Sharekhan
by BNP PARIBAS

Persistent Systems

Strong quarter, improving outlook

Sector: IT & ITES
Results Update

	Change
Reco: **Buy**	↔
CMP: **Rs. 856**	
Price Target: **Rs. 1,000**	↑

↑ Upgrade ↔ No change ↓ Downgrade

Company details

Market cap:	Rs. 6552 cr
52-week high/low:	Rs. 915/420
NSE volume: (No of shares)	1.1 lakh
BSE code:	533179
NSE code:	PERSISTENT
Sharekhan code:	PERSISTENT
Free float: (No of shares)	5.2 cr

Shareholding (%)

Promoters	31.5
FII	21.0
DII	27.8
Others	19.8

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	35.2	81.2	18.7	59.9
Relative to Sensex	26.7	65.3	26.5	59.3

Sharekhan Research, Bloomberg

Persistent Systems Limited (PSL) reported a strong set of numbers in a tough environment, led by strong performances in BFSI healthcare and life-science verticals.USD revenue increased by 3.1% q-o-q and 9.5% y-o-y to $131 million, way ahead of our estimates, owing to strong growth in IP-led business and continued growth momentum in IT services revenues. Technology services revenue grew by 2.2% q-o-q on the back of a prudent mining strategy and ramp-up of new deals. Alliance unit reported 6.4% q-o-q growth after a decline of revenue in last two consecutive quarters, led by strong growth in the re-seller business, while royalty income remained steady. EBITDA margin improved 100bps q-o-q to 14.8%, exceeding our estimates, led by lower travelling expenses and rupee benefits (+110bps). The margin headwinds during the quarter were provision for doubtful debt ($650K) and pricing discount to customers. Net profit of Rs. 90 crore was 22% ahead of our estimates owing to higher profitability, partially offset by higher forex losses and higher tax provision. Post the management change, the company's has been delivering strong performance especially in the technology services segment with new deal wins. The recent vendor consolidation deal in BFSI vertical along with a large deal signings ($50 million over five years) in the emerging vertical and continued growth momentum in technology services segment would help the company to maintain its growth momentum in FY2022E. Additionally, management expects revenue recovery in its alliance business to continue in the coming quarters because of anticipated higher opportunities from the Red Hat business of IBM, higher access to IBM's clients and strong growth momentum in the reseller business. We expect margins to improve in coming quarters on the back of lower travel expenses, normalcy of pricing discounts, reduction in subcontractor costs and reduction in expenses of new engagement.

Key positives

- Revenue growth stronger than expectations, best sequential growth among mid-cap IT companies
- Strong account mining in TSU – 11.3% and 4.5% q-o-q revenue growth in top and top 5 accounts (specific to TSU)
- Strong deal signings in emerging verticals

Key negatives

- Top account declined by 4.9% q-o-q
- DSO increased to 69 days from 65 days in Q4FY2020

Our Call

Valuation – Growth momentum to continue, retain Buy: We have revised our earnings estimates upward for FY2021E/FY2022E on account of strong Q1FY2021 and strong deal signings during the quarter. We expect PSL would be one of mid-tier IT companies to report positive revenue growth in FY2021 despite challenging environment. With large deal signings in Q1FY2021 and prudent client mining strategy, the company would maintain its strong growth momentum in technology services. EBITDA margin is expected to improve in the coming quarters on account of lower sales and marketing expenses, completion of re-branding exercise and lower subcontractor expenses. At the current market price, the stock is trading at a reasonable valuation of 17x/15x its FY2021E/FY2022E earnings. Further, cash and cash equivalents account for 23% of its current market capitalisation. Hence, we retain our Buy rating on the stock with a revised price target (PT) of Rs. 1,000.

Key Risks

Any slowdown in non-Internet of Things (IoT) revenue/delay in product launches/ stronger rupee and/or adverse cross-currency movements could affect earnings.

Valuation — Rs cr

Particulars	FY18	FY19	FY20	FY21E	FY22E
Revenue	3,033.7	3,365.9	3,565.8	4,036.5	4,448.8
OPM (%)	15.5	17.2	13.8	14.8	14.9
Adjusted PAT	323.1	351.7	340.3	389.5	447.1
% YoY growth	3.3	8.8	-3.2	14.5	14.8
Adjusted EPS (Rs.)	40.4	44.0	44.4	51.0	58.5
P/E (x)	21.2	19.5	19.3	16.8	14.6
P/B (x)	3.2	2.9	2.7	2.5	2.3
EV/EBITDA (x)	13.1	10.9	12.5	10.0	8.4
RoNW (%)	16.0	15.7	14.4	15.6	16.5
RoCE (%)	20.9	21.4	18.8	20.7	21.6

