor for many organizations. The prohibition of gathering in groups required many organizations to find ways for people to communicate, collaborate, and complete projects remotely while simultaneously customers made it clear that they would prefer to receive services with little to no human contact. The two forces fueled the digital transformation that is transforming businesses in almost every industry, and many of these changes are likely here to stay. And companies such as Perficient that facilitate the ongoing digital transformation and rise in automation will benefit immensely from these changes.

While Perficient is small cap, and it has garnered considerable amount of attention from its impressive ascent on the Nasdaq over the past few months. And this is for good reason. The company has not only benefitted tremendously from the ongoing pandemic but should continue to see remarkable growth over the next few years with the ongoing digitalization efforts around the world by private and public organizations of all shapes and sizes.

For businesses, success in digital transformation is nothing short of making an enterprise agile that can easily create something, scale it up, scale it down, and completely change directions. As such, companies such as Perficient are best positioned in IT services to create such a value proposition are the ones with agile development methodologies, in other words those that are not weighed down with legacy baggage. There are several growth tailwinds including a solid acquisition strategy, with some M&As that created nice synergies. And roughly 80% of what Perficient is doing in terms of revenue is connected to digital transformation, which is a great opportunity. What is more, around 33% of Perficient's revenue comes from healthcare-related clients and health sciences, which is an industry that is ready for digital transformation. And so, there is considerable opportunity to take market share there. Perficient already has a lead on its competitors thanks to its strong brand name and its attractive client base continues to grow.

In 2020, the global digital transformation market was valued at USD999bn and is expected to reach a value of more than USD2.7tn by 2026

The company's investments in its sales force over the past several years started paying off in terms of revenue acceleration before the pandemic and this is picking up as solutions to deal with Covid are coming to light. In short, the company offers tremendous growth tailwinds, along with an opportunity for long-term margin expansion. IT continues to move increasing amounts of new work offshore and nearshore, which will translate into a higher margin going forward. Accelerating revenue growth coupled with margin expansion frequently drives multiple expansion, when considering the valuation multiples, along with additional upside from its ongoing success with its M&A strategy, a transformational M&A could propel the company's structural growth rate markedly higher.

Acceleration of digital transformation

Digital transformation the process in how an organization uses technology, people, and processes to transform and improve its business performance. Digital transformation encompasses a wide range of technologies including AI, cybersecurity HMI, IoT, additive manufacturing, and robotics all of which are being used by wide range of public and private sector users. In 2020, the global digital transformation market was valued at USD999bn and is expected to reach a value of more than USD2.7tn by 2026, at a CAGR of 18.5% from 2021-26.

Amidst the pandemic, the reliance on digital solutions has greatly increased and is expected to remain in place after the pandemic ends. Industry 4.0 is seeing plants adopting digital technologies to automate, enhance, and modernize their processes. Digital transformation technologies such as IoT are growing prevalent, due to the tremendous benefits. Digital transformation helps organizations improve their brand's reputation, customer experience, and customer retention ratios via the implementation of software. Digitally transformed organizations are able to adapt to the evolving technological landscape and tackle rapid shifts in the industry. The merging of big data with new technology has simplified processing large data sets, and manufacturing organizations are increasingly relying on these intelligent tools. Among the enabling technologies, AI will play a significant role as it is also used to boost safety by providing preventive maintenance, despite the growing number of accidents. As such, intelligent AI-based cameras based are now being used mitigate the potential damage.

Greater focus on technology investments

Businesses now understand that introducing technology into their systems need not be perfect. According to McKinsey, companies were able to adopt digital changes 20-25x faster than they expected. Specifically, for remote working, businesses were able to implement solutions 40x faster than expected prior to the pandemic. What employees expected would take a year to implement at their organizations only took an average of 11 days, enabling employees to continue working remotely. Before the pandemic, more than half of businesses thought that a lack of prioritization was a leading reason why digital transformations and capabilities were not adopted. When Covid forced organizations to make such changes a top priority, they did so at blistering speed.

