Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

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 Updated Jul 08, 2022	20.80

Medium Risk

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

Source: Morningstar

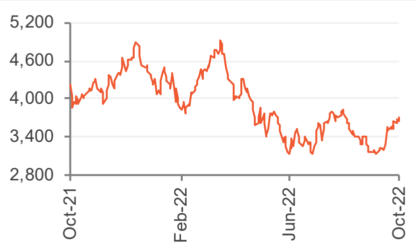
Company details

Market cap:	Rs. 28,333 cr
52-week high/low:	Rs. 4,986 / 3,092
NSE volume: (No of shares)	3.3 lakh
BSE code:	533179
NSE code:	PERSISTENT
Free float: (No of shares)	5.3 cr

Shareholding (%)

Promoters	31.3
FII	20.5
DII	25.9
Others	22.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	16.5	4.0	(7.1)	(12.2)
Relative to Sensex	17.4	(2.3)	(10.9)	(8.9)

Sharekhan Research, Bloomberg

Persistent Systems Ltd

Strong Q2; Maintain Buy

IT & ITES	Sharekhan code: PERSISTENT		
Reco/View: Buy ↔	CMP: Rs. 3,707	Price Target: Rs. 4,300 ↔	

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Persistent Systems Limited (PSL) reported strong revenue for Q2FY23 led by strong IP led and Services revenues. Revenue in constant currency terms grew 6.6% on q-o-q basis against our estimate of 5.8%, EBIT Margin at 14.6 % for Q2FY23 reported an uptick of 27 bps over Q1FY23 as supply side pressure eased, attrition moderated supported by favourable currency tailwind despite impact of wage hike in July.
- Despite macro-overhang the management indicated that demand is robust, and it does not see any delay in decision making process on deals. Utilization rates at 79.9% for Q2FY23 improved by 40 bps compared to Q1FY23.
- Key verticals and geographies have continued to grow in Q2FY23, but some moderation in growth was visible as compared to Q1FY23. The management cited that clarity on impact of furloughs would be known only in mid-November.
- We retain a Buy on PSL with an unchanged PT of Rs. 4,300, given strong bookings, sustained acceleration in deal TCVs, strong execution capabilities and new growth avenues from recent acquisitions.

Persistent Systems Limited (PSL) reported revenue of $255.6 million in Q2FY23, up 5.8% on q-o-q and up 40.2% y-o-y. Revenue in constant currency terms grew 6.6% on q-o-q basis led strong growth in the IP-led and Services business. While the revenue numbers were in-line with our estimates the beat came on the EBIT margin front which improved by 27Bps q-o-q (exceeded estimates by 86 bps) as annual wage hike taken in July was offset by higher IP led and Services revenues and favourable currency tailwinds. The company recorded low other income on account of lower treasury income, MTM loss on hedges. The Management indicated that despite the war getting prolonged, demand continues to remain robust and did not see any material delay in decision making process on deals or project cancellation. Management indicated that some softness in Europe in Q2FY23 was led by vacations and that the clarity on the impact of furloughs would be known by mid-November. Growth in the medium-term would be supported by healthy bookings, revenue synergies in the acquired business, new logo additions and rising cost optimisation and transformation opportunities.

Key positives

- IP led revenues mix at 7.8% grew 18.1% in Q2FY23 on q-o-q basis while offshore revenue mix grew at 57.4% grew 7.5% on q-o-q basis
- LTM Attrition rate in Q2FY23 fell sharply by 110 bps to 23.7% on a q-o-q basis.
- Onsite and Offshore Utilization rates at 85.4%/79% improved by 80 bps and 30 bps respectively on q-o-q basis

Key negatives

- Net headcount addition of 838 employees q-o-q compared to 3039 employees in Q1FY23
- Book to Bill ratio of 1.4 is at lowest ever since company started reporting the metric in Q3FY21.

Management Commentary

- Management tried to allay fears on low Book to Bill, citing not to read too much into the numbers as deal TCVs and ACVs continue to remain healthy.
- Management indicated that softness in Europe was on account of vacations
- Management indicated that large deal TCV of $368 million included a large deal TCV of $80 million to be executed over five years.

Revision in estimates – We have fine-tuned our estimates for FY23/24/25 owing to macro-overhang and INR-USD reset.

