Persistent Systems (PERSYS)

ICICI direct Research

CMP: ₹ 4467 | Target: ₹ 5170 (16%) | Target Period: 12 months | BUY

April 26, 2023

Aiming for industry leading growth; top client recovery likely sustainable…

About the stock: Persistent Systems (Persistent) offers cloud, data, product & design led services to BFSI, healthcare & hi-tech verticals.

- Persistent had a strong year (FY23) with revenue growth of 35.2% in dollar terms & rupee revenue growth of 46.2%
- Net debt free and healthy double digit return ratio (with RoCE of 20%)

Q4FY23 Results: Persistent reported steady revenue growth in Q4FY23.

- Revenue grew 3.5% QoQ in CC terms and 3.8% QoQ dollar terms
- EBIT margins was flat sequentially at 15.4%
- Reported TCV was US$421.6 mn, down 4.2% QoQ & 16.8% YoY

What should investors do? Persistent's share price has grown by ~6.2x over the past five years (from ~₹ 726 in April 2018 to ~₹ 4,467 levels in April 2023).

- We maintain our **BUY** rating on the stock

Target Price and Valuation: We value Persistent at ₹ 5,170 i.e. 26x P/E on FY25E.

Key triggers for future price performance:

- The company has achieved US$1 bn revenue in FY23 and is now aiming at US$2 bn annual revenue in the medium term
- Persistent is actively looking for acquisitions to acquire capabilities in the areas of cyber security, consumer tech, generative AI, healthcare & BFSI
- Strong deal win momentum will help improve its revenue growth. We expect dollar revenue to grow at 18.1% CAGR in FY23-25E along with EBIT margin expansion of ~140 bps to 16.3% over FY23-25E

Alternate Stock Idea: Apart from Persistent, in our IT coverage we also like Infosys.

- Key beneficiary of improved digital demand, industry leading revenue growth and healthy capital allocation prompt us to be positive
- BUY with a target price of ₹ 1,600

PERSISTENT

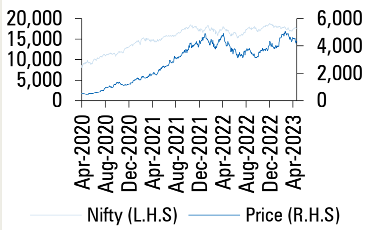
Particulars

Particular	Amount
Market Cap (₹ Crore)	34,251
Total Debt (₹ Crore)	654
Cash & Invests (₹ Crore)	1,091
EV (₹ Crore)	33,814
52 week H/L	5135 / 3092
Equity capital	76.4
Face value	10.0

Shareholding pattern

	Jun-22	Sep-22	Dec-22	Mar-23
Promoter	31	31	31	31
FII	20	20	20	21
DII	26	26	26	28
Public	22	23	22	21

Price Chart



Recent event & key risks

- FY23 revenue touched US$1bn
- **Key Risk:** (i) Lower-than-expected revenue growth, (ii) Lower-than-expected margins

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Company Update

ICICI Securities – Retail Equity Research

Key Financial Summary

(₹ Crore)	FY21	FY22	FY23	5 Year CAGR (FY18-23)	FY24E	FY25E	2 Year CAGR (FY23-25E)
Net Sales	4,188	5,711	8,351	22.4%	10,065	11,857	19.2%
EBITDA	683	958	1,519	26.5%	1,902	2,300	23.1%
EBITDA Margins (%)	16.3	16.8	18.2		18.9	19.4	
Net Profit	451	690	921	23.3%	1,245	1,520	28.5%
EPS (₹)	59.0	90.3	120.5		162.9	198.9	
P/E (x)	75.8	49.4	35.9		27.4	22.5	
RoCE (%)	21.6	23.1	27.3		29.2	29.3	
RoE (%)	16.1	20.5	23.2		25.4	24.9	

Source: Company, ICICI Direct Research

Key takeaways of recent quarter & conference call highlights

Persistent - ESG Disclosure Score*			
Score	FY20	FY21	FY22
Environmental	26.4	34.3	32.9
Social	26.4	24.8	25.4
Governance	76.1	76.1	76.1
Overall ESG Score	**43.0**	**45.1**	**44.8**

*Source: Blomberg, ICICI Direct Research, *Score ranges from 0 - 100 with a higher score indicating higher ESG disclosures*

