Persistent Systems

Accumulate

Result Update

Alliance revives with 12% growth, TSU momentum sustain up 6%

- Persistent reported stellar Q3 performance, with 7.4% QoQ growth at $146mn (DE 3.4%). OPM improved by 60bps QoQ to 12.7% (DE 11.5%) driven by sustained traction across businesses.
- Alliance (24% of rev) clocked growth of 12% QoQ as it witnessed better traction both on IP as well as reseller side. TSU (76% of rev) reported growth of 6% QoQ as it continues to clock strong deal win momentum.
- Persistent remain confident on sustaining growth traction backed by strong deal wins at $302mn TCV ($256mn ACV) including $175mn as new wins that comforts on growth sustenance Book-to-bill at ~2x. Expect sustenance of OPM at 17% helped by revenue acceleration.
- Accounting for its strong performance, confident commentary (robust deal wins), improved business traction in Alliance and unutilized margin levers we have upgraded our estimates for FY21-23E by ~9%. We assign Accumulate rating on the stock with TP of Rs1,530 valued at 21x FY23E earnings.

Turnaround in Alliance biz to fuel further growth acceleration

Management believes that it would continue its growth momentum in Alliance business hereon as it has been consistently expanding its relationship on hybrid cloud partners side and also adding more service offerings and verticals (earlier Financials and now even Telecom). It has won few large deals that are expected to shape up by Q1FY22 which is adding to its growth confidence. To support the growth momentum company has added 15% growth QoQ in its total headcount – which it has done proactively to support upcoming demand and 6month lag for fresher-to-billed period.

Profitability can sustain despite cost normalization headwinds

The company has managed to improve its profitability during the quarter despite the 2-month wage hike impact during the quarter (Effective Nov'20) led by operating leverage. The company ensured staggered induction of its large headcount intake (added 1600 to its headcount – 600 were fresher rest all laterals) to minimize impact on utilization (flat at 85%) during the quarter. Management expect that the company can maintain its profitability at current levels of 17% EBIDTA margins, as it expects gains from improved operating leverage and offshore leverage.

Q3FY21 Result (Rs Mn)

Particulars	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)
Revenue	10,754	9,227	16.5	10,077	6.7
Total Expense	8,929	7,993	11.7	8,420	6.1
EBITDA	1,825	1,234	47.8	1,658	10.1
Depreciation	461	428	7.6	440	4.8
EBIT	1,364	806	69.2	1,218	12.0
Other Income	286	334	(14.2)	157	82.2
Interest	0	0		0	
EBT	1,650	1,140	44.8	1,375	20.0
Tax	441	260	69.2	355	24.1
RPAT	1,209	879	37.5	1,020	18.6
APAT	1,209	879	37.5	1,020	18.6
			(bps)		(bps)
Gross Margin (%)	34.3	33.3	104	34.7	(43)
EBITDA Margin (%)	17.0	13.4	359	16.4	52
NPM (%)	11.2	9.5	172	10.1	112
Tax Rate (%)	26.7	22.9	386	25.8	88
EBIT Margin (%)	12.7	8.7	395	12.1	60

CMP	Rs 1,524
Target / Upside	Rs 1,530 / 0%
NIFTY	13,635

Scrip Details

Equity / FV	Rs 764mn / Rs 10
Market Cap	Rs 116bn
	USD 2bn
52-week High/Low	Rs 1,700/ 420
Avg. Volume (no)	1,63,724
Bloom Code	PSYS IN

Price Performance	1M	3M	12M
Absolute (%)	2	30	117
Rel to NIFTY (%)	5	14	105

Shareholding Pattern

	Jun'20	Sep'20	Dec'20
Promoters	31.5	31.3	31.3
MF/Banks/FIs	27.2	28.9	29.5
FIIs	19.2	18.7	18.7
Public / Others	22.1	21.1	20.5

Valuation (x)

