

CMP: ₹ 3707

Target: ₹ 4370 (18%)

Target Period: 12 months

October 21, 2022

BUY

## Consistent margin improvement...

**About the stock:** Persistent System (Persistent) offers cloud, data, product & design led services to BFSI, Healthcare & Hi Tech verticals.

- Persistent had a strong year (FY22) with revenue growth of 35.2% in dollar terms, out of which organic growth was 32.8%
- Net debt free and healthy double digit return ratio (with RoCE of 20%)

**Q2FY23 Results:** Persistent reported strong numbers in Q2FY23.

- Revenue grew 6.6% QoQ in CC terms and 5.8% in dollar terms
- EBIT margins improved ~30 bps QoQ to 14.6%
- Deal TCW was at US\$367.8 mn, down 6.6% QoQ, up 30.2% YoY

**What should investors do?** Persistent's share price has grown by ~5.5x over the past five years (from ~₹ 667 in October 2017 to ~₹ 3,707 levels in October 2022).

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

**Target Price and Valuation:** We value Persistent at ₹ 4,370 i.e. 26x P/E on FY25E.

**Key triggers for future price performance:**

- The company has achieved US\$1 bn revenue on a quarterly annualised basis and is now aiming at US\$2 bn annual revenue in the medium term
- It has acquired five companies in FY22 building capabilities in payments, cloud, etc. Persistent is not shying away from acquisitions in coming years as well
- Strong deal win momentum will help improve its revenue growth. We expect dollar revenue to grow at 23.7% CAGR in FY22-25E along with EBIT margin expansion of ~70 bps to 14.6% over FY22-25E

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

- Industry leading growth and healthy margins prompt us to be positive on the stock
- BUY with a target price of ₹ 5,525



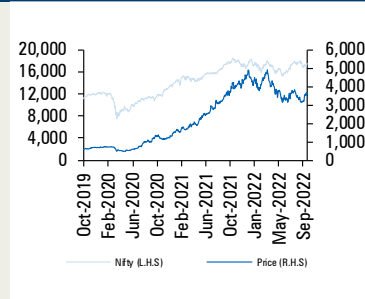
### Particulars

Particular	Amount
Market Cap (₹ Crore)	28,094
Total Debt (₹ Crore)	600
Cash & Invests (₹ Crore)	1,349
EV (₹ Crore)	27,345
52 week H/L	4987 / 3092
Equity capital	76.4
Face value	10.0

### Shareholding pattern

	Sep-21	Dec-21	Mar-22	Jun-22
Promoter	31	31	31	31
FII	19	20	20	20
DII	28	27	27	26
Public	22	22	22	22

### Price Chart



### Recent event & key risks

- Fourth successive quarter of US\$300mn+ TCW wins
- **Key Risk:** (i) Lower than expected revenue growth, (ii) Lower than expected margins

### Research Analyst

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### Key Financial Summary

(₹ Crore)	FY21	FY22	5 Year CAGR (FY17-22)	FY23E	FY24E	FY25E	3 Year CAGR (FY22-25E)
Net Sales	4,188	5,711	14.7%	8,188	9,705	10,808	23.7%
EBITDA	683	958	16.1%	1,444	1,740	1,970	27.2%
EBITDA Margins (%)	16.3	16.8		17.6	17.9	18.2	
Net Profit	451	690	18.0%	954	1,147	1,288	23.1%
EPS (₹)	59.0	90.3		124.8	150.0	168.5	
P/E (x)	62.9	41.0		29.7	24.7	22.0	
RoCE (%)	21.6	23.1		28.2	29.4	28.9	
RoE (%)	16.1	20.5		24.3	24.9	24.0	