- The company reported revenue growth of 3.8% to US$274.6 million (mn). In CC terms, growth was 3.5% QoQ. In rupee terms, the company reported revenue of ₹ 2,254.5 crore, up 3.9% QoQ. Services revenue (93.2% of mix) of the company grew 5.4% QoQ to 255.9 mn while IP led revenue declined 13.9% QoQ
- Geography wise, North America (77.9% of the mix) reported growth of 4.9% QoQ due to a recovery in top clients while Europe (10.3% of mix) continues to grow strongly by 18.8% QoQ on the back of large deals won by the company. India revenue declined 15.6% QoQ. The company mentioned that the decline was due to weak IP revenue due to seasonal weakness during the quarter
- Vertical wise, hi-tech (48% of mix) & life science (19.7% of mix) reported growth of 4.3% & 4.4%, respectively, while financial services grew 2.9%
- EBIT margin of the company was flat QoQ at 15.4%. The company indicated that the currency benefit was flat during the quarter and it also mentioned that the benefits of fresher deployment were negated by the headwinds of increase in travel costs & hosting of annual employee event which impacted the margin by 30 bps
- In FY23, the company achieved a milestone of annual revenue of US$1 bn by reporting revenue of US$1,036 mn, up 35.3% and in rupee terms it reported revenue of ₹8,351 crore, up 46.2%. In FY23, the services revenue grew 42% while IP led revenue declined 14.8% in dollar terms. The company reported an EBIT of ₹ 1,247 crore with a corresponding EBIT margin of 14.9% compared to 13.9% in FY22 due to the tailwinds of SG&A leverage, improved realisations and currency benefits mitigated by headwinds of higher cost of travel & lower utilisation due to fresher hirings. Persistent for FY23 reported PAT of ₹ 921 crore with a PAT margin of 11%
- The company indicated that revenue from top customer has seen some recovery in Q4 after witnessing a decline in the last few quarters but it was on expected lines as indicated earlier. The company mentioned that ramp down by the top client in H1FY23 due to the structured cost cutting programme impacted the revenue contribution to company. The company, however, has aligned its offerings as per the top client's requirements and indicated that top client recovery is likely sustainable. The company also indicated that the revenue from its second largest client has also recovered after the furlough impact in Q3 and reported a sequential growth in Q4
- However, the company mentioned that one of its top hyperscaler clients has ramped down its business with the company, which had a revenue impact of ~US$3 mn in Q4 and ~US$10 mn in annualised basis. The company confirmed that it is a lost opportunity but expects some other revenue opportunity to come up with this client in the coming quarters. The company also confirmed that it is not witnessing any slowdown/ramp down in any other client as of now
- On the FY24 outlook, the company mentioned that the environment remains challenging. However, the company expects a strong year on account of continued strong deal wins. Persistent mentioned that unlike other IT companies where the growth is likely be blackened for FY24, it is expecting their growth to be largely spread out across all quarters, and guided for 3-5% quarterly revenue growth for the next few quarters
- On the margins front, the company mentioned that it aims to improve its margin by 200-300 bps in the next two to three years with levers like i) **fresher deployment**: The company mentioned that it hired 3000 freshers at the start of FY23 and is planning to add 850 to 1000 freshers in FY24. The company mentioned that all freshers hired in FY23 have completed their respective training and have been deployed in the projects including IP business. ii) **utilisation improvement**: Persistent mentioned that its utilisation, which includes freshers, is currently down at 77%. The company mentioned that as in when freshers start billing, utilisation likely starts improving. It believes there is a scope of utilisation improvement and it can touch historical levels of 82-83% in the medium term iii) **Pricing**: The company indicated that as contribution of new offering such as generative

AI, Cloud, would rise in its product mix, it is likely to see margin improvement as they are better pricing technologies

