Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Persistent Systems Ltd

Strong Q4; well placed to capture growth opportunities

IT & ITES	Sharekhan code: PERSISTENT

Reco/View: **Buy**	↔	CMP: **Rs. 4,311**	Price Target: **Rs. 5,550**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Persistent Systems beat estimates; Q4 witnessed strong deal TCVs, robust net headcount additions, and strong client mining; ACV remained strong at $943.1 million in FY2022.
- Revenue growth would be supported by broad-based demand, robust deal intake, client mining, and incremental revenue from acquisitions. PSL is well positioned to once again deliver market-leading growth in FY2023.
- Management remains confident of delivering sustainable margin in FY2023 on strong revenue growth, flattening pyramid, and gradual increase in realisation.
- We retain Buy with a PT of Rs. 5,550, given strong revenue growth potential, robust ACV, and building growth avenues via tuck-in acquisitions.

Persistent Systems Limited (PSL) delivered yet another quarter of outstanding all-round growth, beating our estimates on all fronts. USD revenue grew by 9.1% q-o-q (up 42.2% y-o-y) to $217.3 million, led by continued strong 14.6% q-o-q (up 52.3% y-o-y) growth in IT services. Strong revenue growth in IT services was also led by broad-based growth across verticals and $4.7 million revenue contribution from acquisitions. Q4FY2022 witnessed strong deal TCV, robust net headcount additions, and strong client mining. Over the past four quarters, total deal TCV stood at $1,222.6 million, with implied book-to-bill of 1.6x. Similarly, total ACV remained at $943.1 million versus total revenue of $765.6 million in FY2022. EBITDA margin improved by 34 bps q-o-q to 17.2% despite supply-side challenges and higher cost relating to acquisitions (+30 bps), which was fully absorbed by strong revenue growth, lower subcontractor expenses as a percentage of revenue, recovery of old receivables, and currency tailwinds. With the recent acquisitions, the company could strengthen its capabilities and offerings in emerging technology areas (including Cloud) and accelerate clients' digital transformation journey.

Key positives

- Strong order bookings; Deal ACV grew 30% y-o-y
- Revenue grew at 9%+ sequentially over the past four successive quarters
- Onsite billing rate increased on sequentially, led by strong growth in Europe and higher billing days.

Key negatives

- BFSI vertical's EBIT margin declined by 900 bps.
- OCF to EBITDA declined to 62% due to annual insurance premium and delayed collection payments.

Management Commentary

- Management aims to reach $1 billion annual revenue run rate over the next 4-6 quarters
- Restructuring of its large IP contract had $4 million impact on revenue
- Management remains confident of delivering 10-15% revenue growth in its IP-led revenue
- The company has strong capability in shifting workload to Cloud along with development of industry Cloud.

Revision in estimates – We have tweaked our earnings estimates for FY2023E/FY2024E, factoring in Q4FY2022 results, healthy deal wins, and strong demand outlook.

Our Call

Valuation – Strong growth outlook: We believe PSL is well positioned to deliver market-leading growth in FY2023, given its strong capabilities in the digital engineering space, healthy relationships with hyperscalers, and strong focus on fast-growing verticals. Margin is expected to remain stable in FY2023. At the CMP, the stock trades at a valuation of 38x/31x its FY2023E/FY2024E earnings estimates, justifying the strong revenue growth potential, robust deal wins, and higher return ratios. We expect USD revenue/earnings to report a CAGR of 23%/25% over FY2022-FY2024E. Given healthy cash flow generation and strong balance sheet, we retain our Buy rating on the stock with an unchanged price target (PT) of Rs. 5,550.

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.

3R MATRIX

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

\+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

ESG Disclosure Score NEW

ESG RISK RATING 20.80

Updated Apr 08, 2022

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

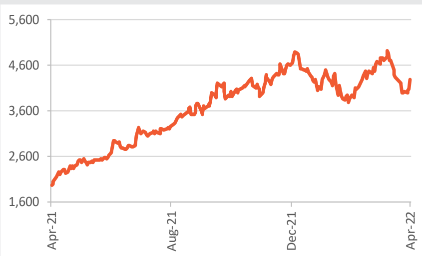
Company details

Market cap:	Rs. 32,949 cr
52-week high/low:	Rs. 4,986 / 1926
NSE volume: (No of shares)	3.1 lakh
BSE code:	533179
NSE code:	PERSISTENT
Free float: (No of shares)	5.3 cr

Shareholding (%)

Promoters	31.3
FII	21.5
DII	27.6
Others	19.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-9.6	5.7	6.6	119.5
Relative to Sensex	-8.9	5.2	12.4	103.7