Source: Company, ICICI Direct Research

## Key takeaways of recent quarter & conference call highlights

- The company reported revenue growth of 5.8% to US\$255.6 million (mn). In CC terms, growth was 6.6% QoQ. Persistent indicated that the organic contribution was 4.7% in dollar terms and 5.5% in CC terms. In rupee terms, the company reported a revenue of ₹ 2,048.6 crore, up 9.1% QoQ
- Geography wise, North America (78.6% of the mix) grew 6.1% while Europe & India and RoW reported growth of 3.3% & 7.7% QoQ, respectively. In terms of verticals, hitech reported growth of 8.3% QoQ while BFSI reported moderate growth of 3% QoQ
- EBIT margin of the company improved 30 bps QoQ to 14.6%. The company indicated the following tailwinds for margin improvement: a) increase in IP revenues +80 bps, b) currency benefit +90 bps and c) lower travel & sub-contractor costs + 120 bps mitigated by the following headwinds: a) wage hike -230 bps, b) provision for doubtful debts -20 bps and c) CSR spend -10 bps
- On demand environment, the company indicated that the global economy is experiencing headwinds like inflation as well as geopolitical risk, which is unfolding as we speak. Persistent and its clients are watching these events closely. There is a constant discussion on cost optimisation programs that its clients are looking for. It also indicated that it is staying closer to the clients and working on every possible solution required by its clients to remain competitive in such a challenging environment. The company witnessed slower decision making on the client side but outright order cancellation is not yet visible. The company expects normal furlough in Q3
- As far as top customer (which is a global major tech company) is concerned, revenue mix for the same is coming down as a result of continued revenue decline. Persistent mentioned that quarterly variations are a reflection of certain decision making at its end pertaining to prioritisation of certain tech spends. The company further said it is working with this client for the last 18 years and is also a part of their certain future programs. There is no risk to this revenue mix. Persistent also reiterated that there were certain contract changes (for five-year deal) that it did with this client, a few quarters back, wherein time and material contract has been converted into fixed price contract to scale up margins. It may reflect in future company margins. Persistent expects around US\$2 mn impact of these developments on its revenue
- As far as weak BFSI revenues for the quarter are concerned, the company mentioned that quarterly variations are possible in this vertical. It also mentioned that banks and insurance businesses are prioritising their tech spends. Hence, some moderation is possible but long term growth is intact. Persistent also said that its BFSI is largely in the US, India geography while it has minimal exposure to mortgage business clients in BFSI segment. Hence, it is not expecting any impact of weak macros on its banking business
- On M&A aspiration, the company said that all its historical acquisitions are largely integrated as integration of recently acquired data glove and media agility is in final stages. Persistent indicated that it is now actively looking for acquisitions, especially in the Europe regions where significant valuation correction is visible and will not shy away from the deal if it is a strategic fit for them
- The company added 838 employees during the quarter where the mix is skewed towards freshers. It also mentioned that it has honoured all offers to freshers and there is no cancellation from its side. It added 3000 freshers in the last two quarters. Persistent's fresher target is complete for FY23
- The company's LTM attrition declined 110 bps QoQ to 23.7%. This the third consecutive quarter wherein the attrition has declined. Persistent further indicated that it expects attrition to moderate further in H2FY23

- The company signed large deals of TCV US\$70 mn in Q1 and US\$80 mn in Q2. Onshore revenues were up 4.7% due to 4.8% increase in pricing while volumes were up 2.5%. In case of onsite, revenues were up 0.9% in which volumes were up 2.5% while pricing was down 1.5%. The management indicated offshore price is a function of its ability to manage fixed price projects and pricing power in terms of contracted price increase

**Exhibit 1: P&L**

	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	Comments
Revenue (USD mn)	255.6	182.3	40.2	241.5	5.8	Revenue grew at 6.6% QoQ in CC terms with organic contribution of 5.5%
Revenue	2,048.6	1,351.2	51.6	1,878.1	9.1	
Employee expenses	1,349.5	895.5	50.7	1,223.9	10.3	
Gross Margin	699.1	455.7	53.4	654.2	6.9	
Gross margin (%)	34.1	33.7	40 bps	34.8	-71 bps	
Other expenses	331.2	231.3	43.2	320.9	3.2	
EBITDA	368.0	224.4	64.0	333.3	10.4	
EBITDA Margin (%)	18.0	16.6	135 bps	17.7	22 bps	
Depreciation & amortisation	69.3	37.1	86.9	64.5	7.4	
EBIT	298.7	187.3	59.4	268.8	11.1	
EBIT Margin (%)	14.6	13.9	72 bps	14.3	27 bps	Margin grew despite headwinds of -260 bps including wage hike (-230 bps) while tailwinds were increase in IP revenues (+80 bps), currency benefits (+90 bps) and lower travel & sub-contractor expenses (+120 bps)
Other income	-3.1	30.3	-110.1	13.1	-123.3	
PBT	295.6	217.6	35.8	281.9	4.9	
Tax paid	75.6	55.9	35.3	70.3	7.6	
PAT	220.0	161.8	36.0	211.6	4.0	