- The company indicated that it will roll out wage hikes from July 1 and further indicated that wage hike for offshore employees will in the range of 8-9% & on-shore employees will be in the band of 3-4%
- In the hi-tech segment the company indicated that it is seeing ramp up in business by its hi-tech & enterprise clients despite the slowdown in growth of hyperscalers like Microsoft, Google, etc. which are laying off employees due to demand slowdown. Persistent also mentioned that mid-size hyperscalers, which were backed by PE investors that went for listing post pandemic, are finding it difficult to maintain costs due to higher costs & lower demand. The company indicated this is leading to increase in offshoring which provides growth opportunity for the company
- The company further mentioned that now since the acquired companies are fully integrated, it is now actively looking for inorganic opportunity to strengthen its capability in the areas of consumer tech, cyber security, generative AI technology wise, healthcare & BFSI vertical wise and Europe region geography wise. Persistent indicated that it looking for M&A opportunity to strengthen its capability & not for revenue growth
- On generative AI the company mentioned that it has invested to leverage generative AI capability & software to train its employees and improve their efficiency. The company also indicated that it is working on integrating generative AI solutions with its IP to deploy solutions for its clients. On cyber security initiatives the company mentioned that it is working to develop its capabilities in this area and it has made investments to procure third party software & licenses to enhance its offerings in cyber security
- The subcontractor cost of the company declined in Q4 by 290 bps QoQ to 10.3% due to client ramp-down. The company indicated that this number is not sustainable as some project wins required subcontractors. Hence, the number is likely to go up in the next quarters. The company mentioned that 12-12.5% of sales will be an appropriate number to consider for the future
- On the DSO front, the company mentioned that due to collapse of Silicon Valley Bank it had to redirect its receivable in other banks, which created a time lag and led to increase of DSO by one day to 68 in Q4. In FY23, the DSO increased by 10 days due to winning of large IP led deals during the year, which had billing gap in the initial time. The company mentioned that it is working to the reduce the DSO to the levels of 64-65 days
- The company during the quarter won TCV of US$421.6 mn, down 4.2% QoQ & up 16.8% YoY, out of which US$250.3 mn was new TCV wins. It also reported ACV of US$310.4 mn, down 4.9% QoQ & up 18.5% YoY
- The company's net addition during the quarter were 291 taking total employee strength to 22,889. Persistent indicated that apart from 850-1000 fresher hiring it is planning to do lateral ,hiring which will be aligned as per demand
- The company's LTM attrition declined 180 bps QoQ to 19.8%. Persistent further mentioned that attrition will decline as supply side challenges are easing out and the market is normalising
- The company mentioned that in Q4 it inaugurated its new campus in Nagpur and also mentioned that it has shortlisted site for new centre in Kolkata with capacity of 250 seats. Persistent also mentioned that in FY24 it will open new centres in Chennai, Kochi in India and in Poland to expand its European presence
- The company declared a final dividend of ₹ 12 per share. On the mark of the company achieving the landmark US$1 bn in annual revenue the company declared a special dividend of ₹ 10 per share taking the total dividend announced for FY23 to ₹ 50 per share. The dividend payout for FY23 came at 41.5% compared to 34.3% in FY22 due to the special dividend announced by the company. The company also mentioned that the dividend payout in future will not be at the level of FY23 as the company is actively looking for M&A opportunity

Exhibit 1: P&L

	Q4FY23	Q4FY22	YoY (%)	Q3FY23	QoQ (%)	Comments
Revenue (USD mn)	274.6	217.3	26.3	264.4	3.8	Revenue grew by 3.5% QoQ in CC terms, Services revenue grew by 5.4% QoQ while IP led revenue declined 13.9% QoQ
Revenue	2,254.5	1,637.9	37.6	2,169.4	3.9	
Employee expenses	1,470.5	1,078.3	36.4	1,419.3	3.6	
Gross Margin	784.0	559.6	40.1	750.0	4.5	
Gross margin (%)	34.8	34.2	61 bps	34.6	20 bps	
Other expenses	367.6	278.4	32.1	348.5	5.5	
EBITDA	416.3	281.2	48.1	401.6	3.7	
EBITDA Margin (%)	18.5	17.2	130 bps	18.5	-4 bps	
Depreciation & amortisatio	69.7	51.1	36.4	68.4	2.0	
EBIT	346.6	230.0	50.7	333.2	4.0	
EBIT Margin (%)	15.4	14.0	133 bps	15.4	1 bps	Margins were flat sequntially as the benefits of fresher billings was negated by impact of higher travel cost & expenses incurred on hosting annual employee meet
Other income	-6.0	37.1	-116.2	19.2	-131.2	Forex losses impacted number for Q4
PBT	340.6	267.2	27.5	352.4	-3.4	
Tax paid	89.1	66.2	34.6	84.8	5.0	
PAT	251.5	201.0	25.1	238.0	5.7	

Source: Company, ICICI Direct Research

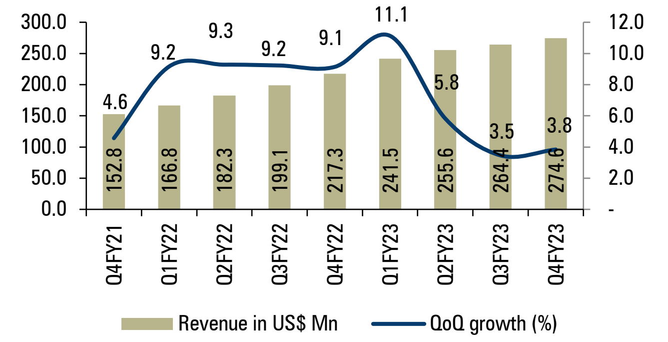
Exhibit 2: Change in estimates

	FY24E			FY25E			Comments
(₹ Crore)	Old	New	% Change	Old	New	% Change	
Revenue	9,594	10,065	4.9	10,951	11,857	8.3	
EBIT	1,480	1,570	6.1	1,712	1,933	12.9	
EBIT Margin (%)	15.4	15.6	17 bps	15.6	16.3	67 bps	Margins increased on management focus on margin improvement
PAT	1,259	1,245	-1.1	1,441	1,520	5.5	
EPS (₹)	165	163	-1.1	189	199	5.5	