Our Call

Valuation – Strong Q2, Maintain Buy: We expect margin headwinds to moderate and be offset by higher utilization, reduction in subcontracting costs and currency tailwinds. Given strong bookings, sustained acceleration in deal TCVs, strong execution capabilities PSL is likely to continue to deliver decent performance in the quarters ahead. We retain Buy on PSL with an unchanged PT of Rs. 4,300.

Key Risks

Rupee appreciation and/or adverse cross-currency movements and/or constraint in local talent supply in the US would affect earnings. Further, macro headwinds and possible recession in the US are likely to moderate the pace of technology spends.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Revenue	5,710.7	8,306.9	9,877.5	11,549.5
OPM (%)	16.8	17.5	17.3	17.4
Adjusted PAT	690.4	899.3	1,094.7	1,283.6
% YoY growth	*53.2*	*30.3*	*21.7*	*17.3*
Adjusted EPS (Rs.)	90.3	117.7	143.2	168.0
P/E (x)	40.2	30.9	25.4	21.6
P/B (x)	8.2	7.1	6.1	5.2
EV/EBITDA (x)	30.0	19.2	15.8	12.9
RoNW (%)	22.4	24.7	25.7	25.8
RoCE (%)	26.0	27.1	29.2	29.9

Source: Company; Sharekhan estimates

Key Results Highlights

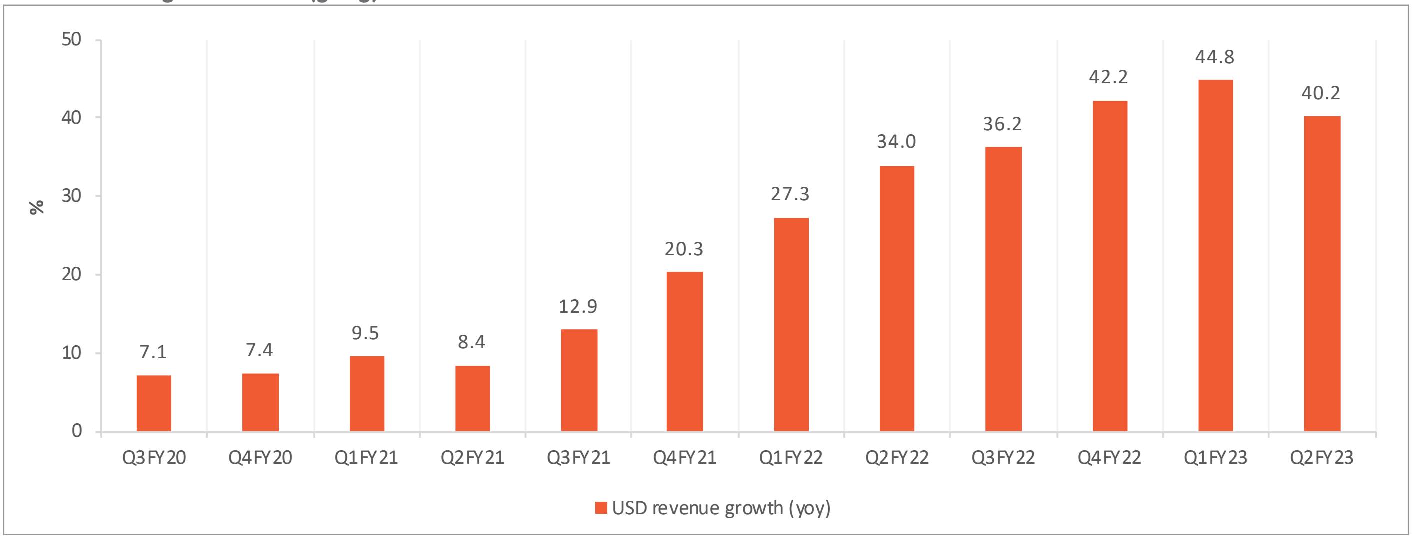
- **Strong order intake provides growth visibility:** Total order booking stood at $367.8 million for Q2FY2023, down 7% q-o-q. This translates into book-to-bill of 1.4x. New business deal TCVs moderated falling 1% q-o-q to $228.3 million. Total deal ACV remained improved sequentially by 3% to $271.2 million. New business deal ACVs fell by 2% q-o-q to $137 million. The company's deal TCVs to deal ACVs declined to 1.36x in Q2FY23 from 1.5x in Q1FY23. During Q2FY23, the company won a large deal TCV of $80 million.
- **Growth momentum in Software Hi-tech & emerging industry continues.** The software, hi-tech, and emerging industries vertical grew by 8.3% q-o-q and 38.4% y-o-y, The BFSI vertical grew by 3% q-o-q and 49.8% y-o-y
- **Moderation in growth across geographies:** Moderation in growth was seen in all key geographies Q2FY2023. North America business grew by 6.1% in Q2Y2023 compared to 10.9% growth in Q1FY2023, while business growth in Europe growth moderated to 3.3% q-o-q. India business reported revenue growth of 7.7% q-o-q. Rest of world (RoW) business had a revenue growth of 5.9% q-o-q.
- **Softness in Top Accounts:** Revenue from the top clients fell 21.3% q-o-q. Revenue from the top-5 clients fell by 7.6% q-o-q, while revenue from the top-10 clients fell by 4.6% q-o-q. Revenues from the top 2-5 clients decelerated by 16.6% q-o-q. Revenue from the top-20 clients was constant q-o-q, while revenue from the non-top-20 clients grew by 11.9% q-o-q.
- **Client Addition:** The number of clients under the $20 million+ bucket increased by two in Q2FY23.
- **Higher utilisation, attrition rate moderates:** Utilisation during the quarter improved by 40 bps q-o-q to 79.9% in Q2FY2023. Offshoring revenue mix improved sequentially to 57.4% in Q2FY2023. Attrition rate moderated by 110 bps to 23.7% in Q2FY2023 compared to 24.8% in Q2FY2022
- **Moderation in net headcount addition:** Headcount increased by 838 employees q-o-q versus net addition of 3039/975 employees in Q2FY2023/Q2FY2022. Net employee addition is 3.9% of total headcount in Q4FY2022, indicating some moderation in hiring.
- **Strong cash generation; DSO constant:** The company had cash and cash equivalents of Rs. 1571.9 crore as of June 30, 2022, versus Rs. 1,479.1 crore as of June 31, 2022. DSO days remained constant at 60 days. OCF to EBITDA ratio improved to 103% in Q2F23.