Source: Company, ICICI Direct Research

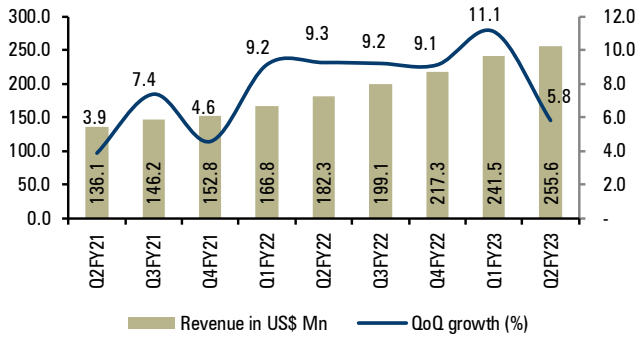
**Exhibit 2: Change in estimates**

₹ Crore)	FY23E			FY24E			FY25E	Comments
	Old	New	% Change	Old	New	% Change	Introduced	
Revenue	7,292	8,188	12.3	8,750	9,705	10.9	10,808	Re-aligned on strong H1 performance
EBIT	1,052	1,149	9.2	1,289	1,391	7.9	1,581	
EBIT Margin (%)	14.4	14.0	-40 bps	14.7	14.3	-40 bps	14.6	
PAT	882	954	8.1	1,071	1,147	7.0	1,288	
EPS (₹)	115	125	8.1	140	150	7.0	168	

Source: Company, ICICI Direct Research

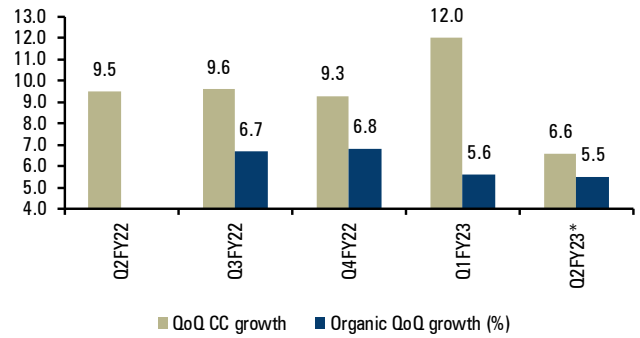
## Key Metrics

**Exhibit 3: Top client & BFSI impact revenue growth**



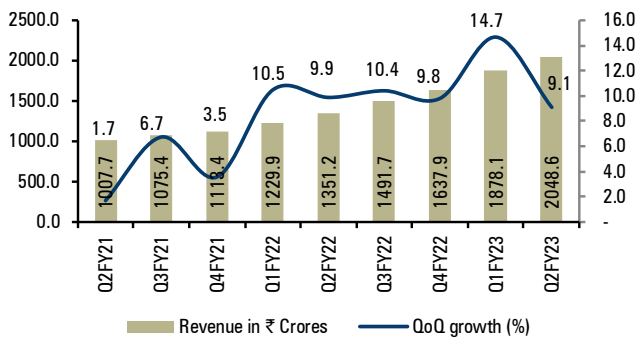
Source: Company, ICICI Direct Research

**Exhibit 4: While organic CC trend has been stable**



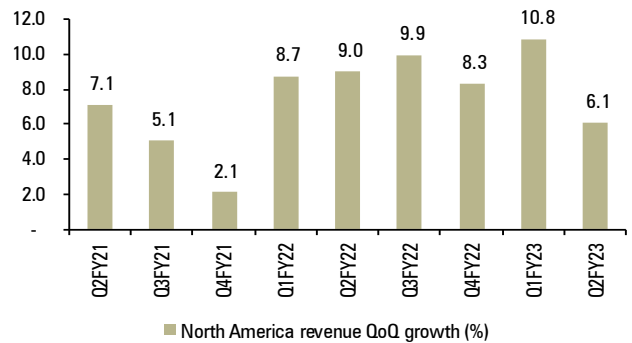
Source: Company, ICICI Direct Research, \* Organic QoQ growth - Q2FY23 growth in CC terms while other period growth in dollar terms