Source: Company, ICICI Direct Research

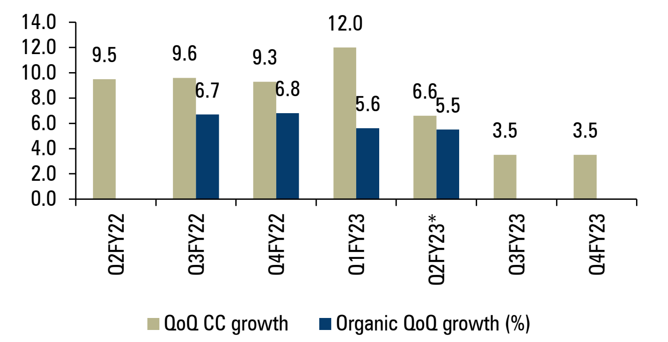
Key Metrics

Exhibit 3: Recovery in top clients aid revenue growth



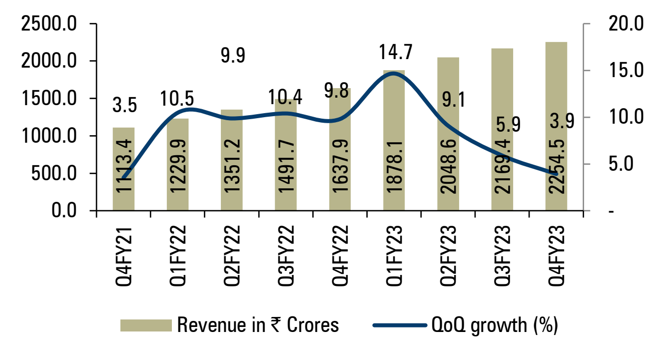
Source: Company, ICICI Direct Research

Exhibit 4: CC growth steady in Q4



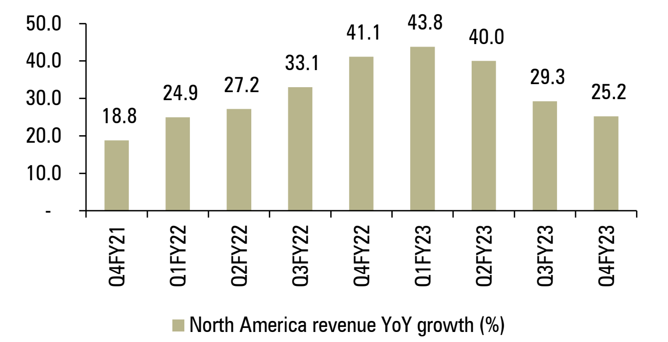
Source: Company, ICICI Direct Research, * Organic QoQ growth - Q2FY23 growth in CC terms while other period growth in dollar terms