With employees working at home, companies were compelled to consider the employee experience with digital. They suddenly were faced with not being able to simply expect employees to accept what was offered. Before the pandemic, employees may have been grateful attitude for benefits of increased workplace flexibility resulting from digital capabilities but as more companies adopt telecommuting, the employee online experience now impacts their satisfaction with their work environment. And this change in employee attitudes is clear with many voting with their feet to work for companies that offer a better remote work experience. As a result, some companies are dealing with the high turnover that comes from low employee satisfaction and the costs that come with hiring replacements. Instead, paying attention to the importance of creating a positive digital experience for employees has an immense benefit for businesses. In addition, companies must now focus on the ease with which their customers engage digitally. With customers increasingly choosing digital options, businesses must eliminate problems that customers may have when converting using their websites.

Digital transformation has pushed many organizations to reassess, prioritize, and organize their technology investments.

Indeed, digital transformation has pushed many organizations to reassess, prioritize and organize their technology investments. In the pre-pandemic world, when businesses only occasionally accessed their digital capabilities, shortcomings in services were often overlooked by employees and management. However, the dependence on technology caused by the pandemic caused many to closely examine their technology investments and if they are aligned with what they need to properly operate a digitally focused business.

As customers increasingly call for contactless services, companies have also experienced a tremendous push towards digitalization and automation, which has enhanced their ability to create this experience for customers. The fewer processes that must be handled directly by employees, the easier it is for brands to create positive, safe experiences for their customers. Automation and digitalization holds massive potential, helping to manage everything from email subscription lists to inventory. While many organizations are already benefiting from automation, more and more companies have been pushed by Covid to change their view and understand the power of automation and digitalization. Prior to the Covid crisis, many businesses saw automation and digitalization technologies as ways to reduce spending. For example, when emails can be sent when triggered and data analyzed, it allows sales and

marketing teams to focus on activities that cannot be carried out with technology. But that has since changed. And as important, digital transformation provides businesses massive opportunities to innovate and become industry leaders.

Perficient is proficient in cybersecurity solutions

With the greater emphasis on digital capabilities, cybersecurity has become a key component in the digital transformation. With organizations around the world depending on technology and software to provide services to customers and students while also working with others on critical projects, maintaining information security is now a top priority. During the pandemic, the priorities for cybersecurity shifted, transitioning away from providing support and maintaining internal networks to empowering the remote workers. Using VPN and educating and protecting employees from attacks and scams, cybersecurity teams pivoted in their work and emphasis. The increase in telecommuting has caused many industries

The digitalization of the world

The pandemic is an historic tipping point, and there will be even more changes needed as the situation evolves and the pace of change is unlikely to decelerate. During the pandemic, consumers rapidly migrated to online channels, and companies and industries responded in turn. Companies are making pandemic-related changes with a long-term view. For most, remotely interacting and working with customers necessitated an accelerated migration to the cloud and investments in data security. And these changes, along with remote work and customer interactions, are here to stay.

Telecommuting and cloud migration are more cost effective. And the ongoing changes are to meet the burgeoning demand for online interactions and evolving customer needs. Investments in data security and AI are helping to better position organizations. And among all of the changes brought about by the pandemic, telecommuting will be the one that stays the longer the crisis lasts.

Next initiatives

With consumers and organizations embracing digitalization, companies are leveraging the shift to facilitate next-generation digital initiatives across several key areas: operations, customer experience, employee experience, and business model transformation. IoT and Industry 4.0, are driving innovations like digital twins and ML help organizations leverage real-time data to improve operational performance and introduce new services. Customer experience in the new digital era is becoming more personal, with more emotional engagement. Companies are using data to provide better customer experiences. Automation and ML are making routine tasks more efficient, while other technologies such as AR is assisting workers in new ways. In business model transformation, organizations are finding smaller opportunities for digital enhancement and information-based extensions such as optimizing pricing, delivering predictive and proactive services, etc.