**Exhibit 5: Revenue in rupee helped by currency**



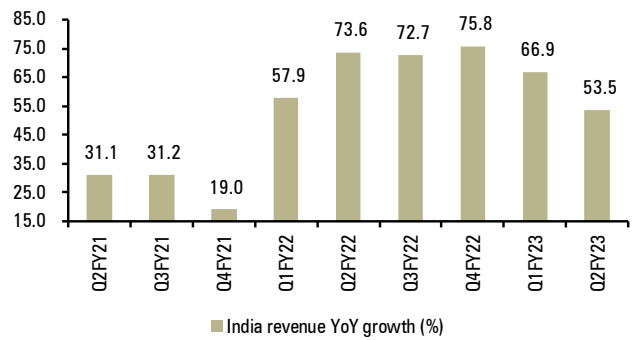
Source: Company, ICICI Direct Research

**Exhibit 6: North America sees some moderation**



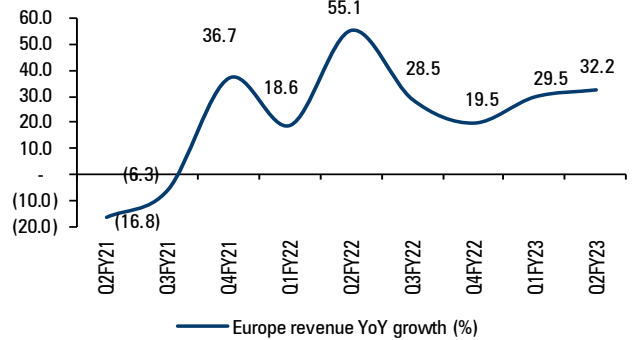
Source: Company, ICICI Direct Research

**Exhibit 7: As does India on YoY basis**



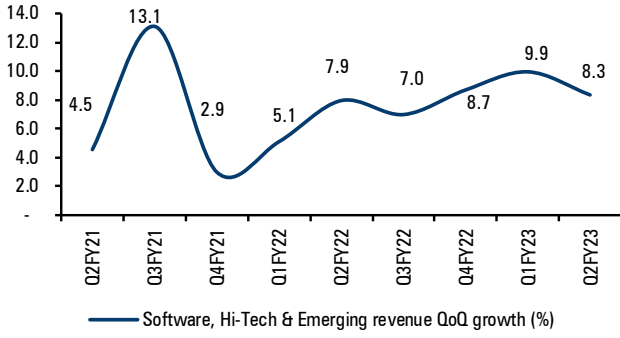
Source: Company, ICICI Direct Research

**Exhibit 8: However, Europe sees uptick on YoY basis**



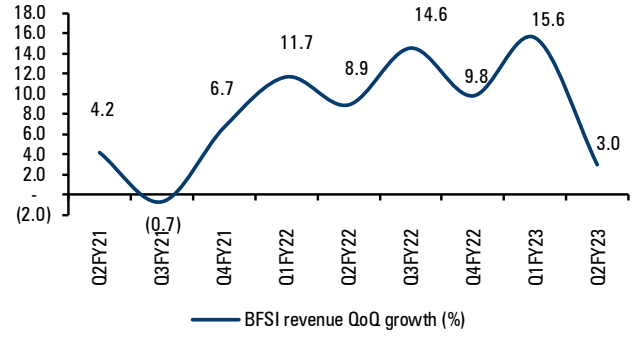
Source: Company, ICICI Direct Research

Exhibit 9: Hi-Tech vertical QoQ growth stable



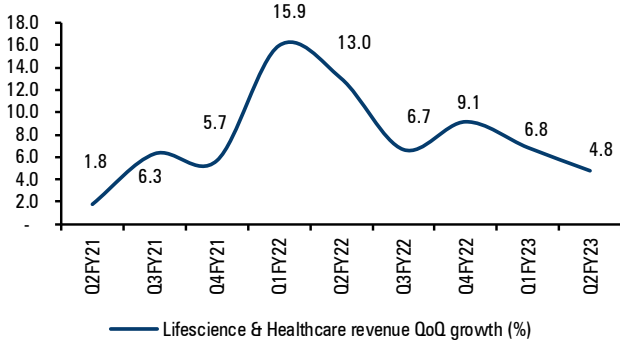
Source: Company, ICICI Direct Research

Exhibit 10: BFSI vertical growth declines



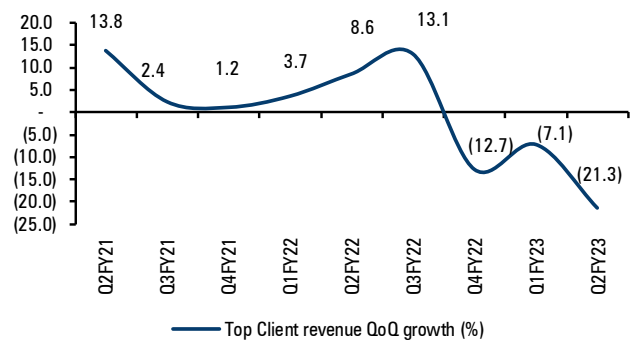
Source: Company, ICICI Direct Research

Exhibit 11: Lifescience & healthcare vertical growth trend



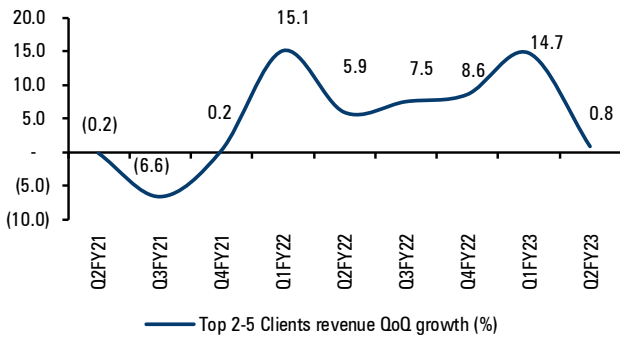
Source: Company, ICICI Direct Research

Exhibit 12: Top client declines