Sharekhan Research, Bloomberg

Valuation

Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Revenue	5,710.7	7,438.8	8,950.5	10,364.3
OPM (%)	16.8	17.0	17.8	18.0
Adjusted PAT	690.4	858.8	1,073.3	1,238.5
% YoY growth	*53.2*	*24.4*	*25.0*	*15.4*
Adjusted EPS (Rs.)	90.3	112.4	140.4	162.1
P/E (x)	47.7	38.4	30.7	26.6
P/B (x)	9.8	8.5	7.2	6.2
EV/EBITDA (x)	35.7	26.5	20.4	17.0
RoNW (%)	22.4	23.7	25.4	25.1
RoCE (%)	26.0	26.1	28.8	29.1

Source: Company; Sharekhan estimates

A strong exit

USD revenue grew by 9.1% q-o-q (up 42.2% y-o-y) to $217.3 million, led by continued strong 14.6% q-o-q (up 52.3% y-o-y) growth in IT services (contributes 91.1% to total revenue). Strong revenue growth in IT services was also led by broad-based growth across verticals and $4.7 million revenue contribution from full quarter consolidation of Software Corporation International (SCI) and Shree Partners and one quarter revenue contribution from the acquisition of Data Glove. The company's organic revenue growth stood at 6.8% q-o-q and 36% y-o-y despite $4 million revenue drop in IP business due to restructuring of its large IP contract. EBITDA margin improved by 34 bps q-o-q to 17.2% despite supply-side challenges, higher cost relating to acquisitions (+30 bps), and lower IP-led revenue, exceeding our expectations. Margin headwinds were absorbed by operating leverage from strong revenue growth, lower subcontractor expenses as a percentage of revenue, recovery of old receivables, and currency tailwinds (+30 bps). Depreciation and amortisation expenses were higher due to recent acquisitions. Hence, EBIT margin remained flat sequentially at 14.0%, owing to higher amortisation expenses on account of recent acquisitions. Net profit was up 13.9% q-o-q and 45.9% y-o-y to Rs. 201 crore and was 10% ahead of our estimates, led by both revenue and EBIT margin beat and higher forex gains.

Key conference call highlights

- **Brief round-up of FY2022 performance:** PSL has reported 35.2% y-o-y revenue growth to $765.6 million in FY2022, including incremental revenue from its acquisitions. The company's organic revenue growth stood at 32.8% y-o-y. EBITDA margin improved by 50 bps y-o-y to 16.8% in FY2022 despite supply-side issues and higher ESOPs expenses. Net profit grew by 53.2% y-o-y to Rs. 690.4 crore. The company declared the final dividend of Rs. 11 per share, taking total dividend of Rs. 31 per share in FY2022 versus Rs. 20 per share in FY2021.
- **Revenue outlook:** Management remains confident of achieving its goal of $1 billion revenue run-rate in the next 4-6 quarters, which implies a CQGR of 2.4% to 3.6%. Growth would be supported by broad-based demand across verticals, robust deal intake, new logo additions, and incremental revenue from the acquired entities. Strong net headcount additions over the past four quarters indicate robust underlying demand. We believe the company is well poised to capture a fair share of strength in demand, given its strong capabilities in digital engineering capability and inorganic investment in new-age technology areas. We expect the company is likely to report 27% y-o-y revenue growth in FY2023E.
- **Expect sustainable margin in FY2023E:** Slightly higher wage hike owing to inflationary environment, rising ESOP expenses, lower IP-led revenue, and return of savings on travel and facility expenses are expected to weigh on margins in FY2023. However, management remains confident of delivering sustainable margin because of strong revenue growth, flattening pyramid, moderation in attrition rate due to significant fresher hiring and gradual increase in realisation. Further, management indicated that amortisation expenses would have an impact of 70-80 bps on EBIT margin in FY2023. We expect the company to report EBIT margin of 14% in FY2023 versus 13.9% in FY2022.
- **Strong order intake provides revenue visibility:** The company has won deals across its verticals and total order booking stood at $361 million for Q4FY2022, up 8% q-o-q. This translates into book-to-bill of 1.7x, same as the previous quarter. Total deal ACV declined by 10.1% q-o-q to $261.9 million. New business deal TCV grew by 23.8% q-o-q to $195.1 million. Of this, new business deal ACV grew slightly by 1.9% q-o-q to $131 million. Over the past four quarters, total deal TCV stood at $1,222.6 million, with implied book-to-bill of 1.6x. Total ACV remained at $943.1 million versus total revenue of $765.6 million in FY2022.
- **Strong momentum in IT services continued:** IT services revenue growth accelerated to 52.3% y-o-y in Q4FY2022 from 44.3% y-o-y in Q3FY2022, led by strong growth across verticals and inorganic revenue contribution from recent acquisitions (full quarter consolidation of SCI and Shree Partners and one quarter revenue contribution from the acquisition of Data Glove). Offshore linear revenue increased by 11.5% q-o-q, led by 9.8% q-o-q growth in volume and 1.5% q-o-q growth in billing rates led by higher billing days. Onsite linear revenue grew by 20.1% q-o-q, led by 17.7% q-o-q growth in volume and 2.1% q-o-q growth in billing rates mainly due to strong revenue in Europe.
- **Increased onsite billing rate:** Increased onsite billing rate was due to higher revenue from Europe, which has higher billing rate. Further, Q4 has higher billing days on a sequential basis.