Results (Consolidated) Rs cr

Particulars	Q2FY23	Q2FY22	Q1FY23	YoY (%)	QoQ (%)
Revenues In USD (mn)	**255.6**	**182.3**	**241.5**	**40.2**	**5.8**
Revenues In INR	**2,048.6**	**1,351.2**	**1,878.1**	**51.6**	**9.1**
Direct Costs	1,362.8	898.2	1,243.3	51.7	9.6
SG&A	317.8	228.7	301.5	39.0	5.4
EBITDA	**368.0**	**224.4**	**333.3**	**64.0**	**10.4**
Depreciation & amortization	69.3	37.1	64.5	86.9	7.4
EBIT	**298.7**	**187.3**	**268.8**	**59.4**	**11.1**
Forex gain/(loss)	-9.1	1.0	4.2	-984.0	-318.5
Other Income	6.1	29.3	8.9	-79.2	-31.8
PBT	**295.6**	**217.6**	**281.9**	**35.8**	**4.9**
Tax Provision	75.6	55.9	70.3	35.3	7.6
PAT	**220.0**	**161.8**	**211.6**	**36.0**	**4.0**
Minority interest	0.0	0.0	0.0		
Net profit	**220.0**	**161.8**	**211.6**	**36.0**	**4.0**
Exceptional items (IL&FS)	**0.0**	**0.0**	**0.0**		
Adjusted net profit	**220.0**	**161.8**	**211.6**	**36.0**	**4.0**
EPS (Rs)	28.8	21.2	27.7	36.1	4.0
Margin (%)					
EBITDA	18.0	16.6	17.7	135	22
EBIT	14.6	13.9	14.3	72	27
NPM	10.7	12.0	11.3	-123	-53
Tax rate	25.6	25.7	24.9	-10	64

