



Persistent Systems Limited

Growth drivers intact, maintain Buy

IT & ITES

Sharekhan code: PERSISTENT

Company Update

3R MATRIX

	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

+ Positive = Neutral - Negative

Reco/View

Reco/View	Change
Reco: Buy	↔
CMP: Rs. 1,040	
Price Target: 1,220	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

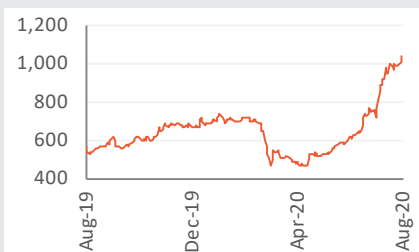
Company details

Market cap:	Rs. 7,950 cr
52-week high/low:	Rs. 1,049/420
NSE volume: (No of shares)	1.5 lakh
BSE code:	533179
NSE 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	45.2	97.9	45.1	82.7
Relative to Sensex	43.7	72.6	51.8	77.3

Sharekhan Research, Bloomberg

Summary

- We retain our Buy rating on Persistent Systems Limited (PSL) with a revised PT of Rs. 1,220.
- Among mid-tier companies, PSL clocked strongest revenue growth given its exposure to less-impacted verticals such as BFSI, technology and healthcare
- Growth momentum in technology services would continue beyond FY21E led by increasing spends on digital program, strong deal wins and a healthy deal pipeline.
- Cash & cash equivalents account for 19% of its current market capitalisation; strong balance sheet and potential strong earnings growth (15% CAGR over FY2020-22E) provide us comfort on the stock.

Mid-tier companies have outperformed tier-I companies in Q1FY2021 despite the traditional concerns such as high client concentration and/or concentrated portfolio. Among mid-tier companies, Persistent Systems delivered strongest revenue performance given its exposure to less impacted verticals such as BFSI, technology and healthcare. Hence, we believe PSL would be a beneficiary given higher spends by clients on digital transformation/cloud migration and strong demand for digital foundation in the above verticals. The company's technology services segment (77.1% of the total revenue) has been consistently growing under the new leadership of Sandeep Kalra, led by large accounts mining and sales re-organisation. We believe the growth moment in technology services business would continue beyond FY2021E on the back of anticipated increase in spends on digital programs, strong deal wins, new logo additions, and a healthy deal pipeline. Revenue from Alliance business is expected to improve in FY2022E as cloud adoption among clients would accelerate. The management expects the impact of selective price discounts provided during Q1FY2021 to return to normalcy in Q2FY2021. We expect margins to move in narrow band in coming quarters on the back of lower travel expenses, normalcy of pricing discounts, reduction in subcontractor costs and stabilisation of expenses in new engagements.

Our Call

Valuation – Growth momentum to continue, retain Buy: We expect PSL would be one of mid-tier IT companies to report positive revenue growth (forecast 6.5%) in FY2021, which would be ahead of its mid-tier peers. With large deal signings in Q1FY2021, absence of COVID-19 impact on its business and strong client mining strategy, the company would maintain its strong growth momentum in technology services space in FY2022E. EBITDA margin is expected to remain in narrow range in the coming quarters on account of lower sales and marketing expenses, completion of re-branding exercise and lower subcontractor expenses. We introduced FY2023E numbers in this note. At the current market price, the stock is trading at a reasonable valuation of 20x/18x its FY2021E/FY2022E earnings. Further, cash & cash equivalents account for 19% of its current market capitalisation. Hence, we retain our Buy rating on the stock with a revised price target (PT) of Rs. 1,220.

Key risk

Any delay in product launches/stronger rupee and/or adverse cross-currency movements could affect earnings.

Valuation

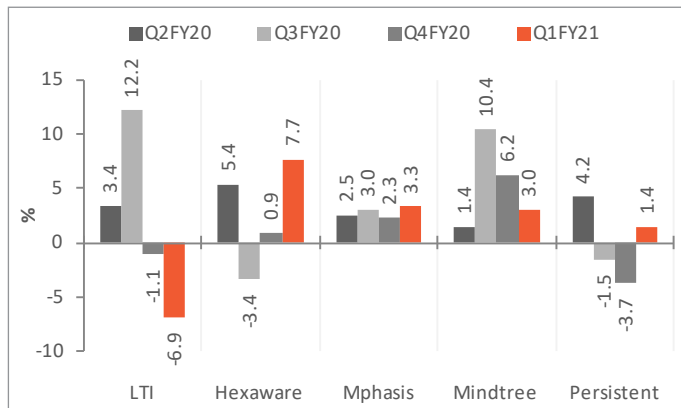
Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenue	3,365.9	3,565.8	4,036.5	4,448.8	4,928.2
OPM (%)	17.2	13.8	14.8	14.9	14.4
Adjusted PAT	351.7	340.3	389.5	447.1	490.3
% YoY growth	8.8	-3.2	14.5	14.8	9.7
Adjusted EPS (Rs.)	44.0	44.4	51.0	58.5	64.2
P/E (x)	23.6	23.4	20.4	17.8	16.2
P/B (x)	3.5	3.3	3.1	2.8	2.6
EV/EBITDA (x)	13.5	15.5	12.4	10.6	9.5
RoNW (%)	15.7	14.4	15.6	16.5	16.8
RoCE (%)	21.4	18.8	20.7	21.6	21.9