Exhibit 5: Rupee revenue grows 3.9% in Q4



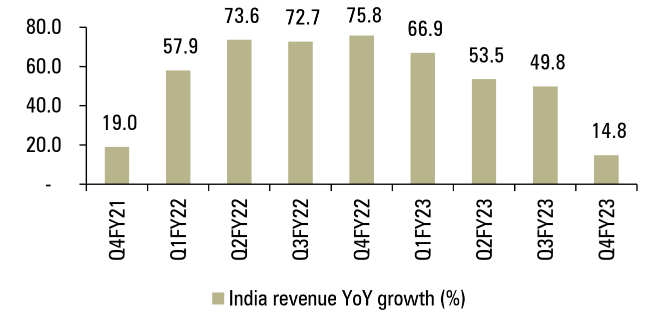
Source: Company, ICICI Direct Research

Exhibit 6: Recovery in top client aids North America



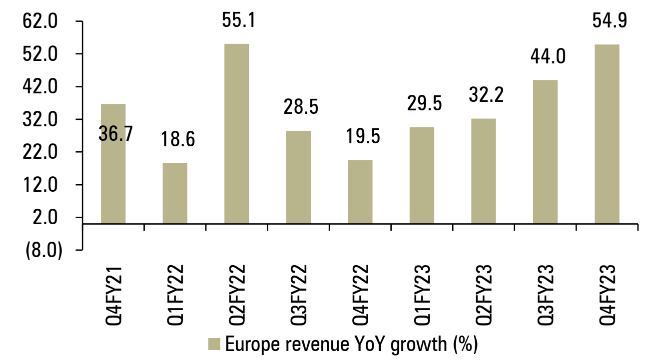
Source: Company, ICICI Direct Research

Exhibit 7: India region declines due to seasonal weakness in IP led business



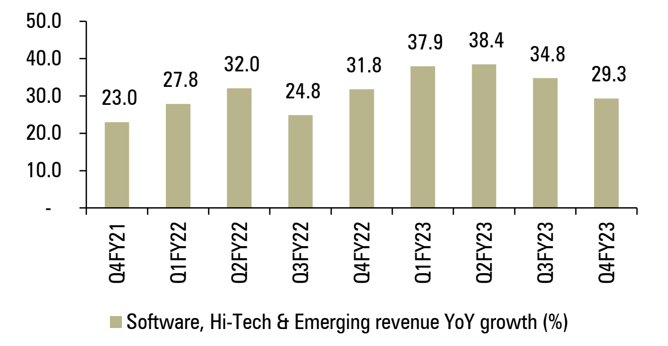
Source: Company, ICICI Direct Research

Exhibit 8: Europe continues to grow on strong order wins



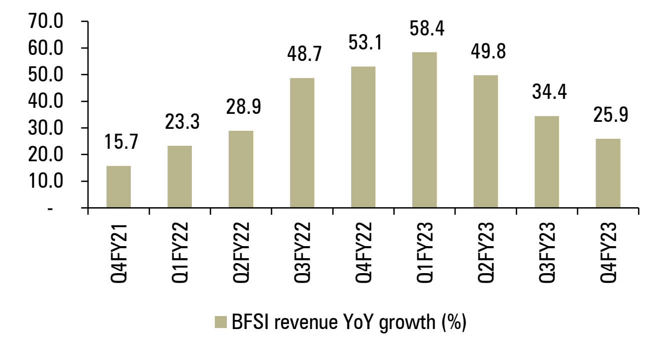
Source: Company, ICICI Direct Research

Exhibit 9: Hi-Tech vertical continues steady growth



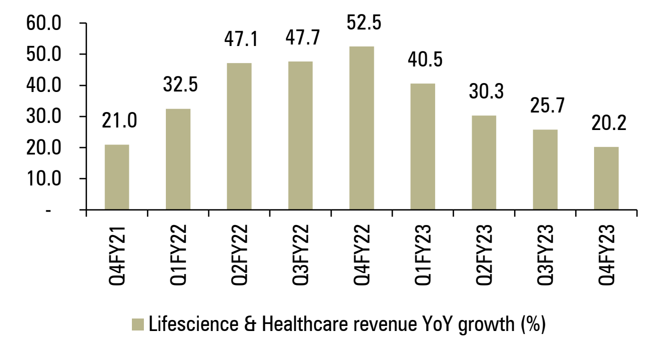
Source: Company, ICICI Direct Research

Exhibit 10: BFSI vertical growth normalising



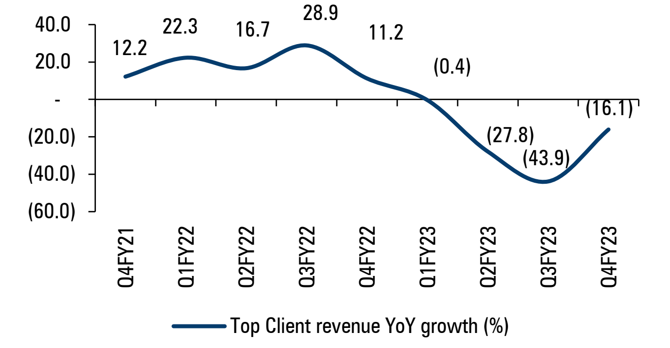
Source: Company, ICICI Direct Research

Exhibit 11: As does lifescience & healthcare



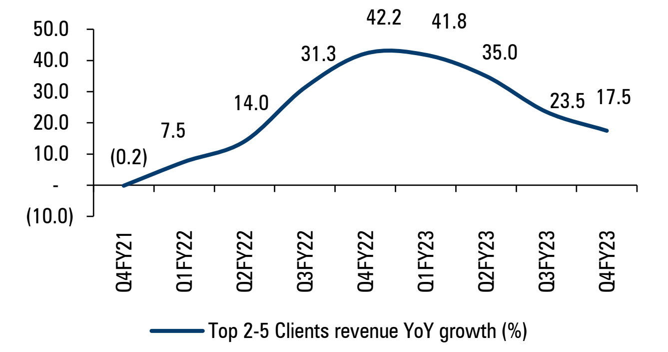
Source: Company, ICICI Direct Research

Exhibit 12: Top client sees recovery



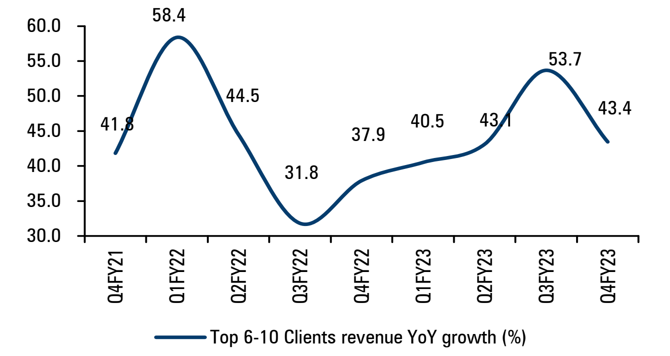
Source: Company, ICICI Direct Research

Exhibit 13: Top 2-5 clients growth trend



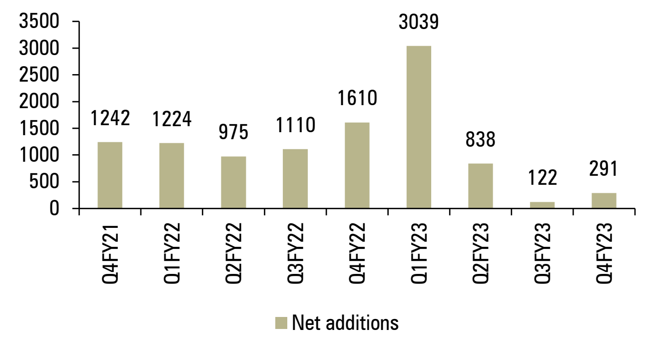
Source: Company, ICICI Direct Research

Exhibit 14: Top 6-10 clients growth trend



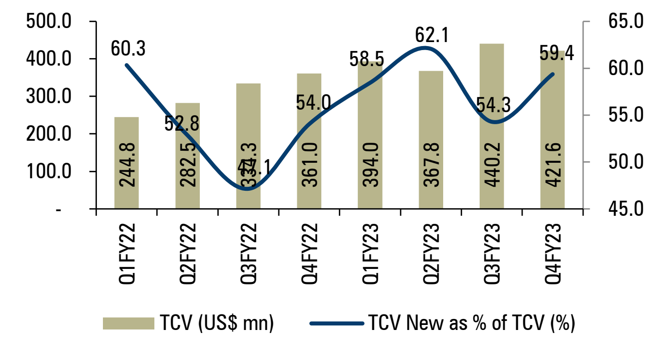
Source: Company, ICICI Direct Research

Exhibit 15: Net additions reflection of demand



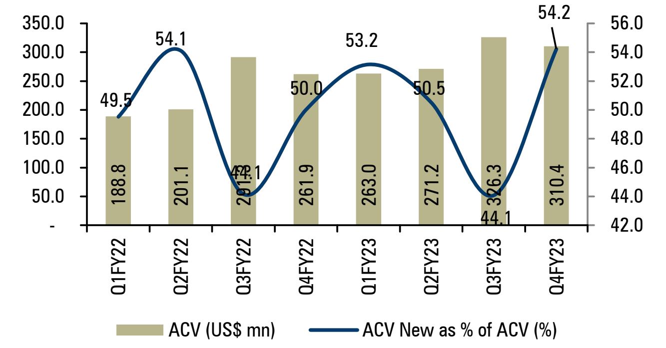
Source: Company, ICICI Direct Research