	FY21E	FY22E	FY23E
P/E	26.8	23.2	20.9
EV/EBITDA	15.4	13.6	11.9
ROE (%)	17.1	17.4	16.9
RoACE (%)	17.8	17.9	17.3

Estimates (Rs mn)

	FY21E	FY22E	FY23E
Revenue	41,684	47,827	54,300
EBITDA	6,766	7,492	8,236
PAT	4,348	5,018	5,582
EPS (Rs.)	56.9	65.7	73.0

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Exhibit 1: Quarterly performance versus estimates

		Estimates		% Variation		
(Rs mn)	Actual	Dolat	Consensus	Dolat	Consensus	Comment
USD Revenue	146	141	144	3.9	1.8	Revenue beat led by revival of Alliance Vertical (up 12.1% QoQ)
INR Revenue	10,754	10,382	10,490	3.6	2.5	
EBIT	1,364	1,190	1,215	14.6	12.2	EBIT beat led by positive operating leverage
EBIT, margin	12.7	11.5	11.6	120 bps	110 bps	
PAT	1,209	1,033	1,096	17.0	10.3	PAT beat extended by higher other income and lower fx losses

Source: Company, DART

Change in Estimates

Factoring in strong beat on financial performance and positive outlook for Alliance business (both on growth/profitability) we have upgraded our growth assumption by 2%-4%% for FY21-FY23 and OPM estimates by ~77bps/49bps for FY21/22E respectively. These factors have led to earnings upgrade of about 6-9% in our earnings estimates over FY21-23E. Our growth estimates are largely aligned with management thought-process of delivering strong secular growth performance however, is still conservative on the profitability perspective, wherein the company expect to sustain 17%+ EBIDTA margins hereon, while we expect it to normalize to more sustainable 15%-15.5% band.

Exhibit 2: Change in Estimates

	FY20A	FY21E			FY22E			FY23E		
Rs. Mn	Actual	Old	New	Chg. (%)	Old	New	Chg. (%)	Old	New	Chg. (%)
USD Revenue	502	551	562	2.1	617	642	4.1	688	714	3.8
YoY growth (%)	4.3	9.7	12.0	228 bps	12.0	14.2	223 bps	11.6	11.3	(28 bps)
INR Revenue	35,657	40,902	41,684	1.9	46,238	47,827	3.4	52,288	54,300	3.8
YoY growth (%)	5.9	14.7	16.9	219 bps	13.0	14.7	169 bps	13.1	13.5	45 bps
EBIT	3,269	4,557	4,967	9.0	5,189	5,602	8.0	6,096	6,286	3.1
EBIT margin (%)	9.2	11.1	11.9	77 bps	11.2	11.7	49 bps	11.7	11.6	(8 bps)
PAT	3,402	3,970	4,348	9.5	4,572	5,018	9.8	5,267	5,582	6.0
EPS (Rs Abs)	44.5	51.9	56.9	9.5	59.8	65.7	9.8	68.9	73.0	6.0

Source: DART, Company

Exhibit 3: Key Assumptions in Our Estimates

Key Assumptions	FY20A	FY21E	FY22E	FY23E
USD revenue growth (%)	4.3	12.0	14.2	11.3
INR revenue growth (%)	5.9	16.9	14.7	13.5
EBIT margin (%)	9.2	11.9	11.7	11.6
EPS growth (%)	1.1	27.8	15.4	11.2
USD/INR	71.1	74.2	74.5	76.0

Source: DART, Company

Exhibit 4: Key Growth Matrix

Growth YoY	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21
Alliance Biz.	(16.2)	1.1	(2.7)	(3.9)	(9.8)	(12.4)	0.2
TSU Biz.	2.9	8.3	11.2	11.1	17.0	16.6	17.5
USD Revenue	(3.2)	6.2	7.1	7.4	9.5	8.4	12.9
INR Revenue	(0.3)	5.9	6.8	11.4	19.1	13.9	16.5

