29 April 2022

Persistent Systems

Services grows ~9% q/q, margins may start trending up by H2 FY23: Buy

Rating: Buy
Target Price: Rs.4,980
Share Price: Rs.4,288

PSYS continues to deliver industry-leading growth (9% q/q org. in Services, surprising positively. It integrated Data Glove for a month (MediaAgility to be integrated from Q1) and had some IP revenue re-classified as services. In margins, it benefited from better realisations and onsite utilisation, leading to a flattish gross margin. SG&A leverage was offset by higher D&A, leading to a 14% EBIT margin, flattish q/q. Ahead, we expect 14%-14.5% margins, despite higher amortisation, on expecting EBITDA margin expansion. We raise PAT estimates 9-15%, taking the target up to Rs4980, 34x FY24. We upgrade to a Buy recommendation.

Growth across buckets; new TCV hits another high. Q4 growth was spread across the three verticals – all growing 9%-15% sequentially, adj. for the top client. Some revenue was lost due to the conversion from IP-led to Services but was comfortably absorbed. Net new TCV hit a high $195m, up 42% y/y, setting the tone for a strong FY23. TCV excludes acquired entities; hence, true TCV would be higher. Top client grew 11% y/y and brought 14% to revenue. Other client buckets reported strong, broad-based growth. Higher realizations stemmed from higher growth in Europe (up 11% q/q).

EBIT margins to be maintained at 14%. The 14% Q4 FY22 reported EBIT margin was unchanged q/q and from the last four-quarter average. The company intends to maintain it despite a ~50bp headwind from acquisitions. The EBITDA margin improved q/q. Attrition was 27% (slightly lower q/q); fresher intake was high (~30-40% of net additions), and offshoring was high (adj. for acquisitions). These three factors, along with 80.6% utilisation (down from 83%) should help manage margins ahead.

Target raised to Rs.4,980, 34x FY24e EPS. We raise our estimates 9-15%, following the strong Q4 FY22 performance and given its ability to get TCV growth going. The multiple is a slight discount to Mindtree on account of the latter's better FCF profile. We upgrade our recommendation to a Buy. **Risk:** M&A-integration related

Key financials (YE Mar)	FY20	FY21	FY22	FY23e	FY24e
Sales (Rs m)	35,658	41,879	57,107	79,928	96,060
Net profit (Rs m)	3,403	4,507	6,904	9,104	11,181
EPS (Rs)	44.5	59.0	90.3	119.1	146.3
P/E (x)	96.3	72.7	47.5	36.0	29.3
EV / EBITDA (x)	63.8	46.1	32.6	22.8	18.0
P/BV (x)	13.7	11.7	9.7	8.3	7.0
RoE (%)	14.4	17.4	22.4	24.8	25.9
RoCE (%)	11.6	15.9	21.3	25.1	27.1
Dividend yield (%)	0.9	0.3	0.6	0.9	1.3
Net debt / equity (x)	-0.4	-0.6	-0.3	-0.1	-0.2

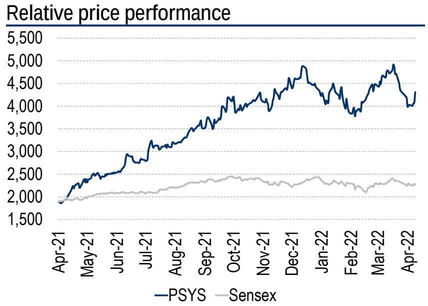
Source: Company, Anand Rathi Research

Key data	PSYS IN / PERS.BO
52-week high / low	Rs4988 / 1925
Sensex / Nifty	57487 / 17235
3-m average volume	$18.2m
Market cap	Rs329bn / $4302.5m
Shares outstanding	76m

Shareholding pattern (%)	Mar'22	Dec'21	Sep'21
Promoters 31.	3	31.3	31.3
- of which, Pledged	-	-	-
Free float	68.7	68.7	68.7
- Foreign institutions	20.0	19.9	19.3
- Domestic institutions	26.8	26.9	27.9
- Public	22.0	21.9	21.6

Estimates revision (%)	FY23e	FY24e
Sales ($)	4.0	5.7
EBITDA	8.8	14.1
PAT	9.0	14.9

Relative price performance



Source: Bloomberg

Mohit Jain
Research Analyst

Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY20	FY21	FY22	FY23e	FY24e
Revenues (US$m)	501.6	566.1	765.6	1,058.7	1,272.3
Growth (%)	4.3	12.9	35.2	38.3	20.2
Net revenues (Rs m)	35,658	41,879	57,107	79,928	96,060
Employee & Direct Costs	23,494	27,650	37,895	52,945	63,994
Gross Profit	12,164	14,229	19,213	26,984	32,066
Gross Margin %	34.11	33.98	33.64	33.76	33.38
SG&A	7,234	7,398	9,557	13,153	14,598
EBITDA	4,930	6,830	9,655	13,830	17,468
EBITDA margins (%)	13.8	16.3	16.9	17.3	18.2
- Depreciation	1,660	1,756	1,660	2,758	3,423
Other income	1,254	1,020	1,248	1,119	928
Interest Exp					
PBT	4,523	6,094	9,243	12,192	14,973
Effective tax rate (%)	25	26	25	25	25
+ Associates/(Minorities)					
Net Income	3,403	4,507	6,904	9,104	11,181
WANS	76	76	76	76	76
FDEPS (Rs/share)	44.5	59.0	90.3	119.1	146.3

Fig 2 – Balance sheet (Rs m)

Year-end: Mar	FY20	FY21	FY22	FY23e	FY24e
Share capital	764	764	764	764	764
Net worth	23,858	27,957	33,682	39,711	46,555
Total debt (including Pref)	46	44	4,326	3,028	2,120
Minority interest					
DTL/(Asset)	-960	-1,038	-1,123	-1,123	-1,123
Capital employed	22,944	26,963	36,885	41,616	47,552
Net tangible assets	2,791	3,254	4,276	4,130	3,919
Net Intangible assets	1,435	1,230	10,974	16,497	18,094
Goodwill	89	86	86	86	86
CWIP (tangible and intangible)	303	122	1,071	1,071	1,071
Investments (Strategic)	4,621	3,621	3,878	3,878	3,878
Investments (Financial)	5,165	6,375	4,347	1,304	2,608
Current Assets (ex Cash) Incl LT a	10,985	11,121	19,242	24,827	28,807
Cash	4,572	9,809	9,144	7,274	7,364
Current Liabilities (ex ST Loan/Cu	7,018	8,654	16,133	17,452	18,274
Working capital	3,967	2,467	3,110	7,376	10,533
Capital deployed	22,944	26,963	36,885	41,616	47,552
Contingent Liabilities	247	506	-	-	-