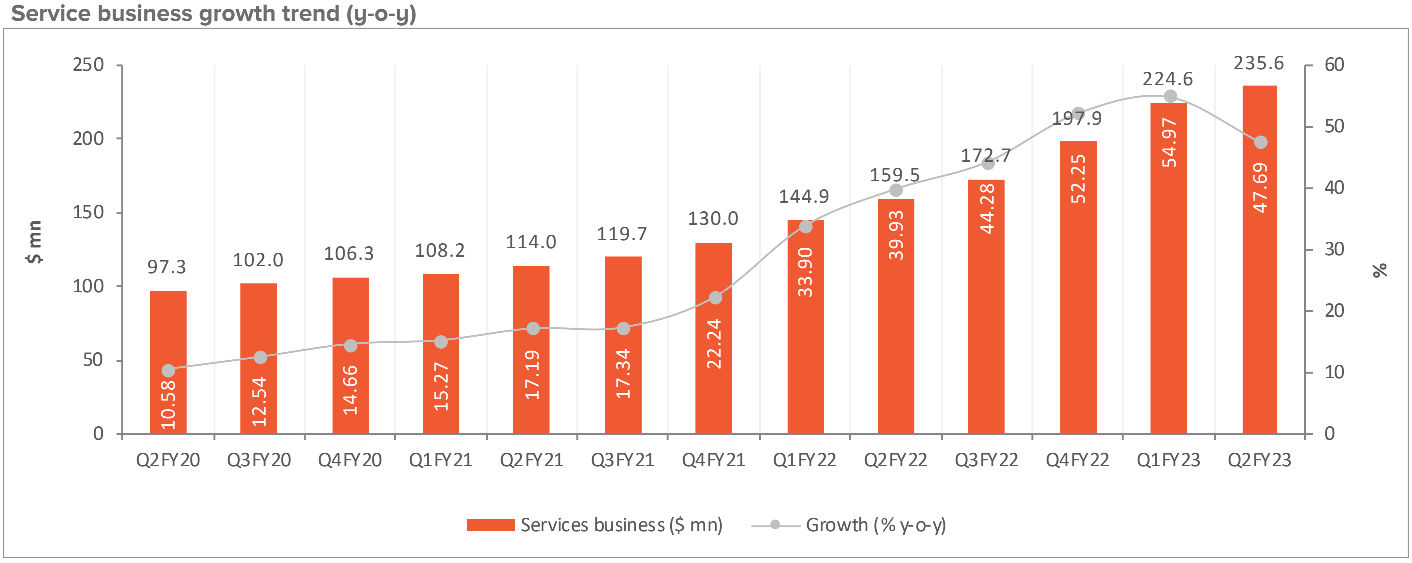
Source: Company; Sharekhan Research

USD revenue growth trend (y-o-y)