Source: DART, Company

Exhibit 5: Quarterly and YTD Trend

Rs mn	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21	YoY (%)	QoQ (%)	YTDFY20	YTDFY21	YoY (%)
USD Revenue	**125.5**	**129.4**	**127.1**	**131.0**	**136.1**	**146.2**	**12.9**	**7.4**	**374.6**	**413.3**	**10.3**
INR Revenue	**8,846**	**9,227**	**9,263**	**9,914**	**10,077**	**10,754**	**16.5**	**6.7**	**26,394**	**30,745**	**16.5**
Operating Expenses	7,630	7,993	7,987	8,449	8,420	8,929	11.7	6.1	22,742	25,798	13.4
Cost of revenue	5,773	6,157	6,130	6,646	6,577	7,064	14.7	7.4	17,365	20,287	16.8
as % of sales	65.3	66.7	66.2	67.0	65.3	65.7			65.8	66.0	
SG&A expenses	1,856	1,836	1,857	1,803	1,843	1,865	1.6	1.2	5,377	5,511	2.5
as % of sales	21.0	19.9	20.0	18.2	18.3	17.3			20.4	17.9	
EBITDA	**1,216**	**1,234**	**1,276**	**1,464**	**1,658**	**1,825**	**47.8**	**10.1**	**3,653**	**4,947**	**35.4**
Depreciation	425	428	420	436	440	461	7.6	4.8	1,239	1,336	7.8
EBIT	**792**	**806**	**856**	**1,029**	**1,218**	**1,364**	**69.2**	**12.0**	**2,413**	**3,610**	**49.6**
Other Income	364	334	274	192	157	286	(14.2)	82.2	980	635	(35.2)
PBT	1,156	1,140	1,130	1,220	1,375	1,650	44.8	20.0	3,393	4,246	25.1
Total Tax	295	260	292	320	355	441	69.2	24.1	828	1,116	34.8
Reported PAT	**861**	**879**	**838**	**900**	**1,020**	**1,209**	**37.5**	**18.6**	**2,565**	**3,129**	**22.0**
Reported EPS	**11.2**	**11.5**	**11.0**	**11.8**	**13.3**	**15.8**	**38.0**	**18.5**	**33.4**	**40.9**	**22.4**
Margins (%)							**(bps)**	**(bps)**			**(bps)**
EBIDTA	13.8	13.4	13.8	14.8	16.4	17.0	359	52	13.8	16.1	225
EBIT	8.9	8.7	9.2	10.4	12.1	12.7	395	60	9.1	11.7	260
EBT	13.1	12.4	12.2	12.3	13.6	15.3	299	170	12.9	13.8	95
PAT	9.7	9.5	9.0	9.1	10.1	11.2	172	112	9.7	10.2	46
Effective Tax rate	25.5	22.9	25.9	26.2	25.8	26.7	386.2	88.3	24.4	26.3	188.4

Source: DART, Company

What to expect next Quarter

We expect strong sequential revenue growth for Q4 led by sustained deal-win momentum in TSU business. However, on overall basis we expect revenue growth of 1.7% QoQ given unfavourable seasonality in Alliance business and OPM decline of 30bps QoQ, as it would have additional one-month impact on wage hike and full quarter impact of strong hiring it did in Q3.

Exhibit 6: What to expect next Quarter

(Rs. Mn)	Q4FY21E	Q3FY20	Q4FY20	QoQ (%)	YoY (%)
USD Revenue	149	146	127	1.7	17.0
INR Revenue	10,939	10,754	9,263	1.7	18.1
EBIT	1,356	1,364	856	(0.6)	58.4
PAT	1,219	1,209	838	0.8	45.5
EPS (Rs. Abs)	15.9	15.8	11.0	0.8	45.5
EBIT Margin (%)	12.4	12.7	9.2	(28 bps)	316 bps

Source: DART, Company

Valuation

We believe PERSISTENT and other Tier II IT companies would continue to deliver strong revenue momentum over next 5-6 quarters (translating into double digit revenue growth in FY22/FY23E) and thus would sustain current valuations of 20x-24x which implies over 1.5x-2x on PEG basis. We currently value PSYS at 21x (from 19times) on FY23E Earnings of Rs. 73 (earlier Rs. 68.4) with TP of Rs. **1,530** per share (from Rs. 1,300) and maintain our **Accumulate** Rating.