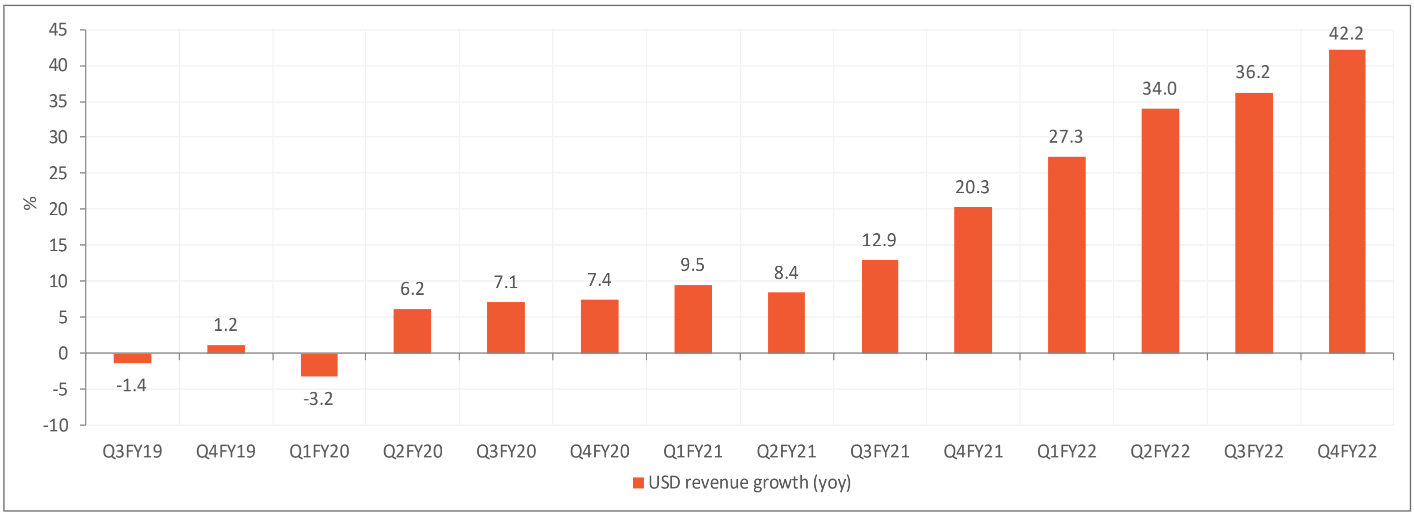
- **Robust growth across verticals:** The BFSI vertical grew strongly by 9.8% q-o-q and 53.1% y-o-y, given its strong execution and incremental revenue contribution from the acquisition. The software, hi-tech, and emerging industries vertical grew by 8.7% q-o-q and 31.8% y-o-y, led by inorganic revenue contribution from Data Glove's acquisition. Both BFSI and hi-tech included some inorganic revenue growth; the inorganic growth in hi-tech was from Data Glove. Revenue of the healthcare and life sciences vertical grew to 9.1% q-o-q and 52.5% y-o-y.
- **Broad-based growth across geographies:** All geographies performed well in Q4FY2022. Growth of Europe business accelerated to 10.5% q-o-q in Q4FY2022 compared to 3.0% in Q3FY2022, while business growth in North America was 8.3% q-o-q. India business reported strong revenue growth of 10.1% q-o-q. Rest of world (RoW) business reported revenue growth of 36.4% q-o-q and 49.7% y-o-y in Q4FY2022.
- **Restructuring of IP contract to optimise margins:** The company restructured one of its long-standing IP contracts and converted to a time and material contract, which would help in improving margin. This current IP contract has depressed margins. Though the restructuring of the contract impacted overall revenue by $4 million q-o-q, management highlighted that gross profit margin of this contract would improve the company's average gross margin levels. Post restructuring of its largest IP-contracts, revenue of that IP reduced to 30-35% of its initial contract value. However, management remains confident of delivering 10-15% revenue growth of its total IP-led revenue.
- **Softness in top account due to restructuring of IP contract:** Revenue from the top client fell 12.7% q-o-q versus growth of 13.1% q-o-q in Q3FY2022. Revenue from the top-5 clients fell by 1.7% q-o-q, while revenue from the top-10 clients grew by 2.1% q-o-q. Revenue from the top 2-5 clients continues to increase, up 9.1% q-o-q. Revenue share of the top customer declined to 14% in Q4FY2022 from 17.5% in Q3FY2022.
- **Strong client addition continued:** Q4FY2022 saw significant improvement in the involvement with customers. The number of clients under the $5 million+ category increased by eight on a y-o-y basis (one on a q-o-q basis) to 25. Further, the number of clients under $1 million+ bucket increased by 27 y-o-y (3 on a q-o-q basis) to 93.
- **Lower utilisation, higher offshoring, and stable attrition rate:** Utilisation during the quarter declined by 240 bps q-o-q to 80.6% in Q4FY2022. Offshoring revenue mix increased to 56.6% in Q4FY2022 versus 55.3% in Q3FY2022. Attrition rate reduced slightly to 26.6% in Q4FY2022 compared to 26.9% in Q3FY2022 despite continued strong demand and shortage of digital skills. Management believes attrition rate will moderate in the second half of FY2023 due to increased hiring of freshers.
- **Decline in sub-contract costs to revenue:** Subcontractor expenses remained at 13.1% of revenue versus 13.6% in Q3FY2022. Management believes subcontractor expenses would further reduce once travel restrictions ease out.
- **Strong net headcount addition:** Headcount increased by 1,610 employees q-o-q versus net addition of 1,110/1,242 employees in Q3FY2022/Q4FY2021. This includes 700 employees from the acquisition of Data Glove. Net employee addition is 9.5% of total headcount in Q3FY2022. The company added around 338 freshers during the quarter.
- **Strong cash position; DSO increased:** The company had cash and cash equivalents of Rs. 1,737 crore as of March 31, 2022, versus Rs. 1,896 crore as of December 31, 2021. DSO days increased by one day to 59 days due to more holidays last quarter. OCF to EBITDA ratio declined to 62% due to preponement of annual insurance premium payments worth Rs. 34 crore and delayed collection payments of Rs. 35 crore (which spilled over to Q1FY2023). Adjusted OCF to EBITDA stood at 87% and 97% for Q4FY2022 and FY2022, respectively.
- **Commentary on the recent merger and acquisition:** During Q4FY2022, the company completed acquisitions of Data Glove. This acquisition along with Shree Partners (consolidated from mid-November) contributed around $4.7 million incremental revenue to PSL's revenue during the quarter.
- **Higher dividend per share:** The board of directors declared a final dividend of Rs. 11 per share versus an interim dividend of Rs. 20 per share, taking the full-year dividend to Rs. 31 per share versus Rs. 20 per share in FY2021.