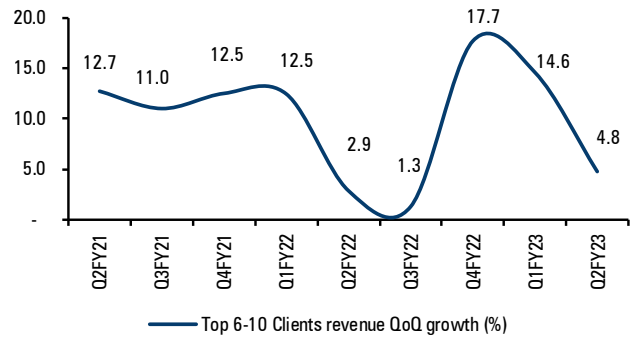
Source: Company, ICICI Direct Research

Exhibit 13: Top 2-5 clients revenue growth trend



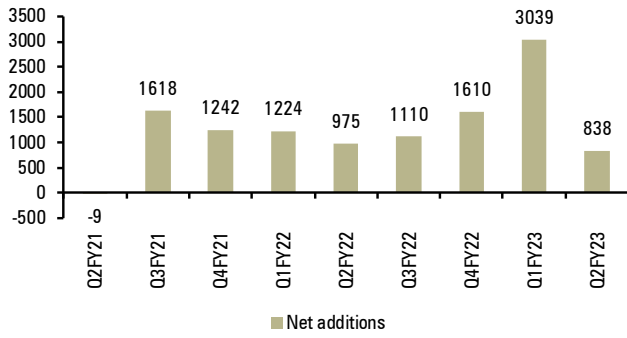
Source: Company, ICICI Direct Research

Exhibit 14: Top 2-5 clients revenue growth trend



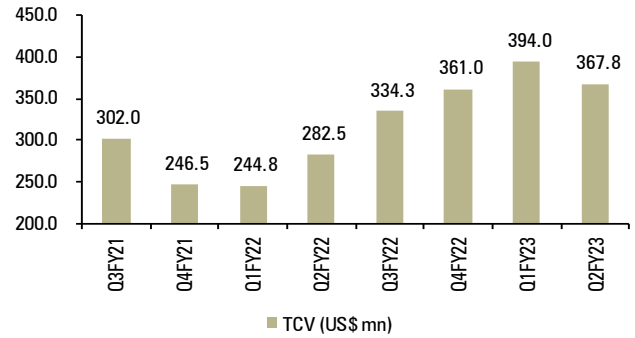
Source: Company, ICICI Direct Research

Exhibit 15: Net additions soft for Q2FY23



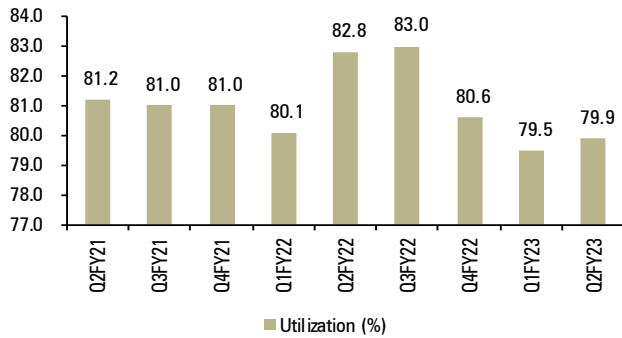
Source: Company, ICICI Direct Research

Exhibit 16: TCV wins remain strong



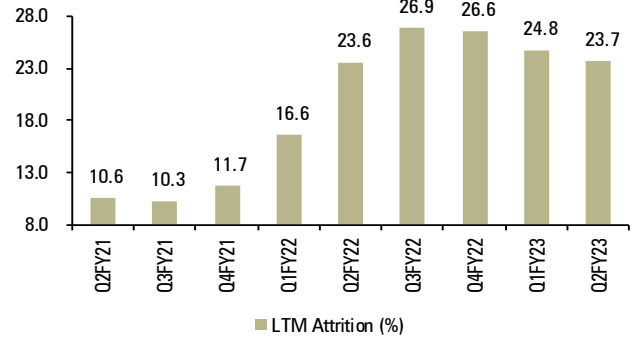
Source: Company, ICICI Direct Research

Exhibit 17: Utilisation improves marginally



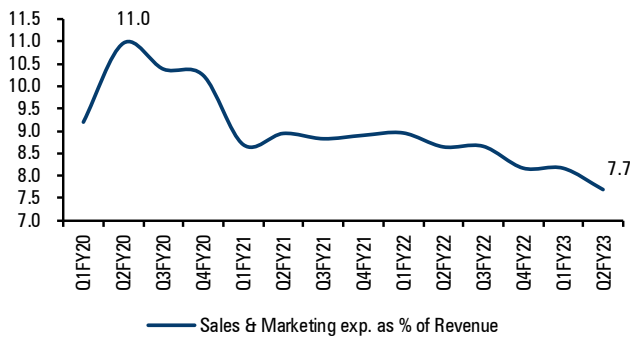
Source: Company, ICICI Direct Research

Exhibit 18: Attrition steadily moderating



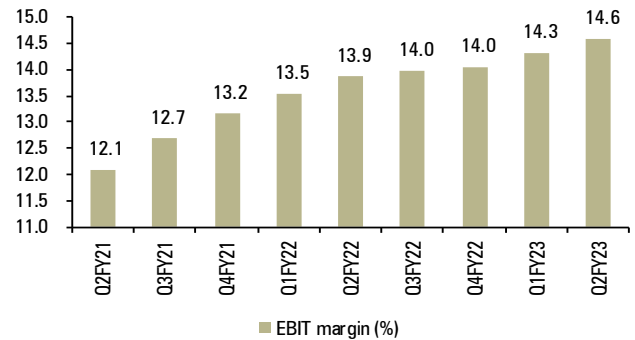
Source: Company, ICICI Direct Research

Exhibit 19: S&M expenditure as percentage of revenue steadily declining



Source: Company, ICICI Direct Research