Key Highlights from Earning Call

- **Revenue:** Persistent Revenue grew by 7.4% QoQ and 12.9% YoY in USD Terms. The INR Revenue growth was 6.7% QoQ and 16.5% YoY. The growth led by both TSU Biz and Alliance Biz. The TSU Biz. continued its momentum with 6.0% QoQ growth. Alliance Biz revived with a growth of 12.1% QoQ and is flat on YoY basis with modest growth of 0.2% YoY. The IP led Revenue (18% of Revenue) grew by 19.8% QoQ to $26.5mn and Services Revenue grew by 5.0% QoQ. Persistent integrated Capiot Systems during the quarter (7th Nov), that have added about $1mn to its revenues - around 65bps.
- **TSU business:** Technology Service Biz. (76.3% of Revenue) reported 6.0% sequential growth and contributed 63% to Incremental Revenue. The momentum here is likely to continue as evident from large TCV addition (added Total order book of about $302mn (ACV is about $256mn).
- **Alliance business:** Alliance Biz. (23.7% of Revenue) reported 12.1% sequential growth in the quarter and contributed 37% of incremental revenue. The segment is expected to do well hereon as well as it continues to identify newer areas for growth – Services (Hybrid cloud partner) and Vertical (earlier focus was only Financials but now added Telecom as well).
- **EBIT Margin:** EBIT margin increased by 60bps QoQ to 12.7%. The strong positive operating leverage was negated by higher cost of Revenue which increased by 7.4% QoQ at 65.7% of Revenue. The Cost Revenue increase was due to 4.0% QoQ growth in employee cost with CoR and higher Royalty Expenses which were 13.9% of Alliance Revenue (5.1% last quarter). The SG&A Expenses grew by only 1.2% QoQ likely due to increase in employee cost as total employee expenses increased 5.3% implying some growth in SG&A employee as well.
- **Vertical Commentary:** BFSI Vertical declined by 1%. Tech & Emerging Vertical led the growth with 13.1% QoQ growth and 87% contributed to incremental Revenue. Healthcare Vertical grew by 6.0% and 16% contribution to incremental revenue.

Exhibit 7: Vertical Trend for Q3FY21

Geography	Amount ($ mn)	Mix (%)	QoQ (%)	YoY (%)	Incremental Revenue ($ mn)	% Contribution of Incremental Revenue
BFSI	43	30	(0.7)	9.2	-0	-3%
Tech & Emerging Vertical	75	51	13.1	14.7	9	87%
Healthcare	28	19	6.0	14.1	2	16%
Total	**146**	**100**	**7.4**	**12.9**	**10**	**99%**

Source: DART, Company

- **Geography Commentary:** North America grew 5.1% QoQ and contributed 57% to incremental revenue. Europe Region also reported growth of 24.4% QoQ and 25% contribution to incremental revenue. India Region grew by 14% QoQ.

Exhibit 8: Geography Trend for Q3FY21

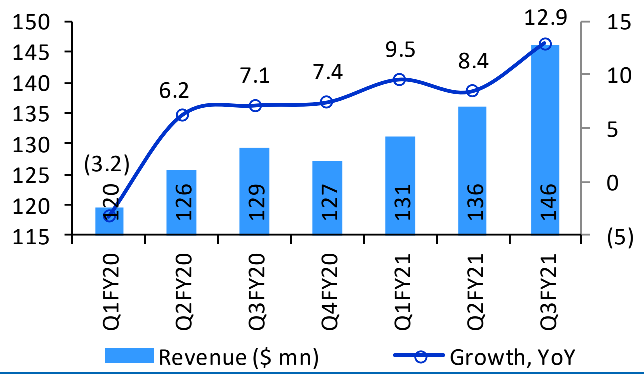
Geography	Amount ($ mn)	Mix (%)	QoQ (%)	YoY (%)	Incremental Revenue ($ mn)	% Contribution of Incremental Revenue
North America	119	81	5.1	14.3	6	57%
Europe	13	9	24.4	(6.3)	3	25%
India	13	9	14.0	31.2	2	15%
RoW	2	2	15.1	(10.9)	0	3%
Total	**146**	**100**	**7.4**	**12.9**	**10**	**100%**