A growing growth stock

Strategic acquisitions are helping it to fuel Perficient's growth.

Perficient is aggressively expanding its global operations, which already span the Americas, Europe, India, and China. It has a good mix of onshore and offsite operations, positioning to enjoy an advantage positions as compared to pure offshore companies. Its extensive network of partnerships with industry leading enterprise partner including names such as Adobe (ADBE), Microsoft (MSFT), Oracle (ORCL), IBM (IBM), and many others and counts Google (GOOG), Twilio (TWLO), Amazon (AMZN) AWS, MicroStrategy (MSTR), and VMware (VMW) as some of its strategic partners. It works with a vast range of companies, including many of the biggest names in global enterprises, to help them with their digital needs with names such Caterpillar (CAT), Facebook (FB), Ford (F), Toyota (TM), Nike (NKE), Merck (MRK), Novartis (NVS), and more.

Perficient has been steadily making strategic acquisitions that are helping it to fuel its growth. In Jun 2020, it acquired PSL for USD33mn with Microsoft as its primary partner, to focus on the LATAM market. In Mar 2020, it acquired Brainjocks for USD13mn to focus on web and content management in Atlanta, GA, and Serbia. In Jan 2020, it acquired MedTouch, a digital healthcare provider to focus serve Boston, MA and Cedar Rapids, MI, both acquisitions were in partnership with SiteCore and bring in clients such as Kinesso, Splunk (SPLK), P&G (PG), Essentia Health and Sage Therapeutics into its portfolio.

In the war with industry giants for contracts, Perficient appears to be pulling ahead of the competition and winning projects such as contracts with a global equipment manufacturer, a leading fashion design brand for data analytics, a large healthcare payor to build a new platform for insurance services, and a leading financial services company, beating larger rivals such as Accenture (ACN), Cognizant (CTSH), Capgemeni (CGEMY), and Deloitte.

The company expects to see higher cash flow, and this should drive the share valuation higher

Growth investors focus on stocks that offer above-average financial growth, as this helps such securities draw the market's attention and deliver outsized returns. That said, finding a great growth stock can prove to be a daunting task, especially in todays richly valued markets. Growth stocks typically carry above-average risk and volatility. Indeed, buying a stock when the growth story is over or approaching an end can prove to be a lossmaking endeavor. And so, the superiority of a potential growth stock can be validated by examining the trend in earnings estimate revisions. Research shows a strong correlation between trends in earnings estimate revisions and near-term stock price movements. Investors looking for growth should consider a company's prospects before purchasing shares. Buying a great company with a promising outlook at a reasonable price is usually a good investment. When examining Perficient's future expectations, we see that profit should grow more than 2x over the next couple of years. We like that the company expects to see higher cash flow, and this should drive the share valuation higher. Indeed, the robust positive outlook is alluring, and so we are recommending accumulating shares on any dip in the share price.

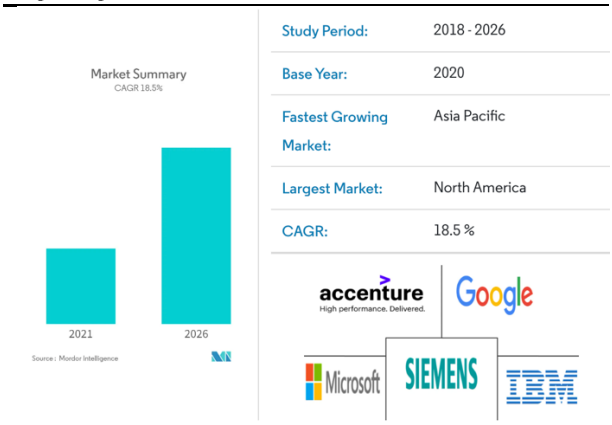
Perficient's primary growth driver is its digital consultancy business, its core business. The company helps large companies become more responsive to market opportunities and also ensures growth of these companies through this business. The company offers businesses software products or solutions

in AI, big data, business analytics, and ML. As competition is increasing in every sector, businesses are hiring digital consultancy firms and spending more to acquire customers and ensure revenue growth. Perficient's solutions are comprehensive and diversified, empowering its clients. The solutions will drive revenue growth higher over the next five years. In short, Perficient's solutions help businesses enhance productivity, reduce costs, and increase revenue growth. The solutions also help businesses launch new products and enter new markets. As businesses can fulfill multiple objectives using these combined solutions, demand is steadily rising.