Source: Company; Sharekhan estimates

Beat on all fronts

PSL reported strong set of numbers despite COVID-19 induced business disruption, led by strong performance in BFSI healthcare and life-science verticals. USD revenue increased by 3.1% q-o-q and 9.5% y-o-y to $131 million, ahead of our estimates, owing to strong growth in both IP-led and IT services revenues. IP-led revenue during the quarter grew 9.8% q-o-q (down11.6% y-o-y), while IT services revenue increased 1.8% q-o-q (up 15.3% y-o-y). Technology Services Unit (TSU) revenue grew by 2.2% q-o-q, while alliance unit reported 6.4% q-o-q growth after a decline of revenue in last two consecutive quarters. EBITDA margin improved 100bps q-o-q to 14.8%, exceeding our estimates, led by lower travelling expenses, better cost management, absence of donation to PM cares and rupee benefits (+110bps). The margin headwinds during the quarter were provision for doubtful debt ($650K) and pricing discount to customers. Net profit of Rs. 90 crore was 22% ahead of our estimates owing to higher profitability, partially offset by higher forex losses and higher tax provision.

Expect growth to continue going ahead, deal wins remain strong

The company's TSU segment (77.1% of the total revenue) has been consistently growing despite a tough environment, under the new leadership team. The company continues to focus on BFSI healthcare and life science verticals and expects growth momentum in these verticals to continue in the medium term on account of strong deal wins, new logo addition, and a healthy deal pipeline. Though the deal wins were broad-based during the quarter, the company indicated that the vendor consolidation deal in BFSI vertical and a $50 million deal in the emerging vertical would help the company to deliver growth in the technology vertical. Additionally, the management expects revenue recovery in its alliance business to continue in the coming quarters because of anticipated higher opportunities from the Red Hat business of IBM, higher access to IBM's clients and strong growth momentum in the reseller business. The management believes that margin improvement would continue in coming quarters on account of lower travel expenses, rebound of discounts in Q2FY2021 that was provided to some customers in the wake of the pandemic, reduction in subcontractor costs and reduction in expenses of new engagement.

Key conference call highlights

- **IT services revenue delivered growth:** IT services revenue grew by 1.8% q-o-q and 15.3% y-o-y.Onsite linear revenue grew by 5.5% q-o-q, driven by 7.0% q-o-q growth in volume, while billing rates declined 1.4% q-o-q. Offshore linear revenue declined by 0.6% q-o-q, owing to2.7% q-o-q de-growth in billing rate, while volume grew by 2.2% q-o-q during the quarter.
- **Strong growth in TSU:** Technology services unit revenue increased by 2.2% q-o-q to $101 million, led by strong growth in BFSI (up 4.8% q-o-q/25.7% y-o-y) and healthcare and life science (up 5.8% q-o-q/14.2% y-o-y). Growth in the TSU business was driven by cross-selling and gaining wallet share in existing customer accounts. The management sees strong traction around cloud-related offerings. The company has a strong pipeline in cloudand infrastructure business. In the TSU business, revenue from the top customer grew by 11.3% q-o-q, while revenue from the top 10 and top 20 customers grew by 4.5% and 9.2%, respectively, on a sequential basis.
- **Segmental performance:** TheBFSI vertical delivered strong4.8% q-o-q/25.7% y-o-ygrowth in Q1FY2021. The share of revenue from the BFSI vertical increased to 31.8% in Q1FY2021 from 31.3% in Q4FY2020.The healthcare and life sciences vertical reported strong revenue growth of 5.8% q-o-q/14.2% y-o-y during the quarter. Revenue of the emerging vertical grew 1% q-o-q during the quarter versus 4% q-o-q decline in revenue in Q4FY2020.
- **Strong growth in Alliance business:** Alliance business'revenue increased by 6.4% q-o-q in Q1FY2021 against a decline of 18.4% q-o-q in Q4FY2020. The recent acquisition of Red Hat by IBM provides a strong growth opportunity.
- **Strong growth in IP revenue:** IP-led business reported growth of 9.8% q-o-q after a sharp decline in revenues (down 24.3% q-o-q) in Q4FY2020. The growth is driven by the reseller business, while the royalty income was steady.