Fig 3 – Cash Flow statement (Rs m)

Year-end: Mar	FY20	FY21	FY22	FY23e	FY24e
PBT	4,523	6,094	9,243	12,192	14,973
+ Non-cash items	1,402	1,269	1,981	1,802	2,714
Operating profit before WC chang	5,925	7,363	11,224	13,994	17,687
- Incr./(decr.) in WC	1,369	-1,578	4,062	4,266	3,157
Others incuding taxes	-1,328	-1,582	1,288	-3,088	-3,792
Operating cash-flow	3,228	7,359	8,450	6,640	10,738
- Capex (tangible + Intangible)	746	1,251	3,808	1,927	1,927
Free cash-flow	2,482	6,108	4,642	4,713	8,811
Acquisitions	435	448	6,154	6,208	2,882
- Dividend (including buyback & ta	2,978	1,070	1,987	3,075	4,336
+ Equity raised	-	-	-	-	-
+ Debt raised	38	4	4,279	-1,298	-908
- Fin Investments	1,797	-634	-1,992	-3,043	1,304
- Misc. Items (CFI + CFF)	-538	-9	3,437	-955	-709
Net cash-flow	-2,152	5,237	-665	-1,870	89

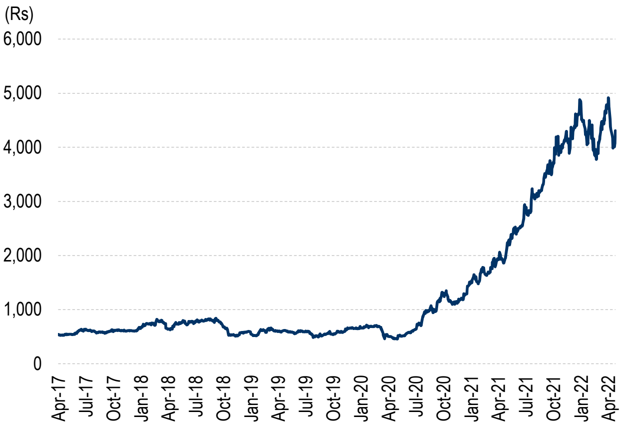
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis

Year end Mar	FY20	FY21	FY22	FY23e	FY24e
P/E (x)	96.3	72.7	47.5	36.0	29.3
EV/EBITDA (x)	63.8	46.1	32.6	22.8	18.0
EV/sales (x)	8.9	7.4	5.6	4.0	3.3
P/B (x)	13.7	11.7	9.7	8.3	7.0
RoE (%)	14.4	17.4	22.4	24.8	25.9
RoCE (%) - After tax	11.6	15.9	21.3	25.1	27.1
RoIC (%) - After tax	25.3	39.0	35.9	28.6	29.1
DPS (Rs per share)	39.0	14.0	26.0	40.2	56.7
Dividend yield (%)	0.9	0.3	0.6	0.9	1.3
Dividend payout (%) - Inc. DDT	87.5	23.7	28.8	33.8	38.8
Net debt/equity (x)	-0.4	-0.6	-0.3	-0.1	-0.2
Receivables (days)	82	69	81	82	82
Inventory (days)					
Payables (days)	27	28	33	30	28
CFO:PAT%	94.9	163.3	122.4	72.9	96.0
FCF:PAT% - includ M&A payout	59.8	124.9	-22.6	-16.4	53.0

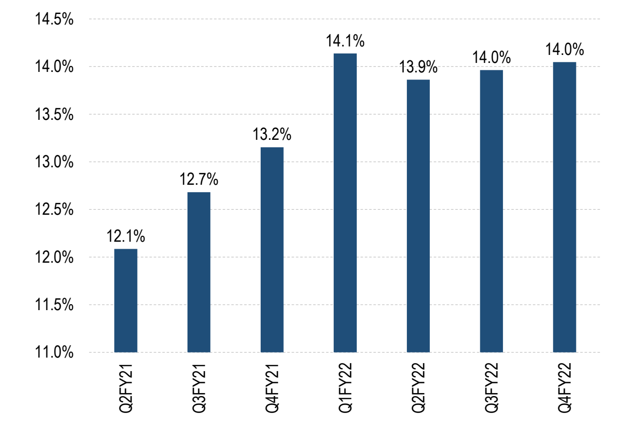
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 6 – EBIT margins



Source: Company, Anand Rathi Research

Result Highlights

Q4 FY22 Results at a Glance

Fig 7 – Segment-wise results

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q/Q	Y/Y
Revenue ($ m)	153	167	182	199	217	9.1%	42.2%
Growth Y/Y %	18.7%	27.3%	34.0%	36.2%	42.2%		
Industry Y/Y % (est.)	6%	21%	21%	21%	19%		
Revenue (Rs m)	11,134	12,299	13,512	14,917	16,379	9.8%	47.1%
Effec. exchange rate	72.9	73.7	74.1	74.9	75.4	0.6%	3.4%
TCV($ m)	246.5	244.8	282.5	334.3	361.0	8.0%	46.5%
TCV(LTM)	961.0	1,018.3	1,075.8	1,108.1	1,222.6	10.3%	27.2%
Y/Y %	119%	31%	26%	11%	46%		
TCV:Rev.	1.6	1.5	1.5	1.7	1.7		
Employees (EoP)	13,680	14,904	15,879	16,989	18,599	9.5%	36.0%
Rev. prod. ($ '000/employee)	11.7	11.7	11.8	12.1	12.2	0.8%	4.4%
Utilisation % (IT Services)	79.1%	80.1%	82.8%	83.0%	80.6%	-240 bps	150 bps
Attrition %	11.7%	16.6%	23.6%	26.9%	26.6%	-30 bps	1490 bps
CoR (excl. D&A)	(7,363)	(8,173)	(8,982)	(9,880)	(10,859)	9.9%	47.5%
As % of revenue	-66%	-66%	-66%	-66%	-66%	-7 bps	-17 bps
SG&A	(1,887)	(2,037)	(2,287)	(2,526)	(2,707)	7.2%	43.5%
As % of revenue.	-17%	-17%	-17%	-17%	-17%	40 bps	42 bps
EBITDA	1,883	2,089	2,244	2,511	2,812	12.0%	49.3%
EBITDA margins %	16.9%	17.0%	16.6%	16.8%	17.2%	34 bps	25 bps
EBIT	1,464	1,739	1,873	2,083	2,300	10.4%	57.1%
EBIT margins %	13.2%	14.1%	13.9%	14.0%	14.0%	8 bps	89 bps
Industry margins % (est.)	17.6%	16.8%	17.2%	17.4%	17.3%	-10 bps	-25 bps
Other income (excl. forex)	211	183	293	251	251	0.0%	19.2%
Non-recurring / Forex	174	109	10	30	120	302.0%	-30.9%
Interest expenses							
PBT	1,849	2,031	2,176	2,364	2,672	13.0%	45%
PBT margins %	16.6%	16.5%	16.1%	15.8%	16.3%	46 bps	-29 bps
Taxes	(471)	(518)	(559)	(600)	(662)	10.3%	40%
ETR %	-25%	-26%	-26%	-25%	-25%	61 bps	71 bps
Associates / Minority							
Net income	1,378	1,512	1,618	1,764	2,010	13.9%	46%
Net margins %	12.4%	12.3%	12.0%	11.8%	12.3%	45 bps	-10 bps
Industry net margins %	12.6%	13.8%	13.9%	14.0%	14.2%	21 bps	160 bps
EPS (Rs)	18.0	19.8	21.2	23.1	26.3	14.0%	46%