Exhibit 20: Helping EBIT margin improvement



Source: Company, ICICI Direct Research

## Financial summary

Exhibit 21: Profit and loss statement					₹ crore
Particulars	FY22	FY23E	FY24E	FY25E	
<b>Total Revenues</b>	<b>5,711</b>	<b>8,188</b>	<b>9,705</b>	<b>10,808</b>	
Growth (%)	36.4	43.4	18.5	11.4	
Employee & Subcon costs	3,763	5,355	6,298	6,982	
Total Operating Expenditure	4,753	6,744	7,965	8,837	
<b>EBITDA</b>	<b>958</b>	<b>1,444</b>	<b>1,740</b>	<b>1,970</b>	
Growth (%)	40.3	50.7	20.5	13.2	
Depreciation & Amortization	166	295	349	389	
Other Income	132	140	159	159	
Interest	-	-	-	-	
PBT before Excp Items	924	1,289	1,550	1,740	
Growth (%)	51.7	39.4	20.2	12.3	
Tax	234	335	403	452	
PAT before Excp Items	690	954	1,147	1,288	
Exceptional items	-	-	-	-	
PAT before MI	690	954	1,147	1,288	
Minority Int & Pft. frm asso	-	-	-	-	
<b>PAT</b>	<b>690</b>	<b>954</b>	<b>1,147</b>	<b>1,288</b>	
Growth (%)	53.2	38.2	20.2	12.3	
EPS	90	125	150	168	
EPS (Growth %)	53.2	38.2	20.2	12.3	