- **Lower travel expenses:** Travel expenses declined by 44.9% q-o-q during the quarter due to restriction in travel in the wake of COVID-19 outbreak.
- **Top clients' performance:** Revenue from the top client continued to declineby 4.9% q-o-q (down 6.4% and 12.3% on sequential basis in Q3FY2020 and Q4FY2020 respectively). Revenue from the top-5 and top-10 clients increased by 1.4% and 1.3% q-o-q, respectively. Revenue from top 2-5 and top 2-10 increased by 6.8% and 5.1% q-o-q, respectively. The share of top customer reduced from 17.7% in Q1FY2021 from 19.2% in Q4FY2020.
- **Client metrics:** The number of clients under the $5 million+ category increased by four on sequential basis to 15. Further, the number of clients under $1 million+ bucket increased by two on a q-o-q basis to 63.
- **Cash balance:** The company had cash and cash equivalents of Rs. 1,493.9 crore as of June 30, 2020, versus Rs. 1,479.6 crore as of March 31, 2020.

Results — **Rs cr**

Particulars	Q1Y21	Q1FY20	Q4FY20	Y-o-Y (%)	Q-o-Q (%)
Revenue ($ mn)	131.0	119.6	127.1	9.5	3.1
Net sales	991.4	832.1	926.4	19.1	7.0
Direct costs	664.6	543.4	613.0	22.3	8.4
SG&A	180.3	168.5	185.7	7.0	-2.9
EBITDA	146.4	120.2	127.7	21.8	14.7
Depreciation & amortisation	43.6	38.6	42.0	12.8	3.7
EBIT	102.9	81.6	85.7	26.1	20.1
Forex gain/(loss)	-8.8	8.0	4.5	-209.8	-296.9
Other income	27.9	20.2	22.9	38.3	21.8
PBT	122.0	109.8	113.0	11.2	8.0
Tax provision	32.0	27.3	29.2	17.4	9.6
Net profit	90.0	82.5	83.8	9.1	7.4
EPS (Rs.)	11.8	10.7	11.0	10.6	7.4
Margin (%)				**BPS**	**BPS**
EBITDA	14.8	14.4	13.8	33	99
EBIT	10.4	9.8	9.2	57	113
NPM	9.1	9.9	9.0	-83	3