Source: Company; Sharekhan estimates

Contrary to traditional observations, mid-tiers performed well in the tough times

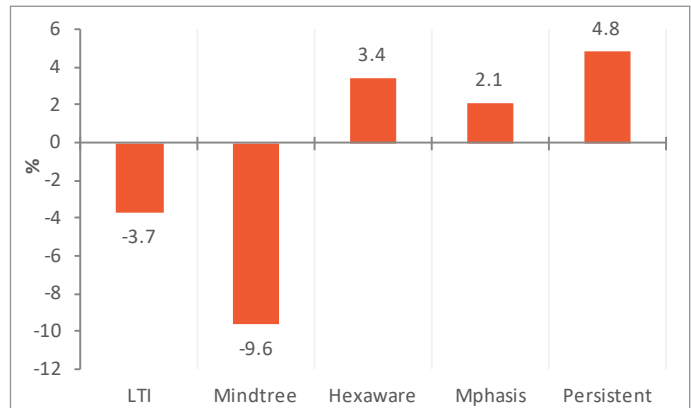
Mid-tier companies outperformed tier-I companies despite concerns of client concentration and concentrated portfolio and among mid-tier companies. Persistent Systems delivered strongest revenue performance given its high concentration to less impacted verticals such as BFSI and healthcare. Note that mid-tier companies such as L&T Infotech, Mphasis, NIIT Tech and Hexaware reported strong revenue performance (declined by 0.9-4.7% in constant currency terms) as compared to 6.3-7.5% CC revenue decline for tier-I companies (excluding Infosys). Contrary to traditional observations, high client concentration (particularly to financial services and/or hi-tech companies) helped these mid-tier companies to protect their revenue from COVID-19-led disruptions.

Mid-tier: revenue growth from top 5 client (q-o-q)



Source: Company, Sharekhan Research

Mid-tier: BFSI revenue growth in Q1FY21 (q-o-q)