Source: DART, Company

- **Capiot Acquisition:** Capiot accounted for about $1mn in revenues for the quarter and also added about 200 resources to its headcount.
- **Order book:** Company disclosed its TCV for the first time as it added $302mn in total order wins for the quarter. This is overall order wins and includes about $175mn in New deals and rest as renewals. Company also shared ACV info which stood at $256mn overall and about $140mn on New deal basis. The company also plans to start sharing 12M executable order data going forward.
- **Collections:** were pretty strong at $154mn, taking DSO to 57 days. Current cash on books are at about $258mn. The company also announced Interim dividend of Rs14 per share.
- **Strategy has worked:** Persistent believed that its strategy on 1) Organizing and better sharpening of vertical/services lines, 2) improving incentivisation for more wallet share win and long term deals, 3) increased partnerships (Hyperscalers, IBM-Redhat, Salesforce) and 4) leveraging influencers, Advisory weigh downs (ISG, Zinnov) has worked for the company and thus would continue to play on those tracks.
- **Capital allocation**: No plans to acquire, IPs kind of deal; did one captives – rebadging kind of deal of about 200 resources couple of quarter ago and is open to more such transaction.
- **Europe:** Currently the geography is small for the company but it is growing its presence by adding leadership and plans to open up more verticals led capabilities. It aims to take the Geo revenue contribution from current levels of sub-9% to 15-18% of revenues in some years from now.