Results (Consolidated) Rs cr

Particulars	Q4FY22	Q4FY21	Q3FY22	Y-o-Y (%)	Q-o-Q (%)
Revenue ($ mn)	**217.3**	**152.8**	**199.1**	**42.2**	**9.1**
Net sales	**1,637.9**	**1,113.4**	**1,491.7**	**47.1**	**9.8**
Direct costs	1,085.9	736.3	988.0	47.5	9.9
SG&A	270.7	188.7	252.6	43.5	7.2
EBITDA	**281.2**	**188.3**	**251.1**	**49.3**	**12.0**
Depreciation and amortisation	51.1	41.9	42.8	22.0	19.5
EBIT	**230.0**	**146.4**	**208.3**	**57.1**	**10.4**
Forex gain/(loss)	12.0	17.4	3.0	-30.9	302.0
Other income	25.1	21.1	25.1	19.2	0.0
PBT	**267.2**	**184.9**	**236.4**	**44.5**	**13.0**
Tax provision	66.2	47.1	60.0	40.5	10.3
Net profit	**201.0**	**137.8**	**176.4**	**45.9**	**13.9**
EPS (Rs.)	26.3	18.0	23.1	45.9	14.0
Margin (%)				**BPS**	**BPS**
EBITDA	17.2	16.9	16.8	25	34
EBIT	14.0	13.2	14.0	89	8
NPM	12.3	12.4	11.8	-10	45
Tax rate	24.8	25.5	25.4	-71	-61