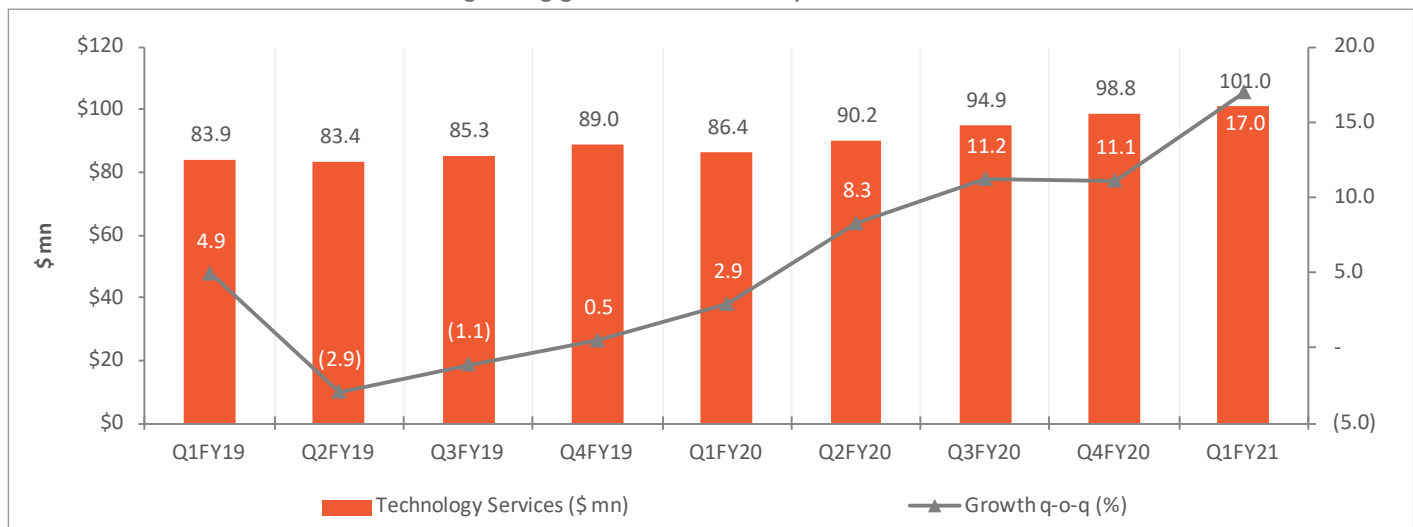


Source: Company, Sharekhan Research

Expect growth momentum to continue; deal wins remain strong

The company's technology services segment (77.1% of the total revenue) has been consistently growing despite a tough environment, under the new leadership of Sandeep Kalra (President of Technology Services division), led by large accounts mining and sales re-organisation. The company continues to focus on the 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 additions and a healthy deal pipeline. PSL's participation in one of BFSI customer's vendor consolidation exercise and large deal wins including \$50 million worth of TCV (over 5 years) in the hi-tech space provide incremental revenue visibility going ahead. Management believes that revenue growth momentum in technology service to continue given absence of any COVID-19 specific impact. Revenue from the Alliance business is expected to improve in FY2022E as cloud adoption among clients would accelerate.

Tech services business has been delivering strong growth in the recent quarters

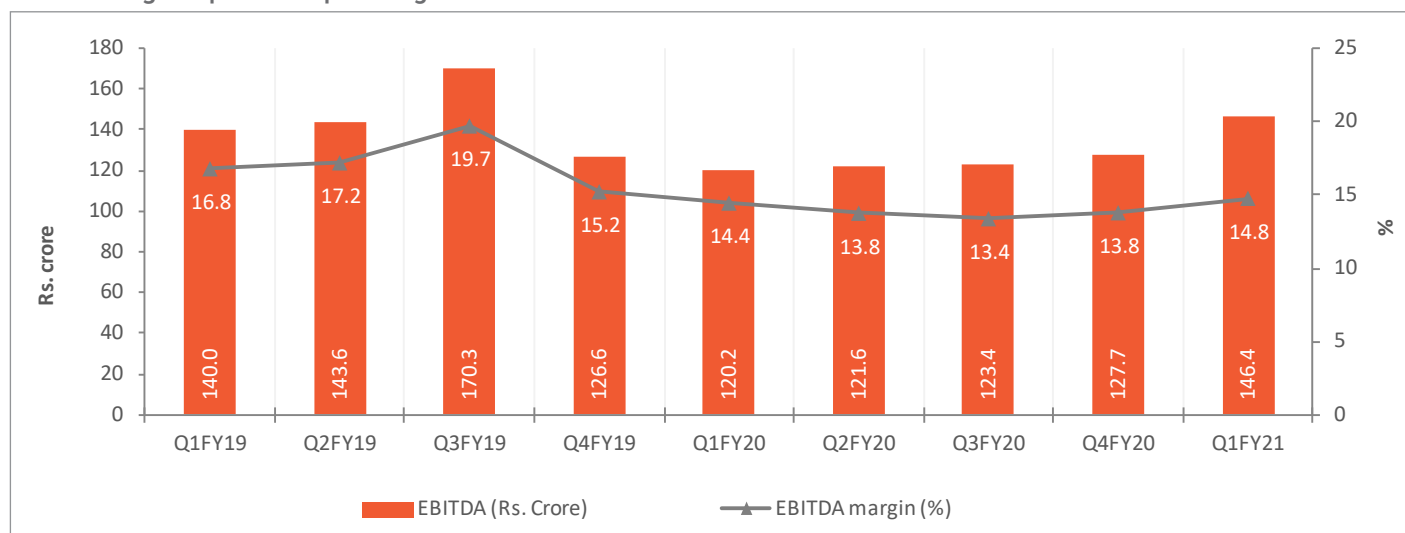


Source: Company, Sharekhan Research

Expect sustainable margin performance going ahead

Cost savings from Work-from-home (WFH) mode, lower travel expenses and higher offshoring are expected to drive margins in the near-term, however, we believe that it will be passed on to clients through pricing reduction in long term. Most of IT companies including Persistent Systems have indicated about rate cut by the clients particularly in the stressed sectors. Management expects the impact of selective price discounts provided during Q1FY2021 to return to normalcy in Q2FY2021. We expect margins to sustain at current level in coming quarters on the back of lower travel expenses, normalcy of pricing discounts, reduction in subcontractor costs and stabilisation of expenses in new engagements.