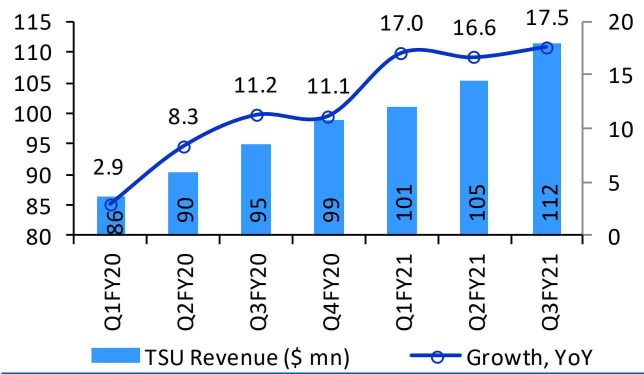
Story in Charts

Exhibit 9: Revenue traction continues with 7.4% QoQ growth



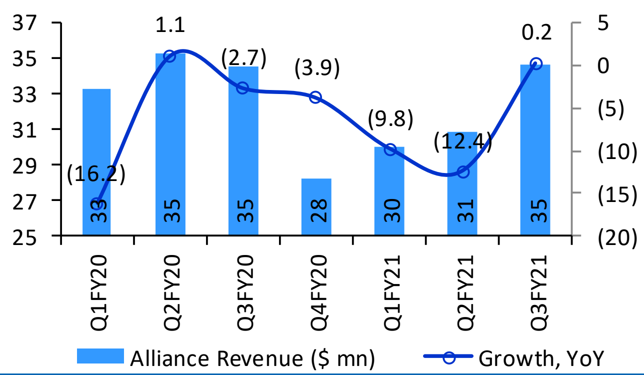
Source: DART, Company

Exhibit 10: Momentum in TSU business continues with 6.0% QoQ growth



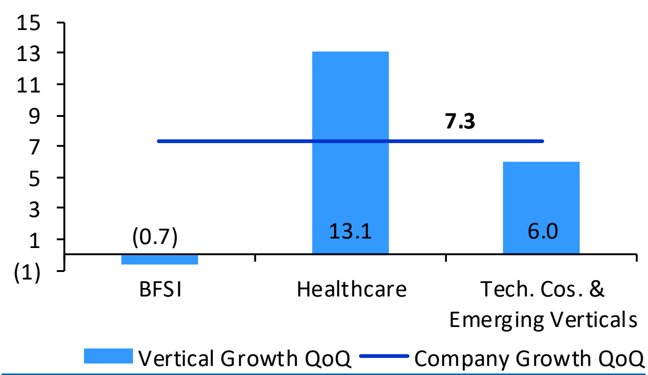
Source: DART, Company

Exhibit 11: Alliance Biz revived with 12.1% QoQ growth and now it up 0.2% YoY



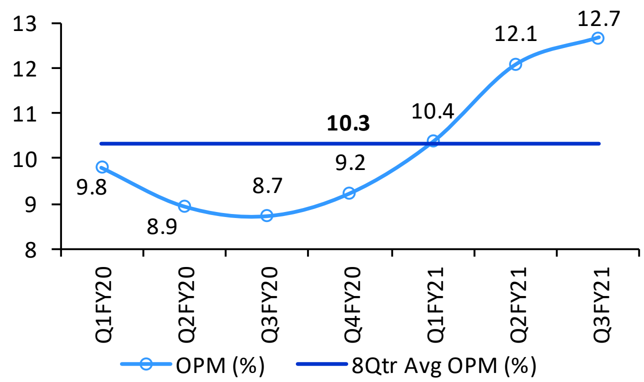
Source: DART, Company

Exhibit 12: Growth was led by Tech & Emerging Vertical & Healthcare Vertical



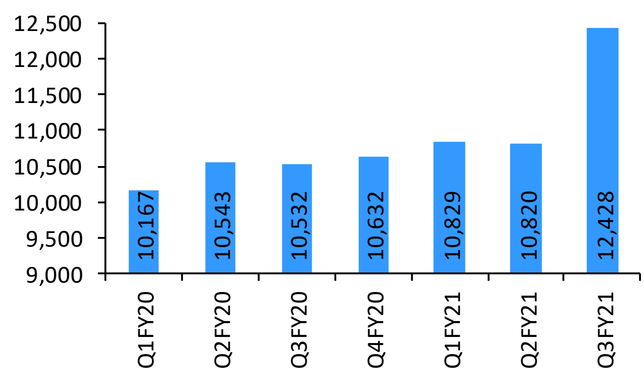
Source: DART, Company

Exhibit 13: OPM recovery continues with 60bps QoQ improvement in EBIT Margin



Source: DART, Companya

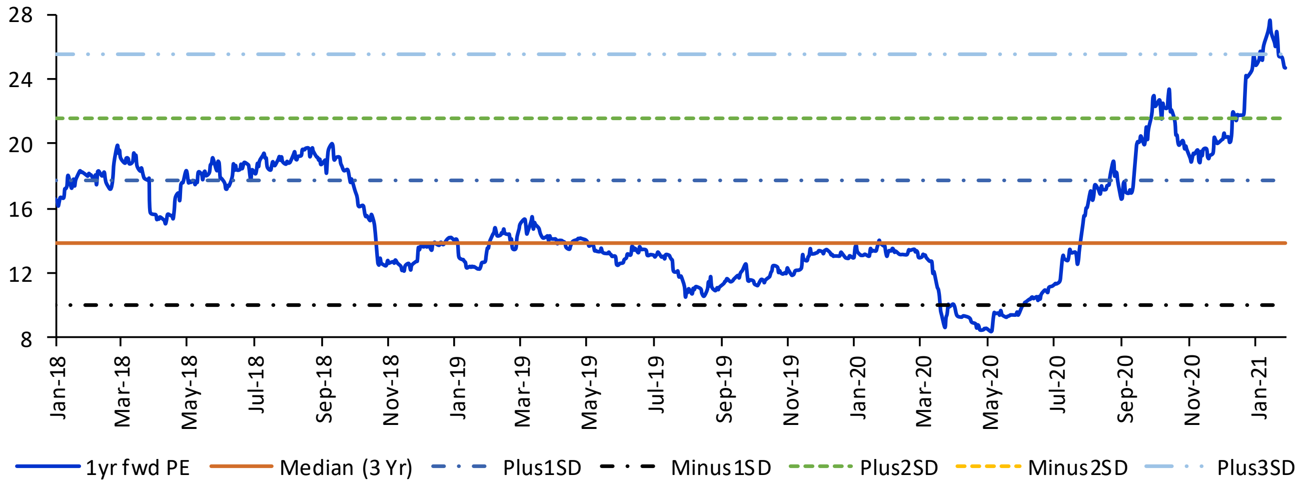
Exhibit 14: Headcount increased in Q3 by 1.4K