Exhibit 16: TCV wins heathy on YoY basis



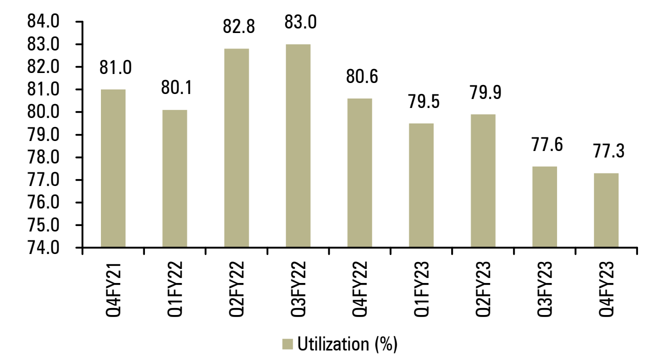
Source: Company, ICICI Direct Research

Exhibit 17: ACV trend



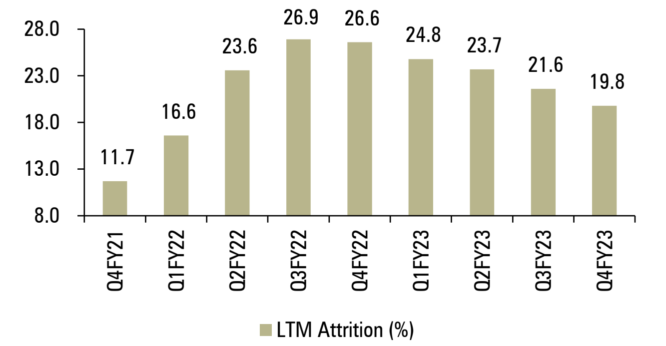
Source: Company, ICICI Direct Research

Exhibit 18: Utilisation to improve after fresher deployment



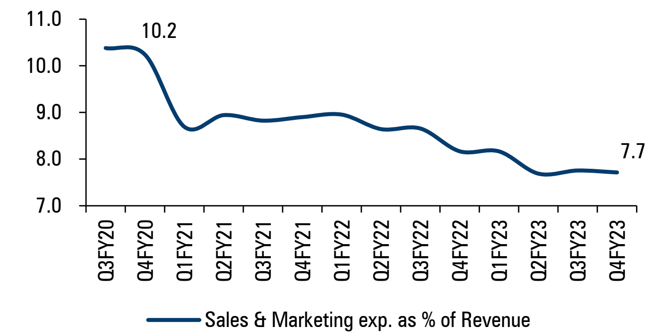
Source: Company, ICICI Direct Research

Exhibit 19: LTM attrition moderating consistently



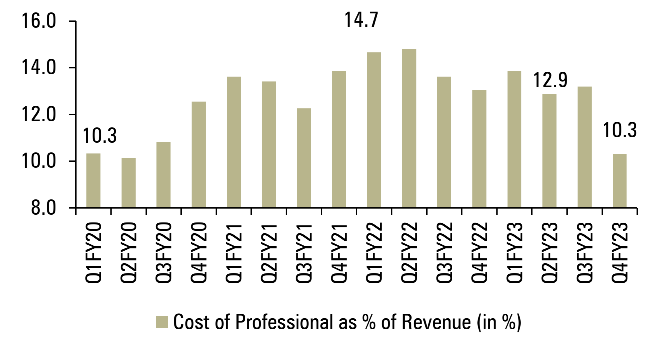
Source: Company, ICICI Direct Research

Exhibit 20: S&M expenses continue to moderate



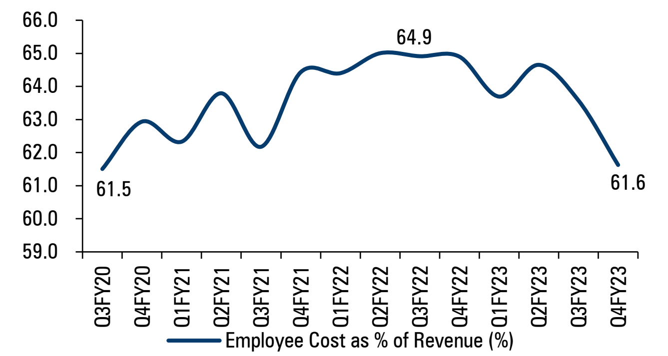
Source: Company, ICICI Direct Research

Exhibit 21: Sub costs low in Q4 due to ramp down by a client



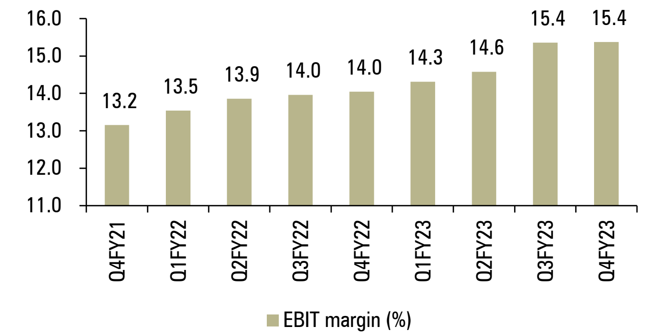
Source: Company, ICICI Direct Research

Exhibit 22: Ease of supply pushing employee cost down



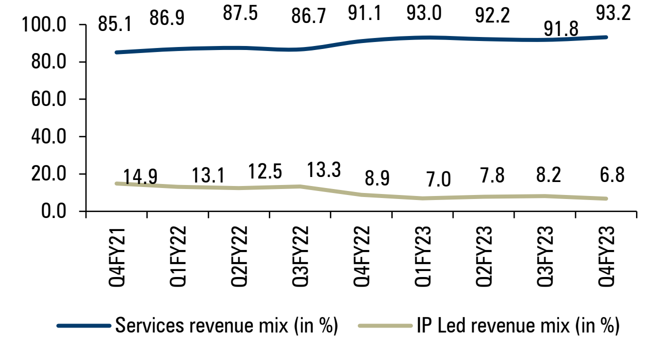
Source: Company, ICICI Direct Research

Exhibit 23: Margins flat in Q4



Source: Company, ICICI Direct Research

Exhibit 24: Revenue mix trend skewed toward services



Source: Company, ICICI Direct Research

Financial summary

Exhibit 25: Profit and loss statement ₹ crore

Particulars	FY22	FY23	FY24E	FY25E
Total Revenues	**5,711**	**8,351**	**10,065**	**11,857**
Growth (%)	36.4	46.2	20.5	17.8
Employee & Subcon costs	3,763	5,463	6,522	7,624
Total Operating Expenditure	4,753	6,831	8,163	9,556
EBITDA	**958**	**1,519**	**1,902**	**2,300**
Growth (%)	40.3	58.5	25.2	20.9
Depreciation & Amortization	166	272	332	368