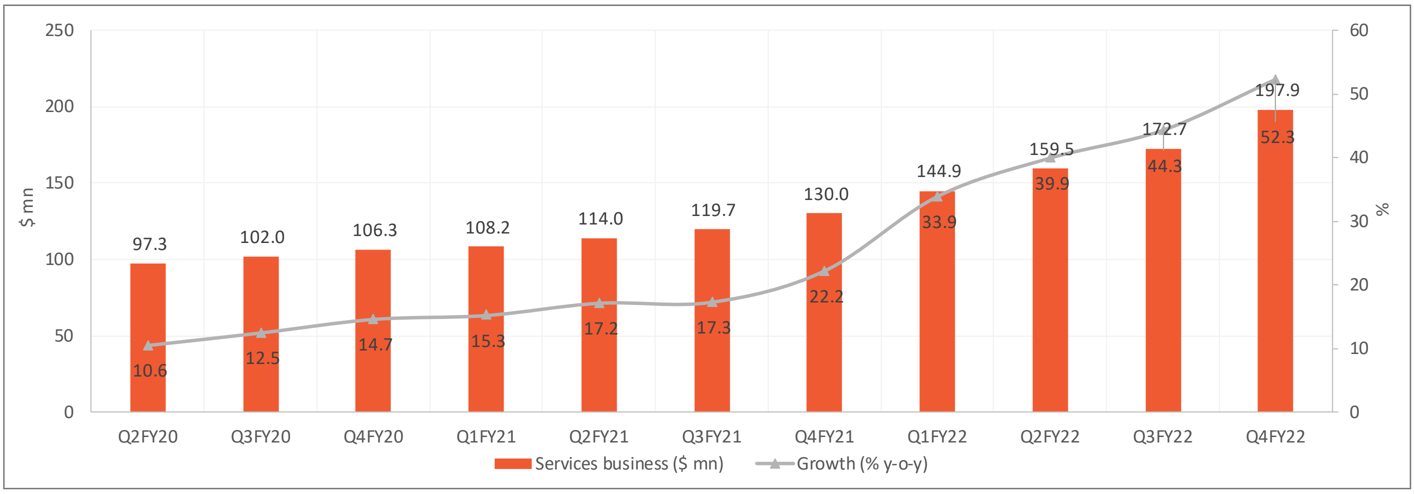
Source: Company, Sharekhan Research

USD revenue growth trend (y-o-y)