Source: Company; Sharekhan Research

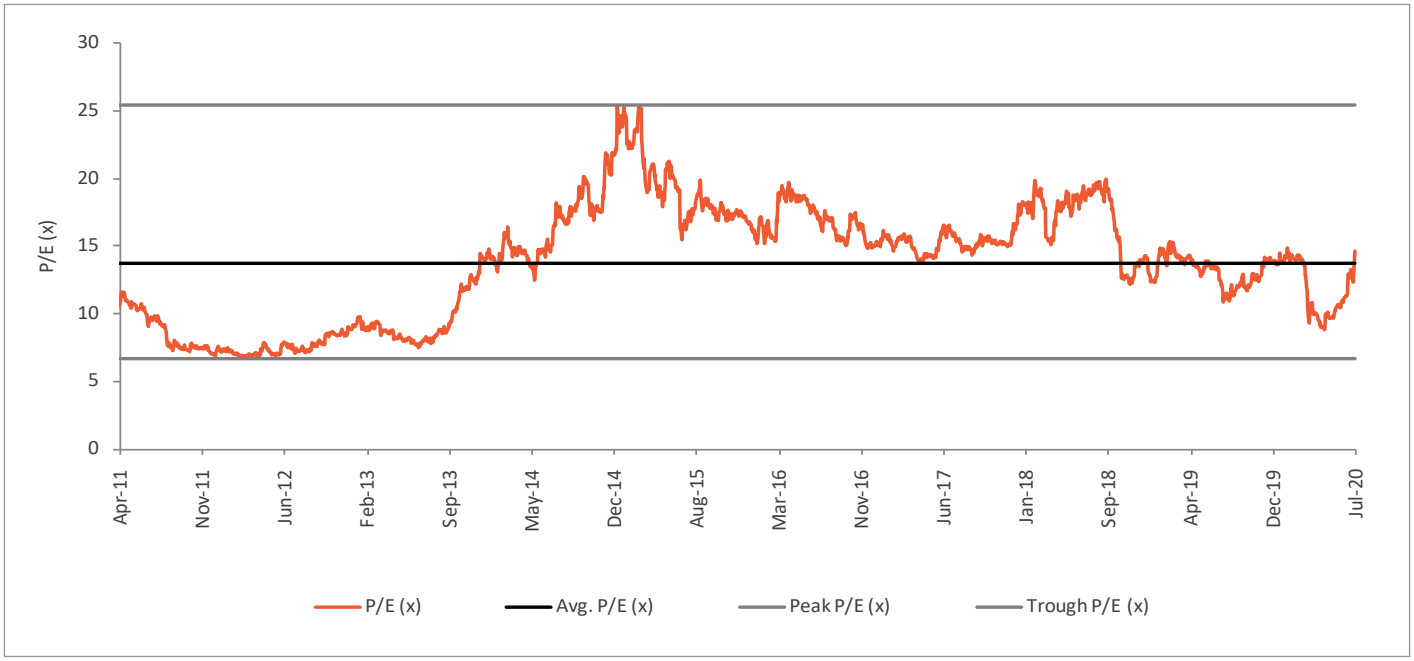
Outlook

Social, mobility, cloud, analytics and IoT are estimated to account for more than 20% of the IT sector's revenue in 2020. As PSL is an early identifier of digital trends and has strong product development capabilities, we believe the company is wellplaced to capture a significant chunk of spends in digital technologies by clients going ahead. Though large exposure to its major clients (IBM) is a risk, the newlyappointed CEO highlighted that the company would de-risk the IBM relationship by balancing the large client portfolio with focus on the industrial sector. Further, the company's leadership position in outsourced product development (OPD), elongated client relationships, and being an end-to-end service provider and partner in the clients' journey would help PSL to make most of the opportunity.

Valuation

Growth momentum to continue, retain Buy: We have revised our earnings estimates upward for FY2021E/ FY2022E on account of strong Q1FY2021 and strong deal signings during the quarter. We expect PSL would be one of mid-tier IT companies to report positive revenue growth in FY2021 despite a challenging environment. With large deal signings in Q1FY2021 and prudent client mining strategy, the company would maintain its strong growth momentum in technology services. EBITDA margin is expected to improve in coming quarters on account of lower sales and marketing expenses, completion of re-branding exercise and lower subcontractor expenses. At the current market price, the stock is trading at a reasonable valuation of 17x/15x its FY2021E/ FY2022E earnings. Further, cash and cash equivalents account for 23% of its current market capitalisation. Hence, we retain our Buy rating on the stock with a revised price target (PT) of Rs. 1,000.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
				FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
Wipro	269	570	153,461	16.7	15.3	4.6	4.0	2.7	2.5	13.9	14.0
HCL Tech	701	271	190,282	16.8	15.6	5.2	4.9	3.3	3.0	20.9	20.4
Tech M	664	97	64,166	16.3	13.0	9.2	6.9	2.5	2.2	15.7	17.8
Persistent	857	76	6,552	16.8	14.6	10.0	8.4	2.5	2.3	15.6	16.5

Source: Company, Sharekhan estimates

About company

Incorporated in 1990, PSL is a global software company specialising in product and technology services. The company has organised itself into four business units - Services, Digital, Alliance and Accelerite. The company has proven expertise, strong presence in newer technologies and strength to improve its IP base. PSL focuseson developing IoTproducts and platforms, as it sees significant traction from industrial machinery, SmartCity, healthcare, and smart agriculture verticals. The company derives revenue from North America, Europe and Rest of the World.

Investment theme

Large corporates have been allocating higher budgets toward digital transformation initiatives and IT spends are moving from ISV to enterprise model. PSL has restructured its business and aligned its sales resources to capitalise the benefits from the clients' digital transformation journey. The alliance with IBM and investments in new-age technologies (IoT, Blockchain, artificial learning and machine learning) are expected to help the company capture opportunities from these spends.

Key Risks

1) Any slowdown in non-IoT revenue; 2) hostile regulatory development against current VISA regime; 3) delay in product launches and traction from clients in Accelerite; 4)stronger Indian rupee and/or adverse cross-currency movements; 5) margin dilution from M&A activity; and 6) high client concentration (around 23%+ revenue comes from IBM) could affect revenue growth.

Additional Data

Key management personnel

Dr. Anand Deshpande	Founder, Chairman and MD
Christopher O'Connor	Chief Executive Officer (CEO)
Sandeep Kalra	President: Technology Services
Sunil Sapre	Chief Financial Officer (CFO)
Mark Simpson	President, IBM Alliance

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	HDFC Asset Management Company Limited	7.67
2	L&T Mutual Fund Trustee Limited	4.26
3	PPFAS Asset Management	3.87
4	Norges Bank Investment Management	3.55
5	Government Pension Fund (Global)	3.51
6	PSPL ESOP managementtrust	3.22
7	UPADHYE NARASINHA	2.82
8	Saif India V FII Holding Limited	2.68
9	ICICI Prudential Asset Management	2.52
10	FMR LLC	1.81

Source: Bloomberg

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;