Fig 1. The 'Digital' opportunity is massive

Source: IDC, Perficient, Hyundai Motor Securities

Fig 2. Digital transformation market

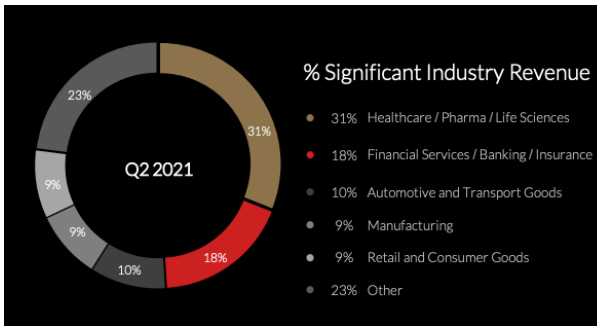


Source: Mordor Intelligence, Hyundai Motor Securities

Fig 3. Top 50 clients

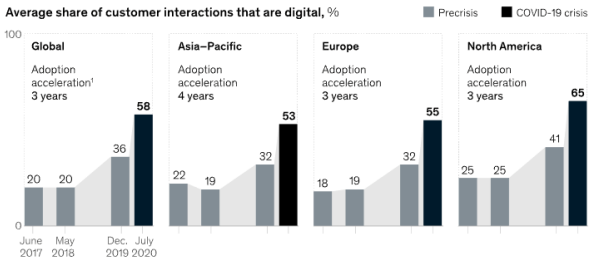
Source: Perficient, Hyundai Motor Securities

Fig 4. Strong vertical expertise



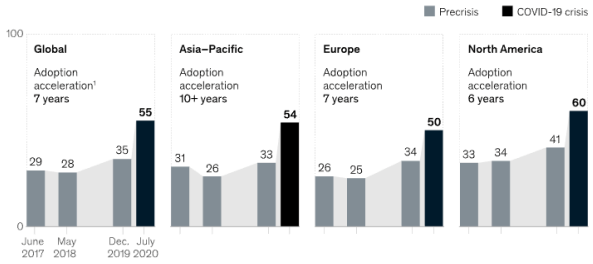
Source: Perficient, Hyundai Motor Securities

Fig 5. Pandemic accelerating the digitalization of customer interactions



Source: McKinsey, Hyundai Motor Securities

Fig 6. Avg. share of products/services that are partially or fully digitized (%)