Source: Company, ICICI Direct Research

Exhibit 22: Cash flow statement					₹ crore
	FY22	FY23E	FY24E	FY25E	
PBT	924	1,289	1,550	1,740	
Depreciation & Amortization	166	295	349	389	
WC changes	(41)	12	(17)	(12)	
Other non cash adju.	32	(140)	(159)	(159)	
<b>CF from operations</b>	<b>845</b>	<b>1,121</b>	<b>1,320</b>	<b>1,506</b>	
Capital expenditure	(996)	(270)	(320)	(357)	
Δ in investments	(53)	-	-	-	
Other investing cash flow	72	140	159	159	
<b>CF from investing Activities</b>	<b>(977)</b>	<b>(130)</b>	<b>(162)</b>	<b>(198)</b>	
Issue of equity	-	-	-	-	
Δ in debt funds	428	-	-	-	
Dividends paid	(199)	(391)	(470)	(528)	
Other financing cash flow	(47)	(30)	(30)	(30)	
<b>CF from Financial Activities</b>	<b>182</b>	<b>(421)</b>	<b>(500)</b>	<b>(558)</b>	
Δ in cash and cash bank balance	50	570	659	750	
Effect of exchange rate changes	-	-	-	-	
Opening cash	981	914	1,484	2,143	
<b>Cash c/f to balance sheet</b>	<b>914</b>	<b>1,484</b>	<b>2,143</b>	<b>2,893</b>	

Source: Company, ICICI Direct Research

Exhibit 23: Balance sheet					₹ crore
	FY22	FY23E	FY24E	FY25E	
<b>Liabilities</b>					
Equity	76	76	76	76	
Reserves & Surplus	3,292	3,855	4,531	5,291	
Networth	3,368	3,931	4,608	5,367	
Minority Interest	-	-	-	-	
Long term Liabilities & provisions	625	647	656	663	
<b>Source of funds</b>	<b>3,993</b>	<b>4,578</b>	<b>5,264</b>	<b>6,030</b>	
<b>Assets</b>					
Net fixed assets	539	551	560	567	
Net intangible assets	823	816	808	799	
Goodwill	279	279	279	279	
Other non current assets	552	552	552	552	
Investments	388	388	388	388	
Debtors	948	1,122	1,329	1,480	
Current Investments	435	435	435	435	
Cash & Cash equivalents	914	1,484	2,143	2,893	
Other current assets	536	599	647	682	
Trade payables	430	538	638	711	
Current liabilities	991	1,108	1,239	1,334	
<b>Application of funds</b>	<b>3,993</b>	<b>4,578</b>	<b>5,264</b>	<b>6,030</b>	

Source: Company, ICICI Direct Research

Exhibit 24: Key ratios					₹ crore
(Year-end March)	FY22	FY23E	FY24E	FY25E	
<b>Per share data (₹)</b>					
EPS	90.3	124.8	150.0	168.5	
Cash Per Share	119.7	194.2	280.4	378.5	
BV	440.7	514.4	602.9	702.3	
DPS	31.0	42.5	51.1	57.3	
<b>Operating Ratios (%)</b>					
EBITDA Margin	16.8	17.6	17.9	18.2	
PBT Margin	16.2	15.7	16.0	16.1	
PAT Margin	12.1	11.6	11.8	11.9	
<b>Turnover Ratios</b>					
Debtor days	61	50	50	50	
Creditor days	27	24	24	24	
<b>Return Ratios (%)</b>					
RoE	20.5	24.3	24.9	24.0	
RoCE	23.1	28.2	29.4	28.9	
RoIC	10.4	19.3	31.6	55.8	
<b>Valuation Ratios (x)</b>					
P/E	41.0	29.7	24.7	22.0	
EV / EBITDA	28.9	18.4	14.9	12.7	
Market Cap / Sales	5.0	3.5	2.9	2.6	
<b>Solvency Ratios</b>					
Current Ratio	1.0	1.0	1.1	1.1	
Quick Ratio	1.0	1.0	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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## ANALYST CERTIFICATION

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