Source: Company, Anand Rathi Research

Fig 8 – Quarterly result

Year-end: Mar (Rs m)	Q4FY22	% chg. Q/Q	% chg. Y/Y	FY21	FY22	FY22 % chg. Y/Y	FY23e % chg. Y/Y
Sales ($ m)	217	9.1	42.2	566	766	35.2	38.3
Sales	16,379	9.8	47.1	41,879	57,107	36.4	40.0
EBITDA	2,812	12.0	49.3	6,830	9,655	41.4	43.2
EBITDA margin (%)	17.2	34bps	25bps	16.3	16.9	60bps	40bps
EBIT	2,300	10.4	57.1	5,075	7,995	57.5	38.5
EBIT margin (%)	14.0	8bps	89bps	12.1	14.0	188bps	-15bps
PBT	2,672	13.0	44.5	6,094	9,243	51.7	31.9
Tax	(662)	10.3	40.5	(1,588)	(2,339)	47.3	32.0
Tax rate (%)	(24.8)	61bps	71bps	(26.1)	(25.3)	75bps	-2bps
Net income	2,010	13.9	45.9	4,507	6,904	53.2	31.9

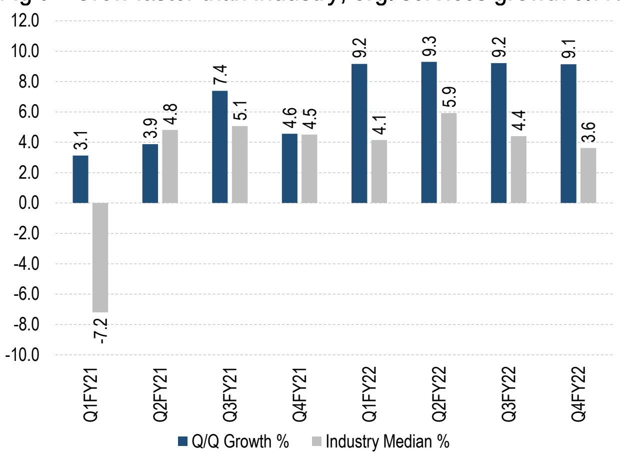
Source: Company, Anand Rathi Research Note: FY22 numbers include acquisitions made, hence not comparable

Strong Q4 despite some softness in peers

Persistent had a strong Q4, beating industry growth rates on an organic basis. In Q4 FY22, it grew 9% sequentially and has been at par or above the industry median growth for the previous six quarters after Q2 FY21. Q4 organic revenue growth was 6.8% q/q, 36% y/y, in dollars. The company had \$4.7m further revenue from all three acquisitions in Q4. In Services, it delivered 9.7% q/q growth (org.). Shree Partners and SCI were fully integrated in Q4 and Data Glove was integrated for a month.

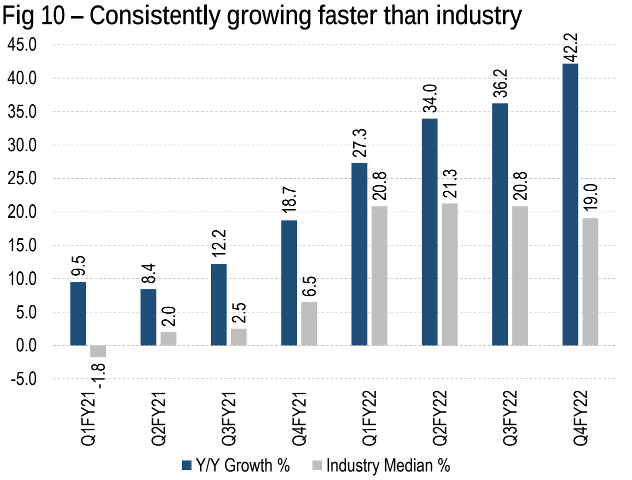
From a y/y perspective, it delivered 42% (36% org.) revenue growth, slightly beating Mindtree's in midcap IT. However, Mindtree had the benefit of a lower base (revenue growth was -1%) while Persistent is delivering it on a solid base (revenue growth was up 13%), rendering FY22 growth more significant. The company has been ahead of industry growth for the last eight quarters, suggesting a healthy mix of deals and ramp-ups, something also visible in client buckets.

Fig 9 – Grew faster than industry; org. services growth 9.7%



Source: Company, Anand Rathi Research

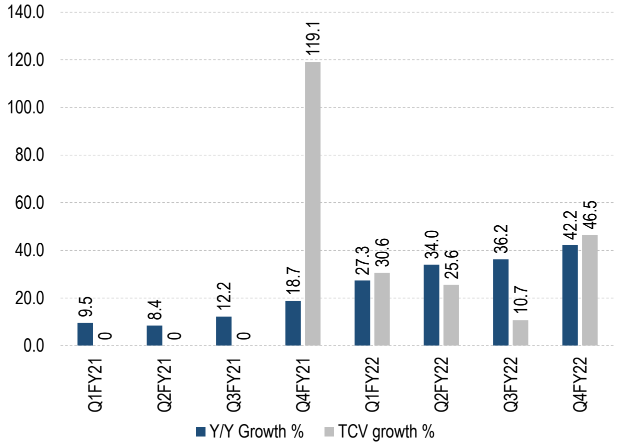
Fig 10 – Consistently growing faster than industry



Source: Company, Anand Rathi Research Note:

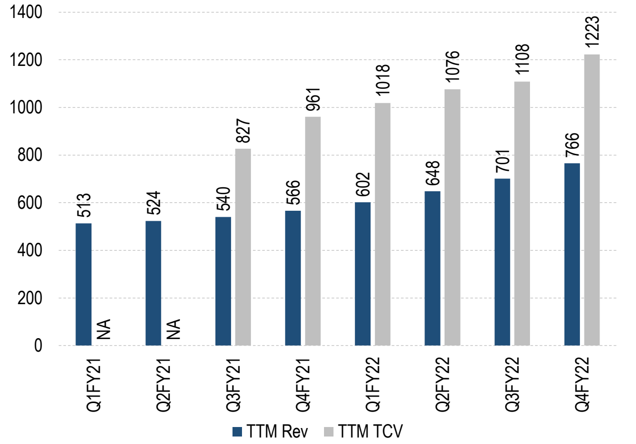
On the TCV front, it had a good quarter with Q4 at \$361m (up 8% q/q, 46% y/y), compared to Q3's \$334.3m. TCV excludes deals won in the recently acquired companies. There is also a good mix of short-, medium and longer-term deals, with no skew in the pipeline. In the last four quarters, its average tenure has been a steady 1.1 to 1.4 years, reflecting more short-duration deals, something peers are talking about. Nevertheless, Q4 deal wins offer strong assurance of growth in FY23. Demand, incl. in Hi-tech, is strong, per management.

Fig 11 – TCV y/y and revenue y/y growth



Source: Company, Anand Rathi Research Note:

Fig 12 – TTM TCV ahead of TTM revenue, excl acquisitions



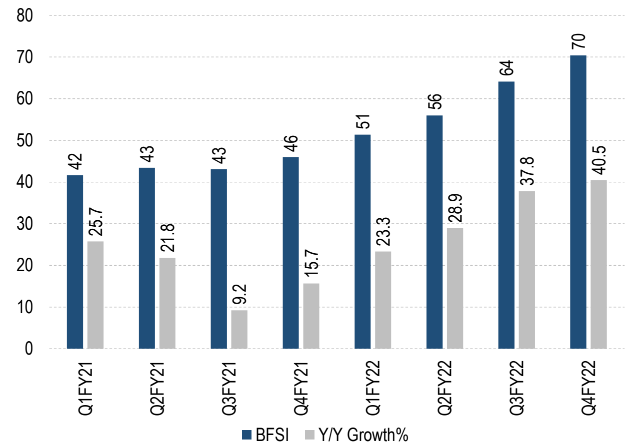
Source: Company, Anand Rathi Research Note:

BFSI, Healthcare, Hi-tech speed up growth

Persistent, from a vertical-exposure perspective, operates in three verticals: Hi-tech (47% of revenue), BFSI (32%) and Healthcare (21%). Interestingly, BFSI is the largest for Indian IT where PSYS is trying to establish itself as a strong challenger (~$242m revenue p.a., growing 39% in FY22). A few large US banks are its clients and it is expanding its base in India in this vertical. In Q4, BFSI growth accelerated by 41% y/y. This vertical was aided by acquisitions over the last few quarters.

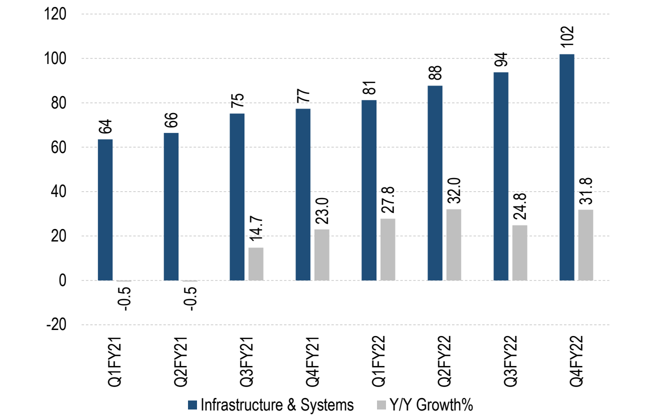
The other two are high-growth verticals for Indian IT. PSYS's Hi-tech vertical grew 32% in Q4 and the outlook is good, with more ISVs looking for partners in their quest to time- and cost-efficient development cycles. This vertical was aided by the Data Glove acquisition integrated for a month. PSYS' top client declined sequentially, having grown for six successive quarters before Q4. Of the drop, $4m was due to restructuring of their contract from revenue-share/IP to T&M. In FY22, it crossed the previous highs of FY17/18 in absolute revenues. Excl. the top client, Hi-tech grew 43% y/y.

Fig 13 – BFSI growth accelerating



Source: Company, Anand Rathi Research Note: Q3FY22 growth is organic (est.)

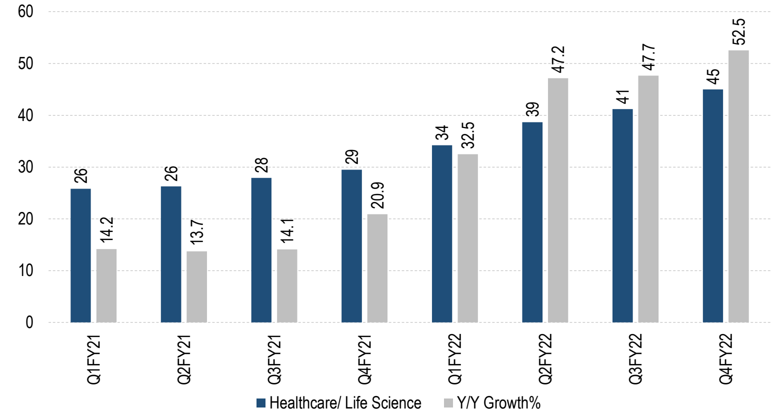
Fig 14 – Software, Hi-tech, Emerging Industries verticals growing well



Source: Company, Anand Rathi Research Note:

In Healthcare & Life Sciences, Persistent has been delivering good growth and this vertical is expected to continue to grow faster than the company.

Fig 15 – Healthcare to continue to grow fast



Source: Company, Anand Rathi Research Note:

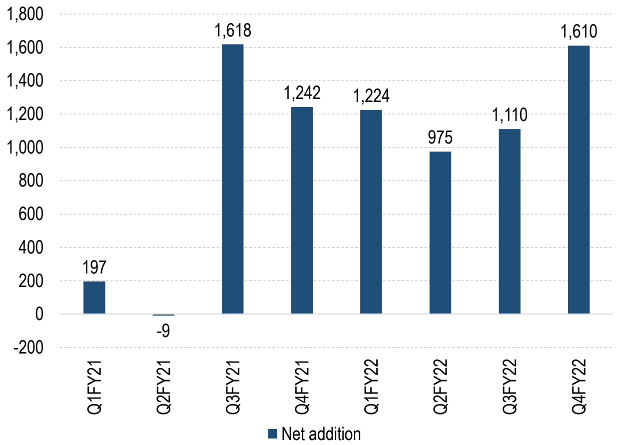
Margins steady q/q; productivity improves

Persistent added 4,919 employees in the last twelve months (1,610 in Q4), despite which utilisation moved to 80.6% in Q4 FY22 from 79.1% a year ago. However, sequentially, it came down from 83%. In Q4, 700 employees were added from Data Glove. Of the net headcount added, 30%-40% were fresh graduates, leading to margin tailwinds. Wage hikes are due on 1st Jul.