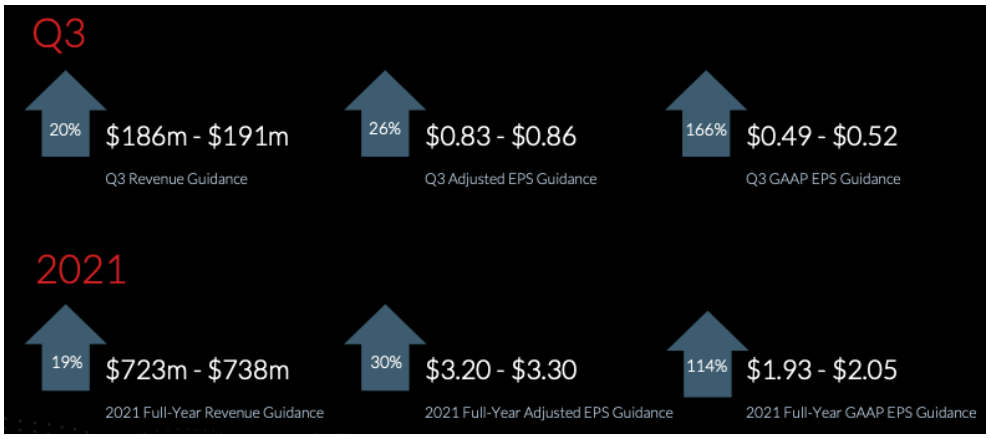


Source: McKinsey, Hyundai Motor Securities

Fig 7. Diverse & specialized in a range of capabilities

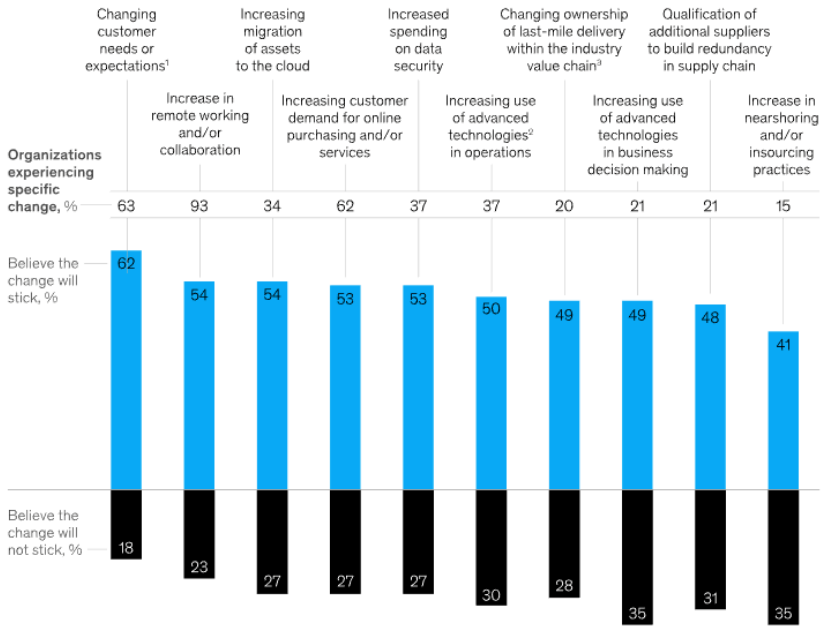
Source: Perficient, Hyundai Motor Securities

Fig 8. 3Q and FY21 outlook



Source: Perficient, Hyundai Motor Securities

Fig 9. Biggest shifts in the crisis also among the most likely to stick through the recovery (share of respondents, %)



Source: McKinsey, Hyundai Motor Securities

The end is the beginning

Looking to the end of the Covid crisis, there are questions about the future the changes businesses made in response to the pandemic. It is likely that many of these changes are here to stay. Since the pandemic forced companies to do away with many of the barriers that used to stand in their way of digital adoption, such as network security for telecommuting, it is now easier for organizations to operate on a remote basis. Organizations have already made investments to protect their digital security and built a technology stack that allows employees to telecommute. And it is likely that many of these changes will last, with capabilities such as flexible scheduling allowing employees to work from home as needed. Businesses have also begun to see the power and potential of digital adoption. With business innovation, adopting technology is just about reducing costs, but also securing an edge over competitors and capitalizing on new opportunities. Organizations are now seeing these advantages and are positioned to keep utilizing technology and take advantage of what it offers. Even in the education sector, where students are now taking remote classes many schools and universities, educators have become skilled at creating remote lesson plans. The potential for education, such as providing access for those who have struggled to attend schools because of distance, are unlikely be given up quickly.

Perficient is perfectly positioned to capture market share in the post-pandemic digitalized era.

Technology offers organizations massive potential to engage with people around the world in an instant. Prior to the pandemic, many organizations were just beginning to see the potential that many of these capabilities offered. However, when in-person meetings and work were limited, they realized the power of technology. The pandemic accelerated the digital transformation, creating an environment that will continue to drive innovation and technological adoption. Organizations now better understand the capabilities of technology as well as the opportunities ahead, and this will not change even once

the pandemic ends. The end of the pandemic will mark the beginning of the new post-pandemic digitalized era. Perficient is perfectly positioned to capture market share in the post-pandemic digitalized era.