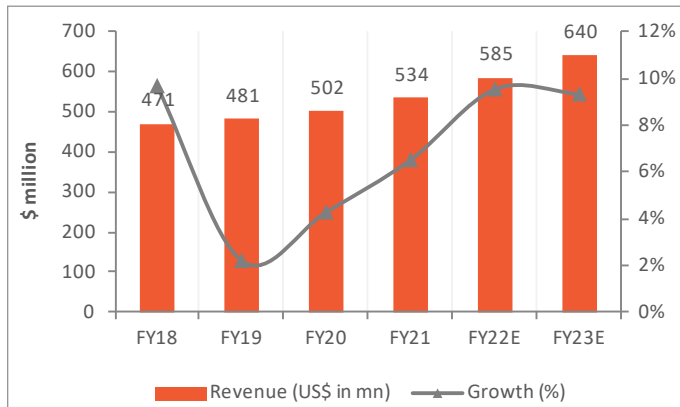
EBITDA margin improved sequentially in Q1FY21



Source: Company, Sharekhan Research

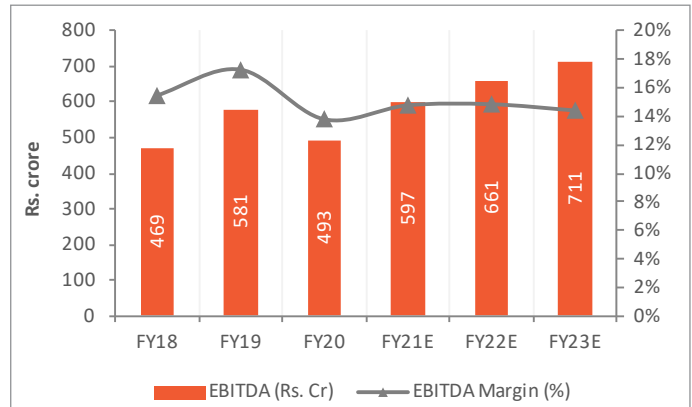
Financials in charts

Revenue in US\$ (mn) and growth (%)



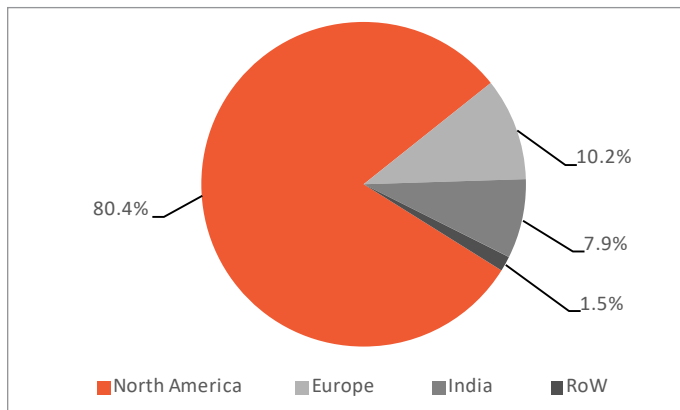
Source: Company, Sharekhan Research

EBITDA (Rs. cr) and EBITDA margin (%)



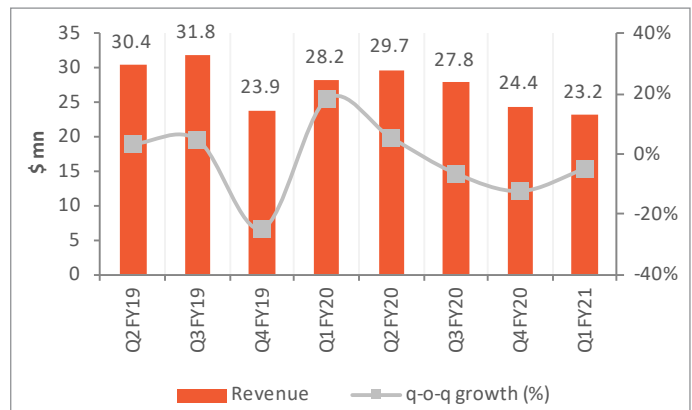
Source: Company, Sharekhan Research

Geography break-up (%)