As of Q4, it increased its technical headcount by 36%, compelling the company to buy another facility in Pune in Q2. It said it aims to hire 3,000 freshers in FY23. The Q4 EBIT margin expanded 89bps y/y, 8bps q/q, despite headwinds from D&A, a one-time cost in M&A (30bps), supply-side challenges and higher CSR.

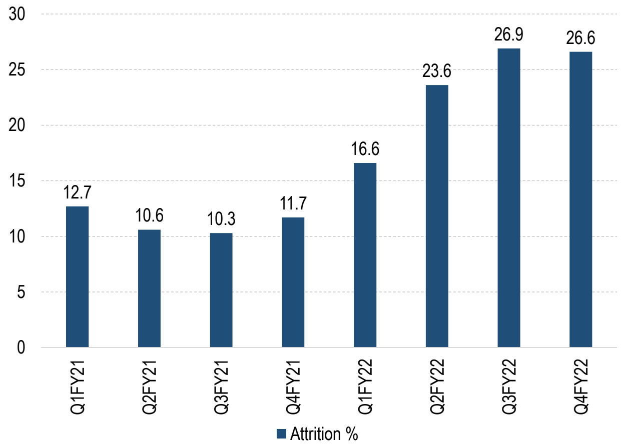
Attrition, on the other hand, was 26.6% (down from its four-year Q3 high). To retain employees, the company approved an ESOP covering ~80% of employees. The higher Services revenue and favorable currency movement (30bps) aided margins and offset the higher cost of operations caused by attrition.

Fig 16 – Net addition strong , tilting to more freshers



Source: Company, Anand Rathi Research

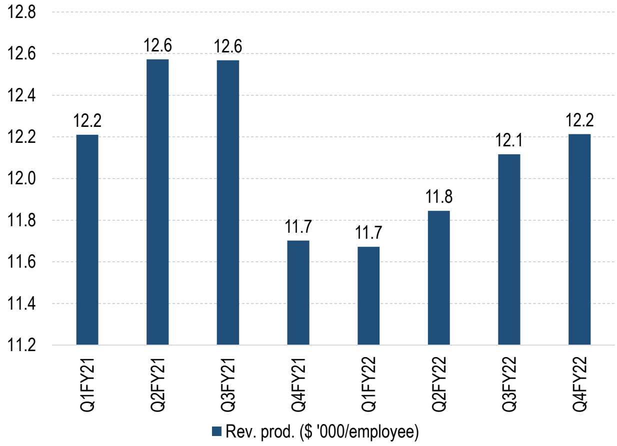
Fig 17 – Attrition eases slightly



Source: Company, Anand Rathi Research Note:

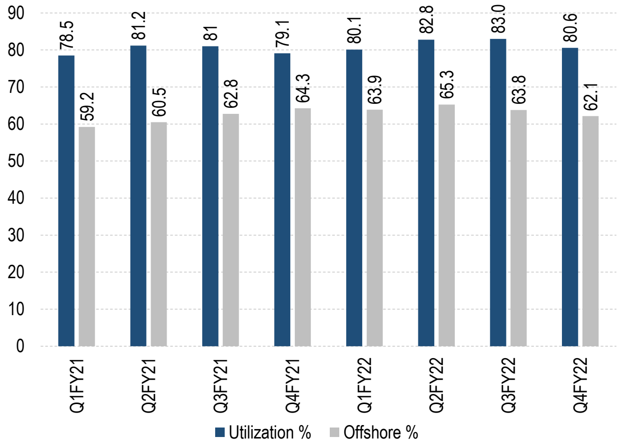
From an employee-productivity perspective, PSYS is ~3% lower than the recent highs but has started improving in the last few quarters. From a y/y perspective, productivity was flattish. PSYS currently has better productivity in Europe and, hence, in quarters (like Q4) when growth in Europe turns out to be strong, productivity also moves up. Besides, given relatively lower utilisation and higher offshore, productivity is likely to be range-bound.

Fig 18 – Productivity improves for the third straight quarter



Source: Company, Anand Rathi Research Note:

Fig 19 – Utilisation and Offshore fall in Q4



Source: Company, Anand Rathi Research Note:

The recent drop in offshore is on account of acquisitions which were largely onsite. As the company grows and acquisitions get integrated, we expect offshore to regain its previous highs.

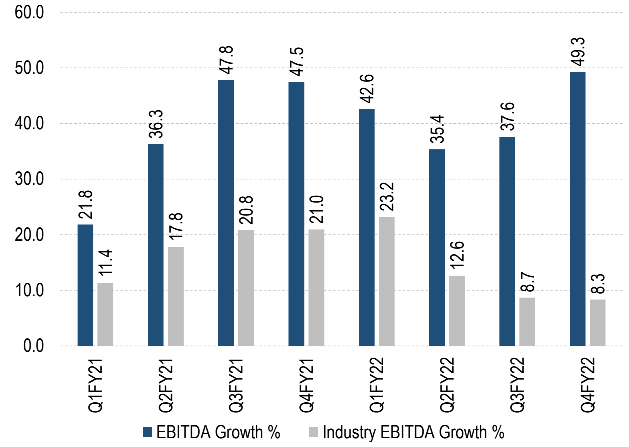
Healthy EBIDTA/NI growth

PSYS delivered 49% y/y EBITDA growth in Q4 FY22 and 41% in FY22, way ahead of the industry. Y/y, its margins expanded 25bps to 17.2% in Q4 FY22. FY23 margins would see headwinds in the form of wage hikes (to be higher than in FY22), a 70-80bp (a further 50bps as FY22 includes 30bps) headwind from acquisitions and high attrition. The company is yet confident of defending a 14% EBIT margins.

Despite supply-side challenges, the EBITDA margin expanded in Q4. The company had a 30bp currency benefit in Q4. It is negotiating with some clients for better billing rates, which would be another, and the strongest, lever for margin expansion ahead. Despite all the challenges, it has done well in terms of margins in the past year and its EBITDA growth is still way above the industry average.