Valuation and risks

The market in which the company operates is very competitive and has low barriers to entry. And so, competition will continue to increase. But the company has some key competitive advantages, which should help it fend off the competition. Its key competitive advantage is its domain expertise, which it offers via its technology solutions and software platforms. The company knows the challenges in industries and helps customers grow their revenue and profitability. The company is now an authority in the market thanks its solid and unique solutions, which address industry-specific business challenges. Indeed, its authority helps it win new business and discover new markets, which help to grow revenue. The company's long-term success depends on developing new products and addressing changes in technology on an ongoing basis.

Perficient is in the IT services sector and has positive earnings, so the PEG and PE ratios are the most appropriate valuation measures. We excluded PB as it likely underestimates the company's book value by overlooking hidden assets such as IP. PSR is not as meaningful as the PE or PEG ratio, due to its positive earnings. At first glance, Perficient appears highly valued with a PEG of 4.67x, one of the highest in the IT services sector. Additionally, its PE of 74.65x is also among the highest in the industry. Perficient's profitability is typical of a company in its sector. While it is better than most at converting revenues to profits on a net and operating margin basis, its GPM of 38.31% is on par with the industry average of 42.69%. Earnings growth outpaced revenue growth TTM at 17.79% better than that of the average of 13.36% in its sector. Perficient's current market cap is about USD3.3bn and even with its incredible run-up, we think its valuation remains attractive given the massive market opportunity ahead.

The bottom line

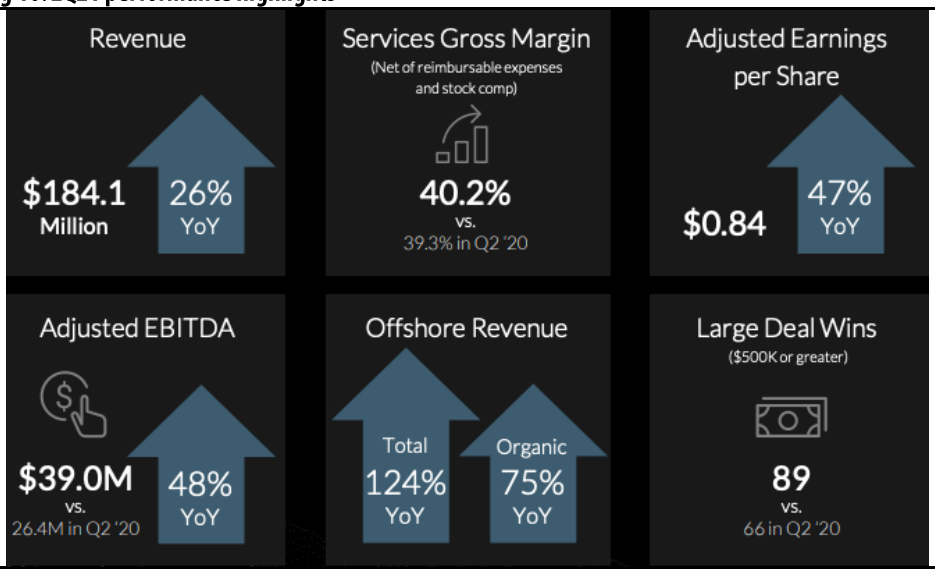
The market for digital transformation is growing at an incredible rate but has just start started to hit its stride. And when the pandemic does finally come to an end, the automation and digitalization infrastructure will remain, and indeed organizations will find new and innovative ways to generate greater revenues through new products, services, and efficiency measures havoc globally.