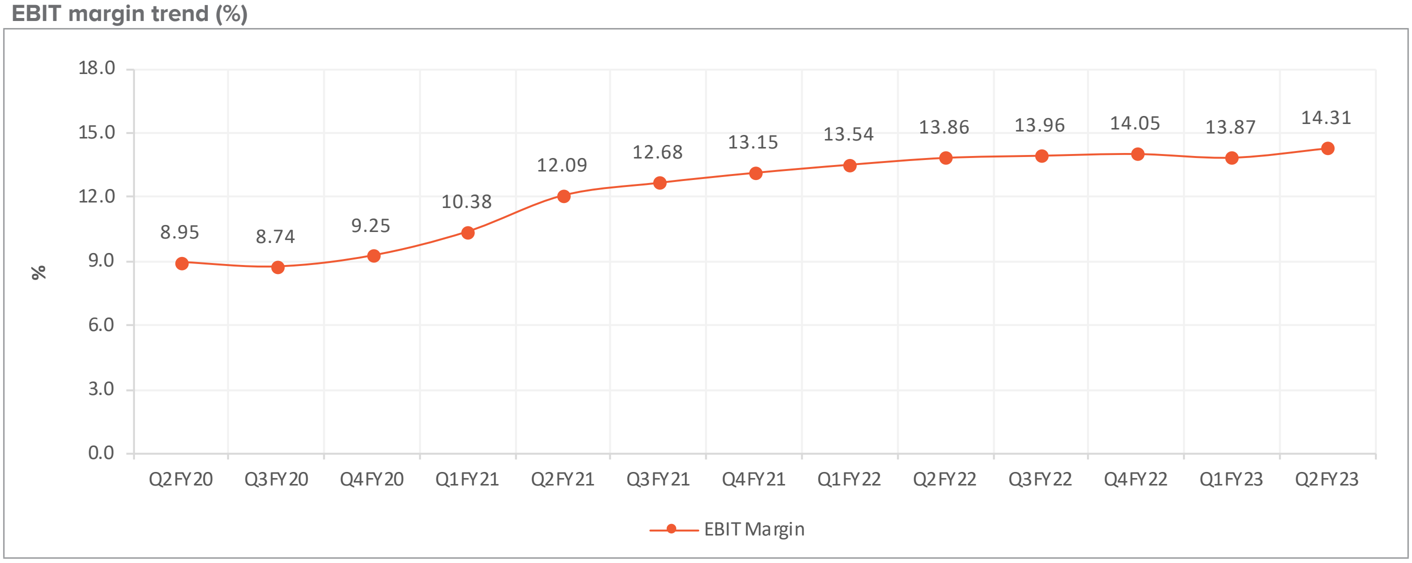
Source: Company; Sharekhan Research

Service business growth trend (y-o-y)



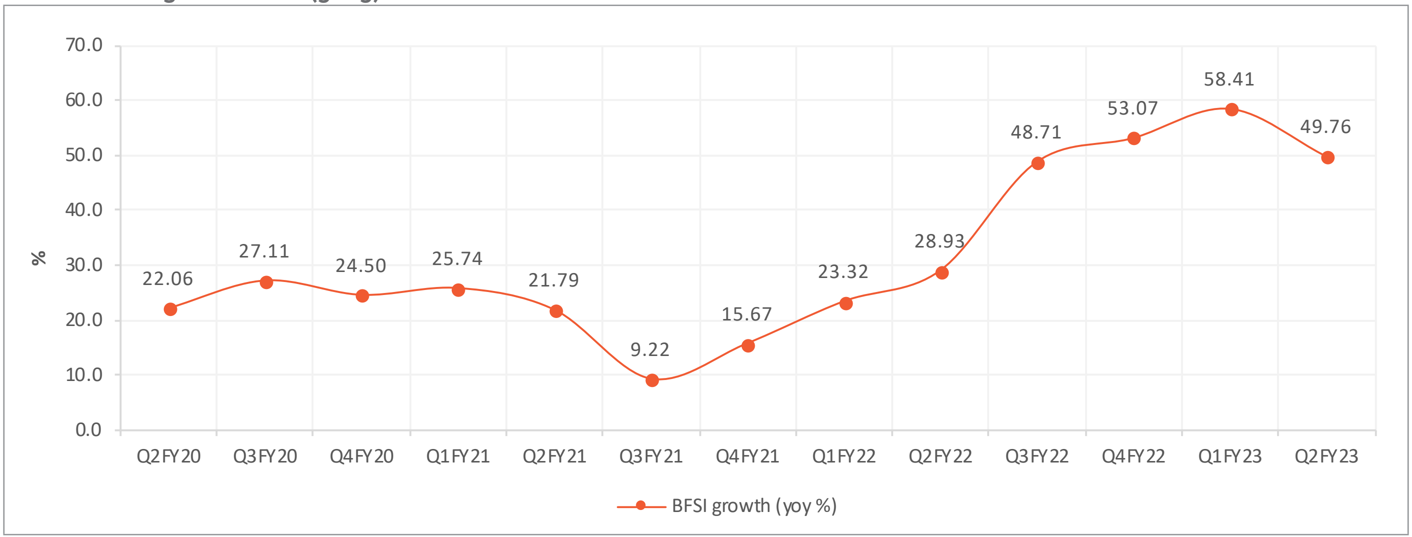
Source: Company; Sharekhan Research

EBIT margin trend (%)