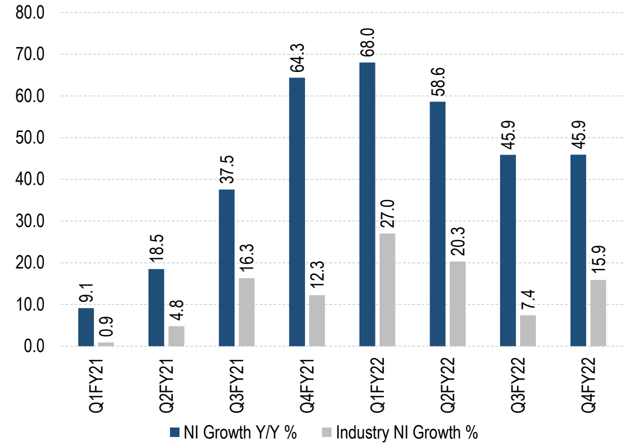
NI grew 46% in Q4 while the NI margins contracted 10bps y/y.

Fig 20 – EBITDA growth, higher than that of the industry



Source: Company, Anand Rathi Research

Fig 21 – NI growth continues to be higher than industry



Source: Company, Anand Rathi Research Note:

In terms of client metrics, Persistent has scaled up well in $5m+ clients with LTM addition of eight (on a base of 17 to reach 25 by Q4 FY22). This is in line with management commentary of efforts in client mining. Further, the maximum success came in the mid-size client ($1m+) base, which increased by 27 in the last 12 months to 93 in Q4. In comparison, smaller clients have grown from 475 a year ago to 560 in Q4 FY22. The count includes clients added through acquisitions over the period.

Conference Call Highlights

Q4 FY22 Concall takeaways

- Q4 organic revenue growth was 6.8% q/q, 36% y/y, in dollar terms. The company had $4.7m further revenue from all three acquisitions in Q4. This was after absorbing a $4m drop in revenue from the top client due to a restructuring of their contract.
- FY22 organic growth was 32.8%.
- IP-led revenue was down due to restructuring of a deal with the top customer. The revenue-share deal is now a T&M one.
- The BFSI and Hi-tech (mainly Data Glove) verticals were aided by acquisitions in Q4.
- Offshore linear revenue grew 11.5% due to 9.8% volume growth and a 1.5% billing-rate increase.
- Onsite linear revenue grew 20.1% due to 17.6% volume growth and a 2.1% billing-rate increase.
- SCI and Shree Partners were fully integrated while Data Glove was integrated for a month. The Media Agility acquisition is expected to be closed in 1-2 weeks.
- TCV data shared do not include acquisitions' TCV.
- Deal highlights. $10m+ deal signed in payments with the help of SCI. Shree Partners not only aided in vendor consolidation but has also helped PSYS close two large multi-year deals and are triple digit on a TCV basis.
- Despite headwinds from D&A, one-time cost in M&A (30bps), supply side challenges and higher CSR, EBIT was flat. The company had a currency benefit of 30bps.
- Margins were down in BFSI due to increase in onsite revenue
- SCI and Shree at similar levels if margins compared to the company
- FY23 margins to see headwinds in the form of wage hikes (to be higher than in FY22), a 70-80bp headwind from acquisitions and high attrition. The company is confident of defending the 14% EBIT margins and is looking to raise prices with some clients.
- The billing rate in Europe is higher than that of the US.
- Of the net headcount addition in Q4, 30-40% were freshers and 700 employees were added from Data Glove. Wage hikes are due on 1st Jul.
- Utilisation was down in Q4 due to capacity building and fresher intake
- The company expects TTM attrition to be high as demand is robust, but expect it to come down over FY23
- Receivables were higher due to billing toward the quarter's end, not due to change in payment terms
- DSO was 59 days vs 58 in Q3
- Total payout for acquisitions (excl. MediaAgility) would be $220m, of which $150m was upfront, the rest in liabilities/earn-outs.

- Management is not seeing any weakness in the ISV market despite inflation and geopolitical tension
- Debt taken of $25m for SCI and $35m for Data Glove. The cost of debt is Libor+155bps. The tenure is three years and is an amortizing structure.
- The company will pause acquisitions for 1-2 quarters and concentrate on integration.
- CMT is an emerging vertical with a $50m run rate.

Business Outlook

- The company is looking at $1bn revenue in 4-6 quarters.
- It is confident of defending a 14% EBIT margin.

Q3 FY22 Concall takeaways

- Q3 organic growth was 6.7% q/q, 33.4% y/y
- SCI's revenue was consolidated for almost the entire quarter, Shree Partners was consolidated for about half the quarter. SCI's revenue for the quarter was $3.7m and Shree Partners revenue was ~$800,000.
- The ESOP plan had a margin impact of 75bps. The higher Services revenue, better IP-led revenue and favourable currency movements aided margins by 50bps, and the focus on utilization helped offset the higher cost of operations caused by attrition. EBIDTA improved 20bps to 16.8%, against 16.6% the previous quarter.
- 1,110 employees added including 258 from the Shree Partners and SCI acquisitions. Fresh graduates constituted ~one fourth of the organic net addition. Looking at hiring 3,000 freshers in FY23.
- Annualized attrition has started to soften, though it remains high. 12-month attrition is likely to be the higher side for at least another couple of quarters. It would then moderate due to the base effect and on account of the new batch of freshers who will join, thereby expanding the supply for industry overall
- Avani Davda was added to Persistent's Board of Directors. Kuljesh Puri joined as an SVP for IBM Alliance and Emerging Verticals. Ajay Kumar joined as SVP for Partner Ecosystems, which includes sourcing advisory, private equity and similar channels. Vijay Iyer joined as Sales VP for digital transformation. PSYS also on-boarded its first member to the Persistent Advisor Network, Werner Boeing, a former CIO of Roche Diagnostics.
- Depreciation and amortization was higher on account of the new acquisitions. On a full-quarter basis, the amortization impact would be ~40bps, then moderate as revenue grows.
- DSO was 58 days, against 55 in the previous quarter, the increase being primarily due to higher IP invoicing in the last month of the quarter and some collections spilling over to the first week of Jan
- PSYS is a significant player in the Salesforce ecosystem in India and has expanded it footprint in Indian domestic financial services. The company expects this to be steady in terms of growth.
- PSYS has a healthy pipeline in the Salesforce market in Europe as well as the non-Salesforce market. In the next few quarters, it is expected to see a positive trajectory from a growth perspective for Europe.