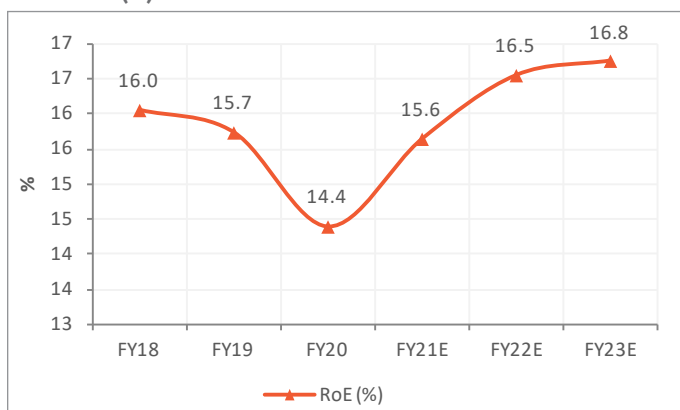
Source: Company, Sharekhan Research

Top account revenue (\$ mn) & growth (%)



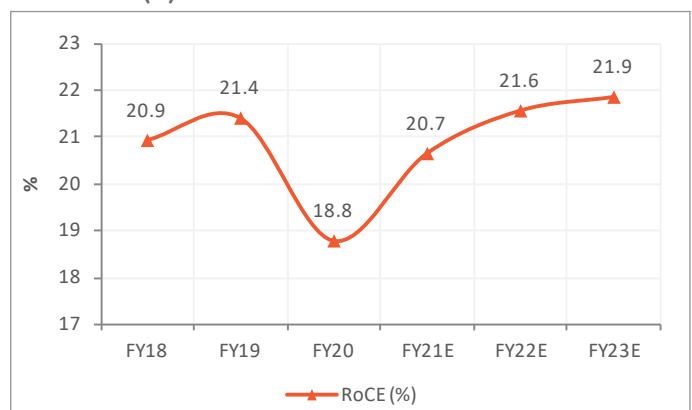
Source: Company, Sharekhan Research

RoE trend (%)



Source: Company, Sharekhan Research

RoCE trend (%)



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – Expect acceleration in technology spending going forward

Industry analysts such as Gartner estimate that IT services spending would grow by 5-8% over CY2021-24E as compared to average of 4.2% achieved in CY2010-19. Forecasts indicate higher demand for cloud infrastructure services, potential increase in specialised software, potential investments in transformation projects by clients and increase in online adoption across verticals. The implications from the COVID-19 outbreak have accelerated the digital activities among large global enterprises, leading to increase in spending on workplace transformation and collaboration tools, cyber-security and higher cloud migration. WFH efficiencies, lower travel costs and higher offshoring would drive margins in medium term, we believe that it will be passed on to clients through pricing reduction in long term.

■ Company Outlook – well positioned to capture opportunities

As PSL is an early identifier of digital trends and has strong product development capabilities, we believe the company is well-placed to capture a significant chunk of spends in digital technologies by clients going ahead. Management 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 would help PSL to make most of the opportunity.

■ Valuation – Growth momentum to continue, maintain Buy

We expect PSL would be one of mid-tier IT companies to report positive revenue growth (forecast 6.5%) in FY2021, which would be ahead of its mid-tier peers. With large deal signings in Q1FY2021, absence of COVID-19 impact on its business and good client mining strategy, the company would maintain its strong growth momentum in technology services in FY2022E. EBITDA margin is expected to remain in narrow range in the coming quarters on account of lower sales and marketing expenses, completion of re-branding exercise and lower subcontractor expenses. We introduced FY2023E numbers in this note. At the current market price, the stock is trading at a reasonable valuation of 20x/18x its FY2021E/FY2022E earnings. Further, cash and cash equivalents account for 19% of its current market capitalisation. Hence, we retain our Buy rating on the stock with a revised price target (PT) of Rs. 1,220.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

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	273	571	156,205	15.8	15.1	4.2	3.7	2.7	2.5	15.6	15.5
Tech M	732	97	70,777	17.9	14.4	11.2	8.8	2.7	2.4	15.7	17.8
L&T Infotech	2,366	17	41,257	27.1	23.2	18.6	16.2	6.0	4.8	25.8	25.4
Persistent	1,040	76	7,950	20.4	17.8	12.4	10.6	3.1	2.8	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 focuses on developing IoT products 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
Sandeep Kalra	President: Technology Services
Sunil Sapre	Chief Financial Officer (CFO)
Sameer Bendre	Chief People Officer
Keith Landis	Chief Marketing Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	HDFC Asset Management Company Limited	7.74
2	L&T Mutual Fund Trustee Limited	4.73
3	PPFAS Asset Management	3.87
4	Norges Bank Investment Management	3.55
5	Government Pension Fund (Global)	3.51
6	Kotak Mahindra Asset Management	3.28
7	PSPL ESOP management trust	3.22
8	Saif India V FII Holding Limited	2.68
9	ICICI Prudential Asset Management	2.56
10	FMR LLC	1.80

Source: Bloomberg

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Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and deteriorating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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