Perficient's market opportunity is massive, and its addressable market is growing

Perficient outperformed during the pandemic and is racing ahead to become one of the world's leading digital consultancy firm. The reasons behind our bullish view include the company's swelling prospects in digital transformation, its highly differentiated service offering, and its key role for a growing list of companies in the ongoing pandemic, expanding global operations, extensive partnerships, and considerable lead on the competition. Its domain expertise makes it a compelling growth story. Its business model is impressive In addition, the company offers custom application solutions to clients, and it has strong relationships with several of the world's biggest software companies. These companies offer Perficient's solutions to their new clients. In short, Perficient's market opportunity is massive, and

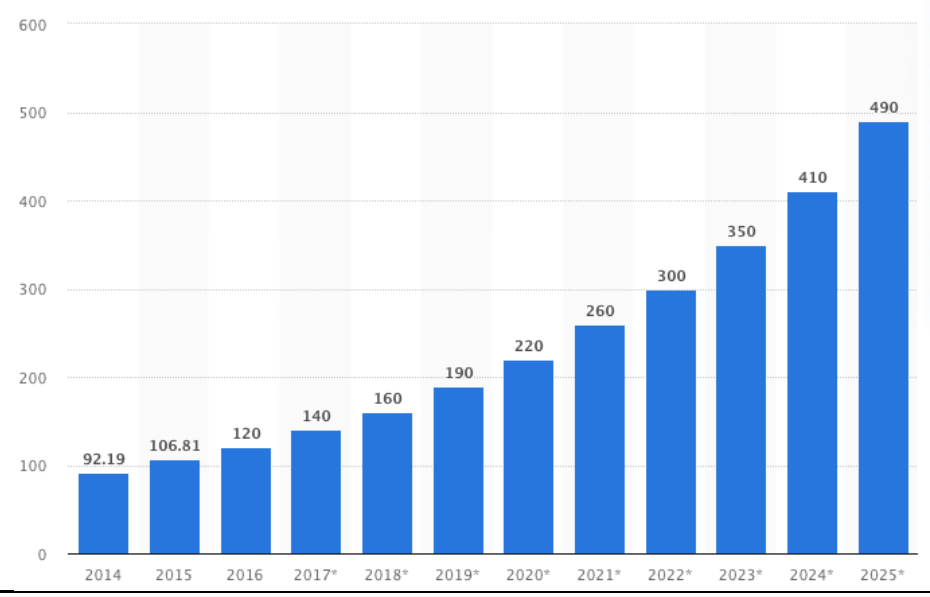
its addressable market is growing. As such, we recommend growth-oriented investors to add Perficient to their portfolios.

Fig 10. 2Q21 performance highlights



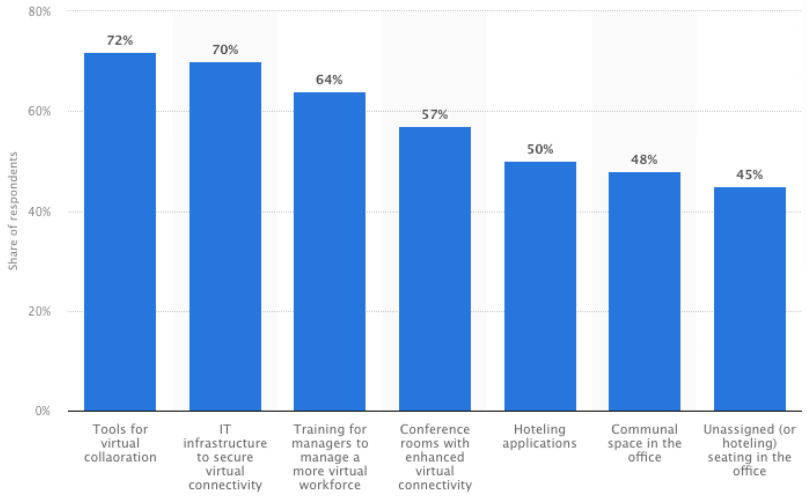
Source: Perficient, Hyundai Motor Securities

Fig 11. Digital transformation market revenue in the US from 2014-25 (USD bn)