- Kuljesh Puri hired as SVP for IBM Alliance and Emerging Verticals. Emerging Verticals has a decent portion of Communications, Media and Technology revenue in it and it is doing well. As it grows more over time, the company will start announcing it as a separate vertical, but does not expect this in FY23.
- Management aims to be a billion dollar-plus organization over the next 4-8 quarters

Q2 FY22 Concall takeaways

- Delivered best q/q and y/y organic growth after a long time.
- Growth in Q2 was led by Healthcare and Life sciences, followed by BFSI and Hi-tech.
- Returned to normal wage hike (Jul) and Q2 saw the full impact (230bps gross), cushioned by growth and utilisation.
- ESOP plan introduced, which covers 80% of employees, in addition to their packages. ESOP scheme to have an impact of 70-80bps on margins; over time this should be offset.
- Acquisition of SCI and Shree Partners in September; no cost or revenue from these two in Q2. The company is evaluating more tuck-in M&As.
- On the IP business, it is working on optimizing margins and has converted a long-standing contract to a T&M one, which should boost margins and not have any seasonality. This will see some additional resources being released and re-deployed to Services or having more billability. In both the scenarios, margins should improve.
- The drop in the billing rate onsite was due to lower revenue from Europe (essentially due to seasonality) and an increase in revenue from Mexico which typically comes at a lower rate than the US.
- SG&A was higher due to more recruitment expenses although revenue growth aided in covering this. We expect operating leverage ahead.
- Supply-side challenges and attrition would pressure margins but the company expects to navigate these challenges.
- DSO was 55 days compared to 54 in Q1.
- It won a deal with a third-party insurance administrator (an existing customer). The TCV exceeds $50m over five years.
- In Healthcare, it won two deals with a contract-research organization and a leading US healthcare provider among other deals
- In Hi-tech the company was chosen by an employee engagement solutions organization and leading tax preparation and financial technology provider amongst other deals
- Management has plans to go bigger in the US, Canada and Mexico for near-shore delivery. This will help it build a more global delivery model.
- Management is seeing a healthy demand environment. TCV is a good representation of revenue ahead.
- Deals are a good mix of short-medium term and medium term.
- Expect 83-84% utilization.
- No further impact from impairments.

- IP business to be stable for some time and decline over a long tail, steep declines behind the company now.
- Acquisitions to have an impact of 30-40bps over two quarters on EBIT but should be manageable. At the gross margin level, acquisitions are accretive.
- Travel expense had a 10-15bp impact in Q2; if travel continues to open up, it expects this to increase 15bps each quarter.
- Its Europe business was hit by attrition in Q2, or it would have seen growth otherwise. In the medium term, this should move to 10-15% of revenue.
- The IP business has healthy margins; higher than the company average
- Goal of a $1bn run rate to be achieved in 6-8 quarters. This will mostly be through organic growth but some inorganic growth like that in Q2 could be added. Looking for capability acquisitions in cloud, data, security or salesforce.
- Q2 margins sustainable; expect margins of 16-17%.
- Margins to improve 100-150bps over the next 8-10 quarters

Q1 FY22 Concall takeaways

- Delivered best q/q and y/y organic growth in the history of the company. Growth was broad based in Q1. Sureline Systems was integrated during the quarter but was small.
- Attrition is an area of focus and measures are in place to bring it down. These measures are better employee engagement, flexible work hours, intake of fresh graduates and upskilling of employees. FY22 returned to a normal wage-hike cycle; hence, wage hikes were given in July.
- Integration of Capiotis is progressing well. IP and business assets of Sureline acquired in Q1. These acquisitions will enhance Persistent's abilities in cloud migration. The company is evaluating M&A targets.
- H1 B visas had an impact of 50bps on margins in Q1 FY22. Gross margin down due to seasonality. Reported G&A for the quarter includes impairment in one of the start-up investments, resulting in a ~60bp impact.
- D&A down as one product completed amortization in Q4.
- Capiot contributed a further $0.5m q/q
- Travel expenses to return gradually; expect 30-40bps increase in travel expenses in the next few quarters. For the quarter, visa expenses are included.
- Wage hike to impact margins by 250-275bps at the gross level; expect levers to absorb most of it; the net impact should not be more than 75-100bps (net impact) in Q2.
- Sub-contracting costs to go down as travel opens up.
- As soon as Covid-19 restrictions are lifted, expect near shore centers and more presence onsite. It is a lever ahead.
- Pricing power with a few customers, most clients are under competitive pricing, limiting scope for increases.

- Added 400 freshers in Q1; for the year looking at adding 2,000. Overall headcount to continue to increase.
- Billing rate moved up in Q1
- Europe growth will not see volatility as it moved to net accounting on the reseller-revenues part of the business.
- Evaluating 3-4 tuck-in acquisitions; hope to announce something in Q2.

Factsheet

Fig 22 – Revenue split

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
Effort-Led	85.1	86.9	87.5	86.7	91.1
IP-Led	14.9	13.1	12.5	13.3	8.9

Source: Company, Anand Rathi Research

Fig 23 – Revenue-split, by region

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
North America	79.2	78.9	78.7	79.2	78.6
Europe	10.0	9.5	8.8	8.3	8.4
Asia-Pacific	10.8	11.6	12.5	12.5	13.0

Source: Company, Anand Rathi Research

Fig 24 – Revenue-split, by industry

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
BFSI	30	31	31	32	32
Healthcare	19	21	21	21	21
Infrastructure & Systems	51	49	48	47	47

Source: Company, Anand Rathi Research

Fig 25 – Client profiles (LTM)

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
Client profiling					
Top 1	17.9	17.0	16.9	17.5	14.0
Top 5	36.4	36.5	35.8	36.1	32.5
Top 10	46.3	46.7	45.4	45.0	42.1
<$1m+	475	471	490	511	560
$1m+	66	76	84	90	93
$5m+	17	21	22	24	25
Active Clients (effort based)	558	568	596	625	678

Source: Company, Anand Rathi Research

Fig 26 – Workforce

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
Employee Movement					
Technical(EOP)	12,706	13,833	14,657	15,721	17,283
Net Adds (Qtr)	1,173	1,127	824	1,064	1,562
Net Adds (LTM)	2,871	3,806	4,656	4,188	4,577
Utilization %	79.1	80.1	82.8	83.0	80.6
Attrition %	11.7	16.6	23.6	26.9	26.6
Sales(EOP)	273	308	296	294	317
Net Adds (Qtr)	(4)	35	(12)	(2)	23
Net Adds (LTM)	10	34	28	17	44

Source: Company, Anand Rathi Research

Fig 27 – Revenue-split, by delivery type and billing rates

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
Delivery Type(%)					
On-site	35.7	36.1	34.7	36.2	37.9
Offshore	64.3	63.9	65.3	63.8	62.1
Reported Billing Rates ($ /hr)					
On-site	88.8	90.9	88.5	85.8	87.6
Offshore	22.5	22.9	23.0	22.7	23.1

Source: Company, Anand Rathi Research

Fig 28 – Key areas and horizontals growth (%)

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
Key Area-wise Growth (Y/Y)					
North America	18.8	24.9	27.2	33.1	41.1
Europe	36.7	18.6	55.1	28.5	19.5
Asia-Pacific	18.1	57.1	76.3	68.6	71.2
Segment Growth (Y/Y)					
Effort-Led	20.4	33.9	39.9	40.4	44.9
IP-Led	10.1	(3.9)	3.2	(0.1)	13.5
Growth, by vertical (Y/Y)					
BFSI	15.7	23.3	28.9	37.8	40.5
Healthcare	20.9	32.5	47.2	47.7	52.5
Infrastructure & Systems	23.0	27.8	32.0	24.8	31.8

Source: Company, Anand Rathi Research Note: Effort-Led Q3FY22 growth is organic (est.)