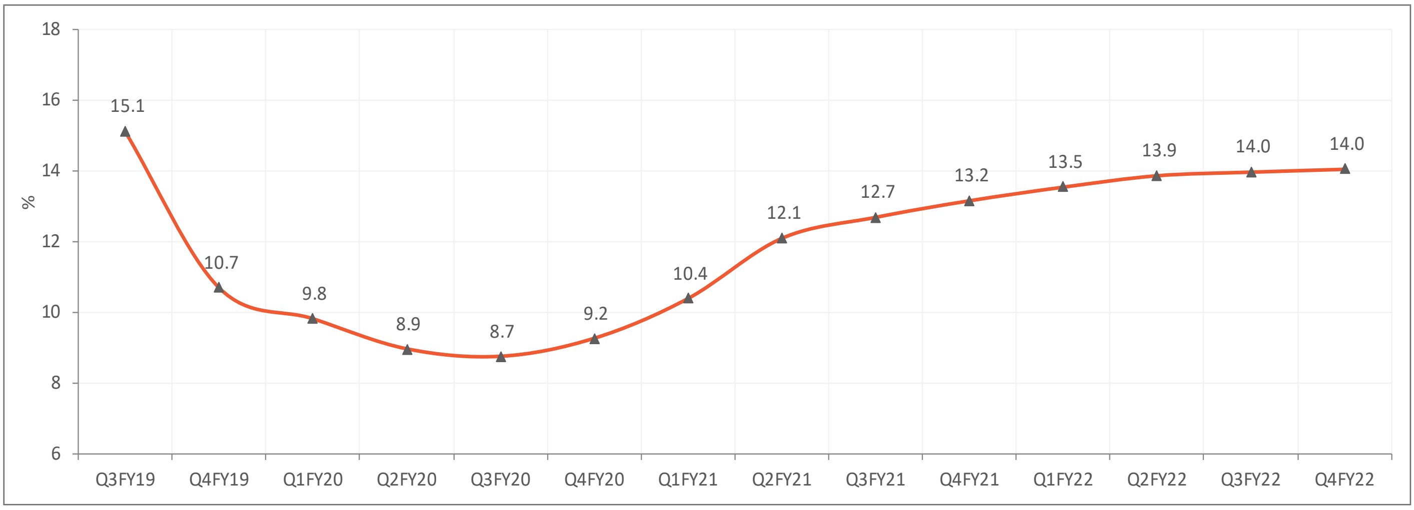
Source: Sharekhan Research

Service business growth momentum remains strong



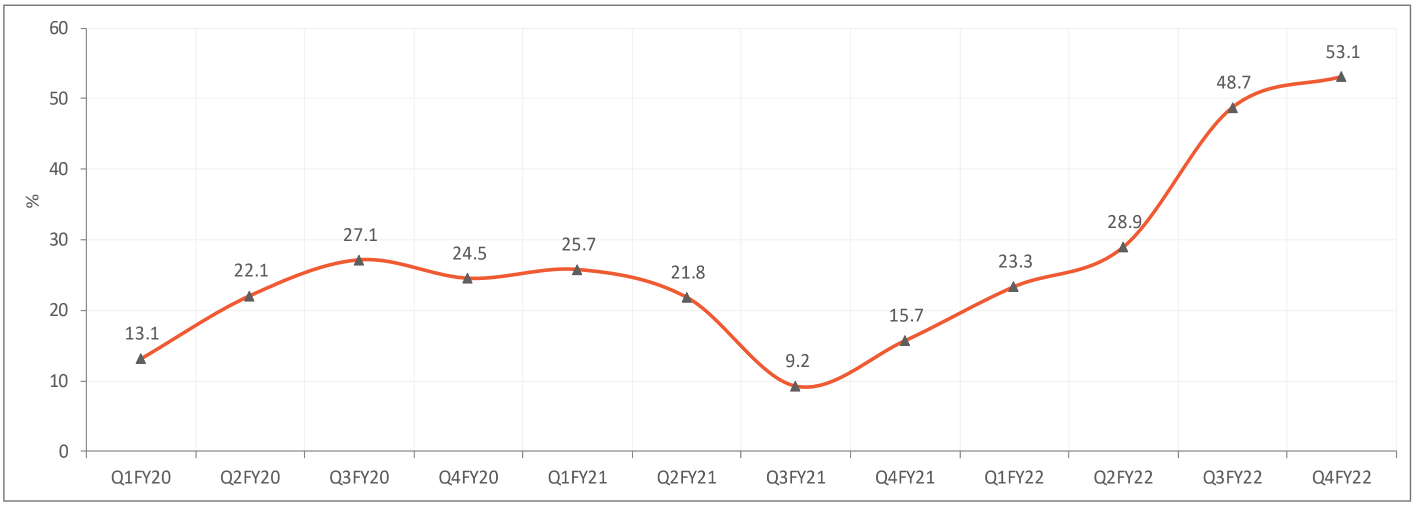
Source: Sharekhan Research

EBIT margin (%) trend



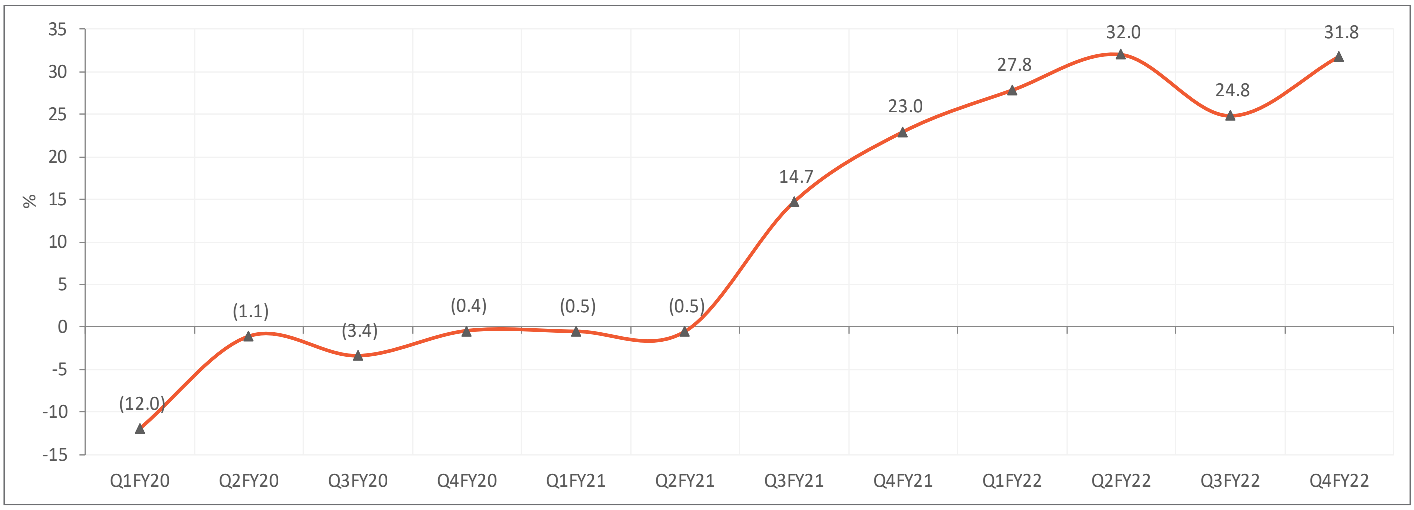
Source: Sharekhan Research

BFSI revenue growth trend



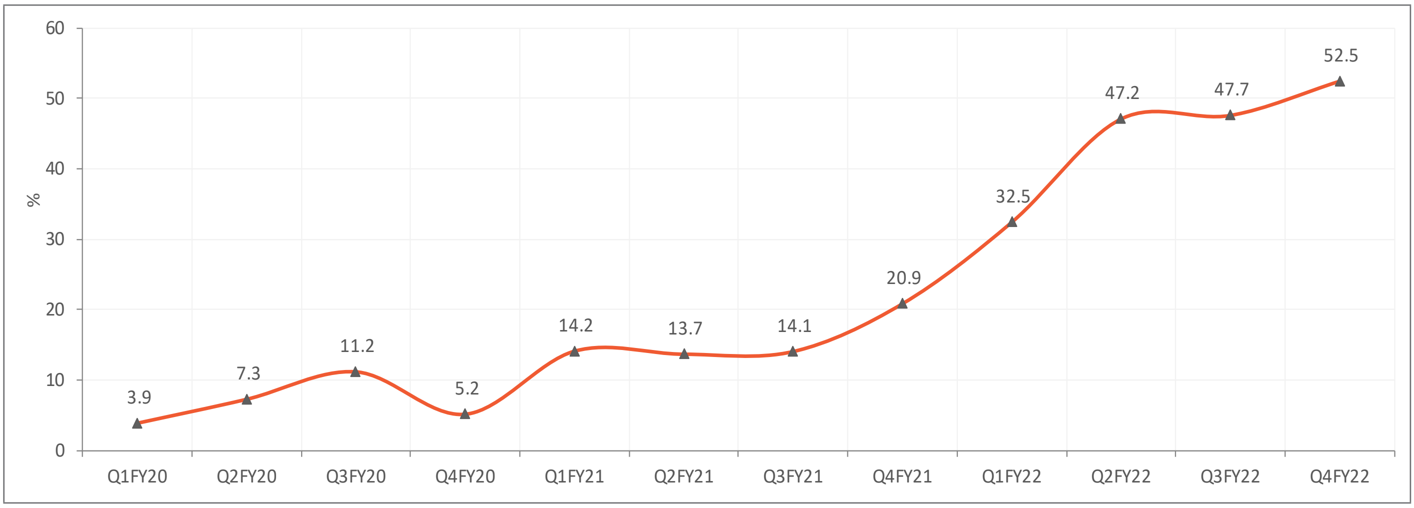
Source: Sharekhan Research

Software & hi-tech revenue growth trend (y-o-y)



Source: Sharekhan Research

Healthcare & life sciences revenue growth trend (y-o-y)



Source: Sharekhan Research

Outlook and Valuation

■ Sector view - Expect acceleration in technology spending going forward

We believe the need for business continuity, operational resilience, and the switch to digital transactions have led to strong demand for IT services post the pandemic. Industry analysts such as Gartner estimate that IT services spending would grow by 8-8.5% in the next four years as compared to the average of 4.3% achieved over 2016-2020. Forecasts indicate higher demand for cloud infrastructure services, a potential increase in specialised software, potential investments in transformation projects by clients, and increased online adoption across verticals.