Other Income	132	23	68	68
Interest	-	-	-	-
PBT before Excp Items	924	1,271	1,638	2,001
Growth (%)	51.7	37.5	28.9	22.1
Tax	234	320	393	480
PAT before Excp Items	690	951	1,245	1,520
Exceptional items	-	30	-	-
PAT before MI	690	921	1,245	1,520
Minority Int & Pft. frm asso	-	-	-	-
PAT	**690**	**921**	**1,245**	**1,520**
Growth (%)	53.2	33.4	35.2	22.1
Diluted EPS	90	121	163	199
EPS (Growth %)	53.2	33.4	35.2	22.1

Source: Company, ICICI Direct Research

Exhibit 26: Cash flow statement ₹ crore

	FY22	FY23	FY24E	FY25E
PBT	924	1,241	1,638	2,001
Depreciation & Amortization	166	272	332	368
WC changes	(41)	(438)	232	100
Other non cash adju.	32	221	(68)	(68)
CF from operations	**845**	**956**	**1,741**	**1,920**
Capital expenditure	(996)	(863)	(906)	(949)
Δ in investments	(53)	388	-	-
Other investing cash flow	72	54	68	68
CF from investing Activities	**(977)**	**(421)**	**(838)**	**(881)**
Issue of equity	-	-	-	-
Δ in debt funds	428	(4)	-	-
Dividends paid	(199)	(298)	(311)	(304)
Other financing cash flow	(47)	(102)	(30)	(30)
CF from Financial Activities	**182**	**(404)**	**(341)**	**(334)**
Δ in cash and cash bank balance	50	131	562	705
Effect of exchange rate changes	(0)	(26)	-	-
Opening cash	981	914	903	1,466
Cash c/f to balance sheet	**914**	**903**	**1,466**	**2,170**

Source: Company, ICICI Direct Research

Exhibit 27: Balance sheet ₹ crore

	FY22	FY23	FY24E	FY25E
Liabilities				
Equity	76	76	76	76
Reserves & Surplus	3,292	3,889	4,822	6,039