Source: DART, Company

PE Band Chart

Exhibit 15: Persistent is trading near Median Plus3SD but is justified given performance turnaround



Source: DART, Company

Profit and Loss Account

(Rs Mn)	FY20A	FY21E	FY22E	FY23E
Revenue	**35,657**	**41,684**	**47,827**	**54,300**
Total Expense	**30,729**	**34,918**	**40,335**	**46,064**
COGS	23,494	27,412	31,609	36,297
Employees Cost	0	0	0	0
Other expenses	7,234	7,506	8,726	9,767
EBIDTA	**4,929**	**6,766**	**7,492**	**8,236**
Depreciation	1,660	1,799	1,890	1,950
EBIT	**3,269**	**4,967**	**5,602**	**6,286**
Interest	0	0	0	0
Other Income	1,254	915	1,134	1,206
Exc. / E.O. items	0	0	0	0
EBT	**4,523**	**5,882**	**6,736**	**7,492**
Tax	1,121	1,534	1,718	1,911
RPAT	3,402	4,348	5,018	5,582
Minority Interest	0	0	0	0
Profit/Loss share of associates	**0**	**0**	**0**	**0**
APAT	**3,402**	**4,348**	**5,018**	**5,582**

Balance Sheet

(Rs Mn)	FY20A	FY21E	FY22E	FY23E
Sources of Funds				
Equity Capital	764	764	764	764
Minority Interest	0	0	0	0
Reserves & Surplus	23,093	26,152	30,065	34,542
Net Worth	**23,858**	**26,916**	**30,830**	**35,306**
Total Debt	46	80	114	148
Net Deferred Tax Liability	(960)	(960)	(960)	(960)
Total Capital Employed	**22,944**	**26,037**	**29,984**	**34,494**
Applications of Funds				
Net Block	**4,452**	**4,742**	**4,941**	**5,080**
CWIP	166	166	166	166
Investments	4,621	4,621	4,621	4,621
Current Assets, Loans & Advances	**20,722**	**24,427**	**29,038**	**34,373**
Inventories	0	0	0	0
Receivables	5,922	6,852	7,862	8,926
Cash and Bank Balances	4,572	6,962	9,890	13,451
Loans and Advances	190	190	190	190
Other Current Assets	4,873	5,258	5,932	6,641
Less: Current Liabilities & Provisions	**7,018**	**7,920**	**8,782**	**9,746**
Payables	2,247	2,629	3,031	3,481
Other Current Liabilities	4,771	5,291	5,751	6,265
sub total				
Net Current Assets	13,704	16,507	20,256	24,627
Total Assets	**22,944**	**26,037**	**29,984**	**34,494**