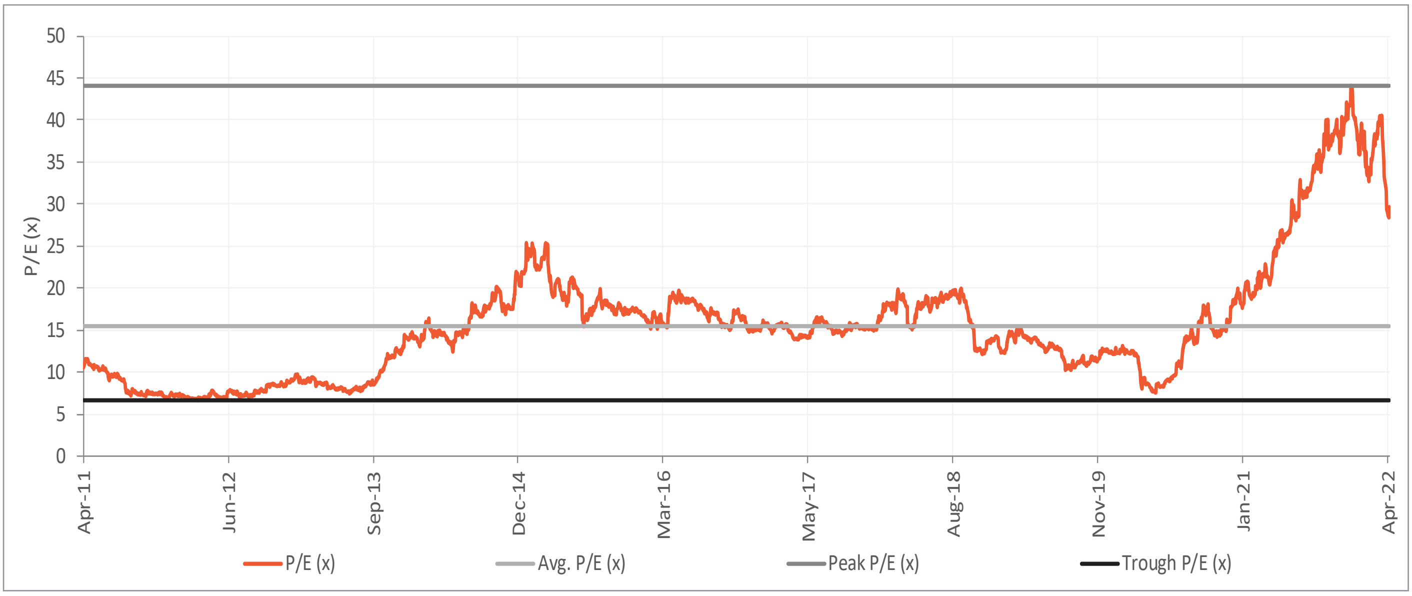
■ Company outlook - Well positioned to capture immense growth opportunity

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 remains optimistic to deliver industry-leading revenue growth in FY2023 on account of broad-based demand across verticals, robust deal intake, new logo additions, and incremental revenue from the acquired entities. We believe 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 the most of the opportunity.

■ Valuation - Strong growth outlook

We believe PSL is well positioned to deliver market-leading growth in FY2023, given its strong capabilities in the digital engineering space, healthy relationships with hyperscalers, and strong focus on fast-growing verticals. Margin is expected to remain stable in FY2023. At the CMP, the stock trades at a valuation of 38x/31x its FY2023E/FY2024E earnings estimates, justifying the strong revenue growth potential, robust deal wins, and higher return ratios. We expect USD revenue/earnings to report a CAGR of 23%/25% over FY2022-FY2024E. Given healthy cash flow generation and strong balance sheet, we retain our Buy rating on the stock with an unchanged price target (PT) of Rs. 5,550.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Companies	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
				FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Mastek	2,838	3	8,519	24.7	20.3	13.6	10.7	6.6	5.3	29.5	29.0
L&T Infotech	4,884	18	85,624	30.7	26.2	23.3	18.7	9.0	7.0	31.7	37.2
Persistent Systems	4,311	8	32,949	38.4	30.7	26.5	20.4	8.5	7.2	23.7	25.4

Source: Company, Sharekhan Research

About company

Incorporated in 1990, PSL is a global software company specialising in product and technology services. 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. PSL has been focusing on product development, establishing processes to build distributed agile teams, and partnering with the world's leading product companies to build software contributing across the entire product lifecycle. The company derives revenue from North America, Europe, and RoW.

Investment theme

Large corporates have been allocating higher budgets towards digital transformation initiatives and IT spends are moving from ISV to the enterprise model. PSL has restructured its business and aligned its sales resources to capitalise the benefits from 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 the current VISA regime; 3) delay in product launches; 4) stronger Indian Rupee and/or adverse cross-currency movements; 5) margin dilution from M&A activity; and 6) high client concentration 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)
Mark Simpson	President, IBM Alliance

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Kotak Mahindra Asset Management Company Limited	4.82
2	HDFC Asset Management Company Limited	4.39
3	Axis Asset Management Company Limited	2.60
4	Vanguard Group	1.99
5	Nippon Life India Asset Management	1.86
6	Dimensional Fund Advisors	1.44
7	L&T Mutual Fund Trustee Limited	1.39
8	PGIM India Asset Management	1.11
9	ICICI Prudential Asset Management	1.04
10	BlockRock Inc.	1.00

Source: Bloomberg

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 detoriating 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

Sharekhan

by BNP PARIBAS

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