Networth	3,368	3,965	4,899	6,115
Minority Interest	-	-	-	-
Long term Liabilties & provisions	625	696	704	712
Source of funds	**3,993**	**4,661**	**5,602**	**6,827**
Assets				
Net fixed assets	535	722	1,019	1,321
Net intangible assets	827	917	1,224	1,532
Goodwill	279	718	718	718
Other non current assets	552	292	292	292
Investments	388	452	452	452
Debtors	948	1,570	1,655	1,787
Current Investments	435	188	188	188
Cash & Cash equivalents	914	903	1,466	2,170
Other current assets	541	856	923	993
Trade payables	430	569	602	709
Current liabilities	996	1,389	1,732	1,918
Application of funds	**3,993**	**4,661**	**5,602**	**6,827**

Source: Company, ICICI Direct Research

Exhibit 28: Key ratios ₹ crore

(Year-end March)	FY22	FY23	FY24E	FY25E
Per share data (₹)				
Diluted EPS	90.3	120.5	162.9	198.9
Cash Per Share	119.7	118.2	191.7	284.0
BV	440.7	518.7	640.9	800.0
DPS	31.0	50.0	33.8	33.0
Operating Ratios (%)				
EBITDA Margin	16.8	18.2	18.9	19.4
PBT Margin	16.2	15.2	16.3	16.9
PAT Margin	12.1	11.0	12.4	12.8
Turnover Ratios				
Debtor days	61	69	60	55
Creditor days	27	25	22	22
Return Ratios (%)				
RoE	20.5	23.2	25.4	24.9
RoCE	23.1	27.3	29.2	29.3
RoIC	6.9	12.3	20.7	42.0
Valuation Ratios (x)				
P/E	49.4	35.9	27.4	22.5
EV / EBITDA	35.0	22.3	17.5	14.1
Market Cap / Sales	6.0	4.1	3.4	2.9
Solvency Ratios				
Current Ratio	1.0	1.2	1.1	1.1
Quick Ratio	1.0	1.2	1.1	1.1

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%

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