Fig 29 – TCV Data

	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22
Net New TCV $ m	138	148	149	158	195
Total TCV	247	245	283	334	361

Source: Company, Anand Rathi Research

Valuations

We raise our target to Rs4,980 (Rs4,640 previously), which translates to 34x FY24e EPS. At the ruling price, the stock trades at a 29x FY24e P/E and an 18x FY24e EV/EBITDA. FY21 grew 13%, with practically no impact from the pandemic; hence, growth in FY22 is more than meets the eye. Revenue was $766m in FY22, and is expected to hit $1,059m by FY23 incl. the three acquisitions. The EBIT margin is expected to expand from 14% in FY22 to 14.6% in FY24.

IP sales were down 4% in FY22 and we expect slow growth as management focus has shifted to building Services. The company's reliance on its top client came down to 16.3% in FY22 (14% in Q4 FY22) from 22% in FY20. In the last three quarters before Q4, the top client had started contributing to growth but in Q4 it fell 13% sequentially. Besides, the company has now added clients and capabilities in the Microsoft ecosystem, which will offer further medium-term growth opportunities.

We value the stock based on a target P/E of 34x FY24e EPS, slightly lower than Mindtree, on the very strong growth execution but also a shade lower on account of weak FCF generation in FY22 and FY23.

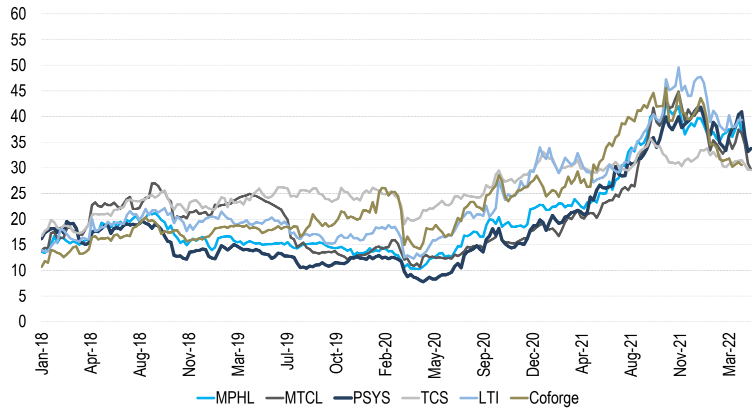
The target multiple reflects Persistent's focus on building BFSI faster, bulking up from inorganic initiatives as well. We also note its reducing exposure to the top client (thereby, reducing volatility) and its improving execution and track record in growth built in the last two years. The constraints related to its evolving client metrics will further ease as the company scales up many client relations to large deals (beyond $5m now).

Fig 30 – Change in estimates

(Rs m)	FY23			FY24		
	New	Old	% Change	New	Old	% Change
Revenue ($ m)	1,059	1,018	4.0	1,272	1,204	5.7
Revenues	79,928	76,538	4.4	96,060	90,561	6.1
EBITDA	13,830	12,717	8.8	17,468	15,308	14.1
EBITDA margins %	17.3%	16.6%	69 bps	18.2%	16.9%	128 bps
EBIT	11,073	10,114	9.5	14,045	12,053	16.5
EBIT margins %	13.9%	13.2%	64 bps	14.6%	13.3%	131 bps
PBT	12,192	11,213	8.7	14,973	13,062	14.6
Net profit	9,104	8,353	9.0	11,181	9,729	14.9

Source: Anand Rathi Research

Fig 31 – PE band



Source: Bloomberg, Anand Rathi Research

Risk

- M&A-integration related.

Appendix

Analyst Certification

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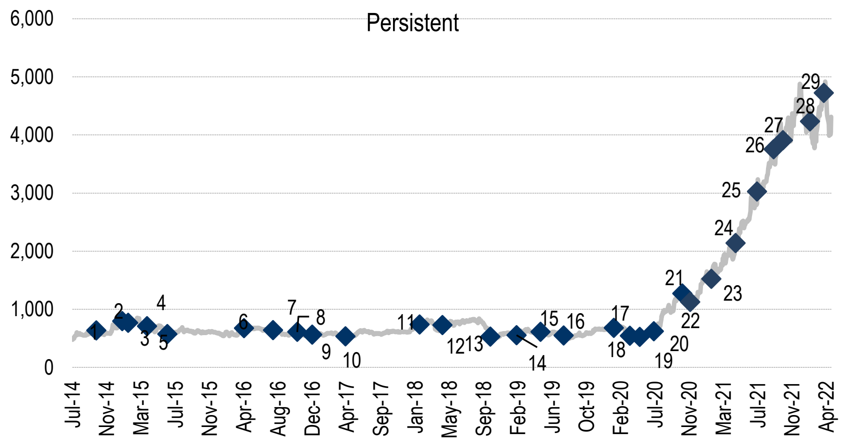

	Date	Rating	TP (Rs)	Share Price (Rs)
14	29-Jan-19	Buy	760	565
15	30-Apr-19	Hold	700	565
16	26-Jul-19	Hold	630	552
17	31-Jan-20	Sell	690	704
18	31-Mar-20	Buy	670	704
19	7-May-20	Buy	630	503
20	29-Jun-20	Hold	680	627
21	15-Oct-20	Sell	940	1,369
22	27-Oct-20	Sell	960	1,187
23	1-Feb-21	Sell	1,270	1,526
24	2-May-21	Hold	2,050	2,038
25	26-Jul-21	Hold	3,290	3,040
26	1-Oct-21	Buy	4,275	3,716
27	28-Oct-21	Buy	4,650	4,007
28	14-Feb-22	Hold	4,640	4,200
29	16-Mar-22	Hold	4,640	4,314

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