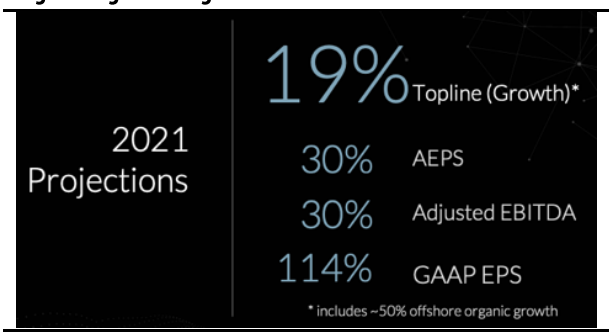
Source: Grand View Research, Hyundai Motor Securities

Fig 12. Planned changes in IT investment levels by area



Source: PwC, Hyundai Motor Securities

Fig 13. High-leverage model

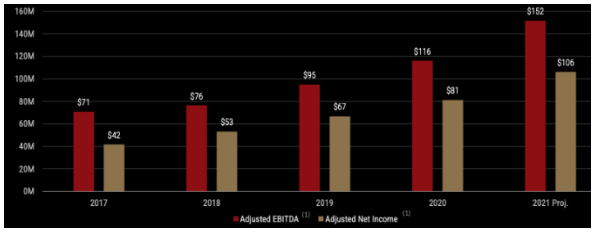


Source: Perficient, Hyundai Motor Securities

Fig 14. Recent acquisitions

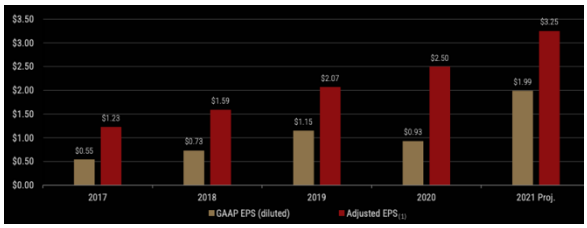
Source: Perficient, Hyundai Motor Securities

Fig 15. Profitability



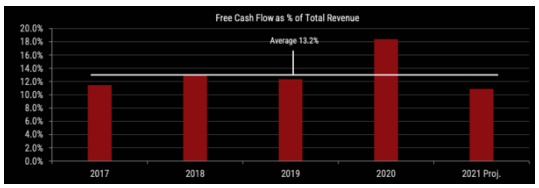
Source: Perficient, Hyundai Motor Securities

Fig 16. GAAP and AEPS performance



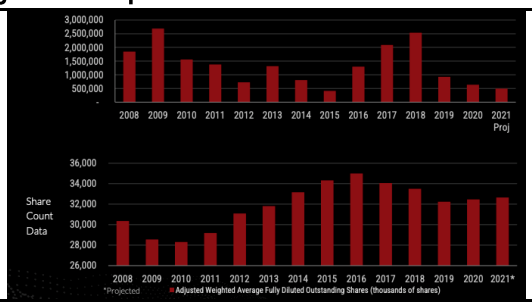
Source: Perficient, Hyundai Motor Securities

Fig 17. Strong FCF



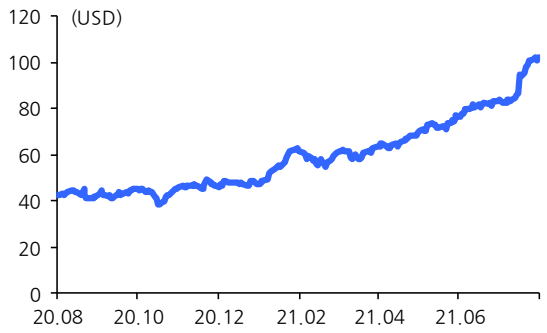
Source: Perficient, Hyundai Motor Securities

Fig 18. Share repurchase



Source: Perficient, Hyundai Motor Securities

Fig 19. PRFT Stock Price



Source: Bloomberg, Hyundai Motor Securities

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