E – Estimates

Important Ratios

Particulars	FY20A	FY21E	FY22E	FY23E
(A) Margins (%)				
Gross Profit Margin	34.1	34.2	33.9	33.2
EBIDTA Margin	13.8	16.2	15.7	15.2
EBIT Margin	9.2	11.9	11.7	11.6
Tax rate	24.8	26.1	25.5	25.5
Net Profit Margin	9.5	10.4	10.5	10.3
(B) As Percentage of Net Sales (%)				
COGS	65.9	65.8	66.1	66.8
Employee	0.0	0.0	0.0	0.0
Other	20.3	18.0	18.2	18.0
(C) Measure of Financial Status				
Gross Debt / Equity	0.0	0.0	0.0	0.0
Interest Coverage				
Inventory days	0	0	0	0
Debtors days	61	60	60	60
Average Cost of Debt	0.0	0.0	0.0	0.0
Payable days	23	23	23	23
Working Capital days	140	145	155	166
FA T/O	8.0	8.8	9.7	10.7
(D) Measures of Investment				
AEPS (Rs)	44.5	56.9	65.7	73.0
CEPS (Rs)	66.2	80.4	90.4	98.5
DPS (Rs)	14.5	16.9	14.5	14.5
Dividend Payout (%)	32.5	29.7	22.0	19.8
BVPS (Rs)	312.2	352.2	403.4	462.0
RoANW (%)	14.4	17.1	17.4	16.9
RoACE (%)	14.8	17.8	17.9	17.3
RoAIC (%)	18.8	26.5	28.6	30.6
(E) Valuation Ratios				
CMP (Rs)	1524	1524	1524	1524
P/E	34.2	26.8	23.2	20.9
Mcap (Rs Mn)	1,16,491	1,16,491	1,16,491	1,16,491
MCap/ Sales	3.3	2.8	2.4	2.1
EV	1,06,800	1,04,444	1,01,550	98,023
EV/Sales	3.0	2.5	2.1	1.8
EV/EBITDA	21.7	15.4	13.6	11.9
P/BV	4.9	4.3	3.8	3.3
Dividend Yield (%)	0.9	1.1	0.9	0.9
(F) Growth Rate (%)				
Revenue	5.9	16.9	14.7	13.5
EBITDA	(15.2)	37.3	10.7	9.9
EBIT	(22.9)	51.9	12.8	12.2
PBT	(7.1)	30.0	14.5	11.2
APAT	(3.4)	27.8	15.4	11.2
EPS	1.1	27.8	15.4	11.2

Cash Flow

(Rs Mn)	FY20A	FY21E	FY22E	FY23E
CFO	3,228	4,819	4,954	5,515
CFI	(148)	(1,174)	(955)	(883)
CFF	(2,966)	(1,255)	(1,071)	(1,071)
FCFF	2,482	2,730	2,865	3,426
Opening Cash	1,742	1,855	4,245	7,173
Closing Cash	1,855	4,245	7,173	10,735

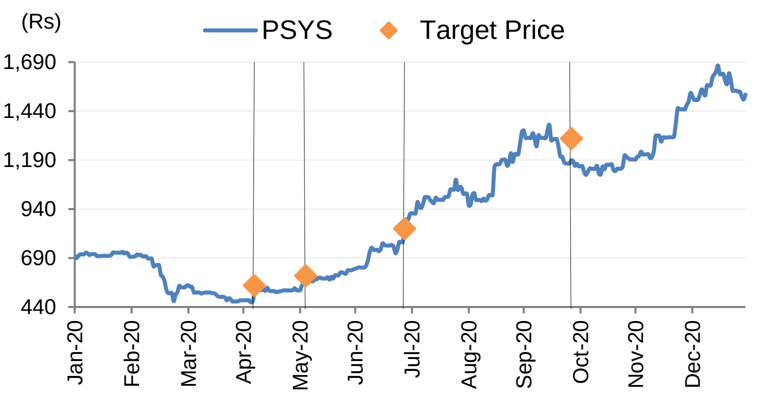
E – Estimates

DART RATING MATRIX

Total Return Expectation (12 Months)

Buy	**> 20%**
Accumulate	**10 to 20%**
Reduce	**0 to 10%**
Sell	**< 0%**

Rating and Target Price History



Month	Rating	TP (Rs.)	Price (Rs.)
May-20	Accumulate	550	505
Jun-20	Accumulate	600	560
Jul-20	Reduce	840	856
Oct-20	Accumulate	1,300	1,189

*Price as on recommendation date

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