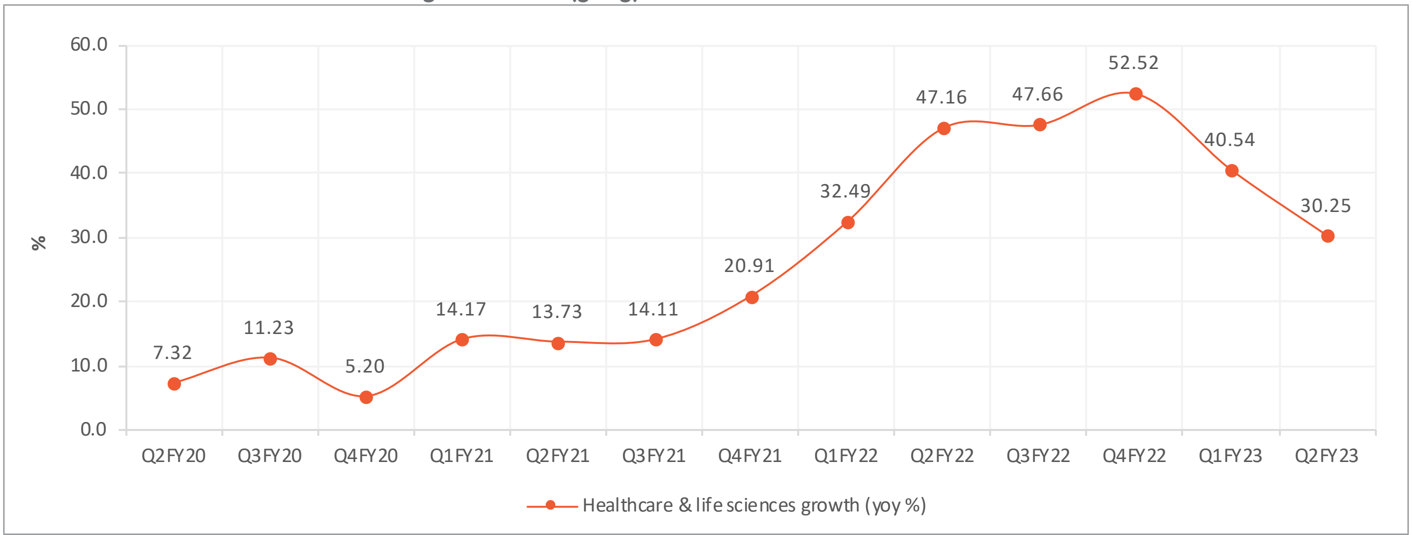
Source: Company; Sharekhan Research

BFSI revenue growth trend (y-o-y)



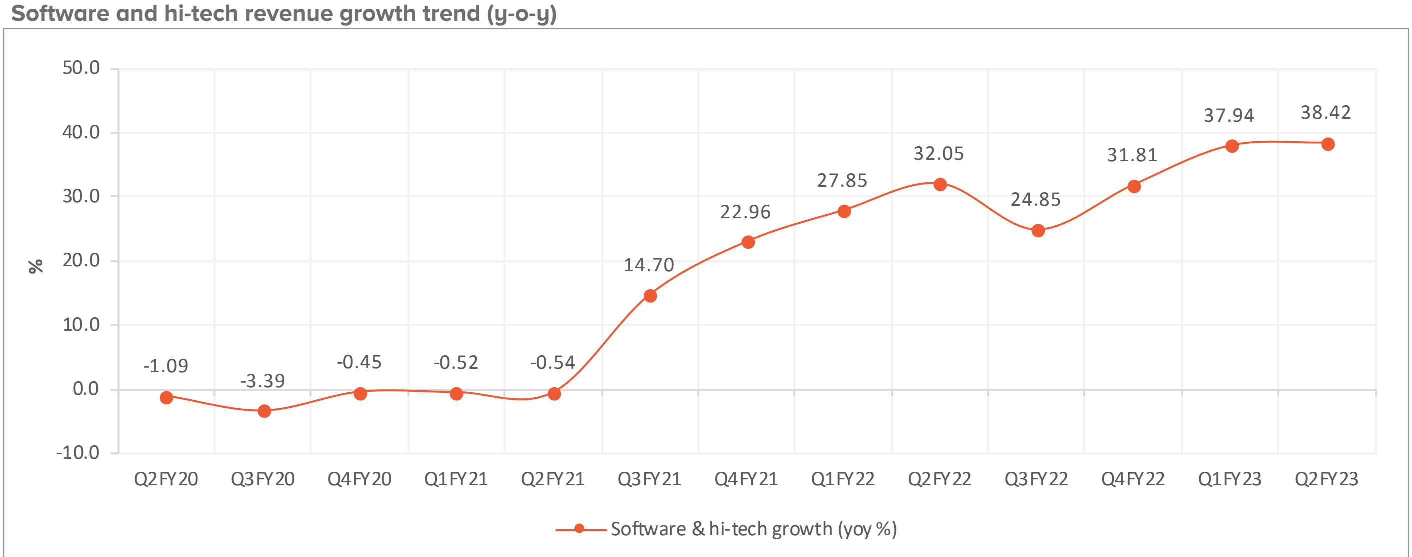
Source: Company; Sharekhan Research

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



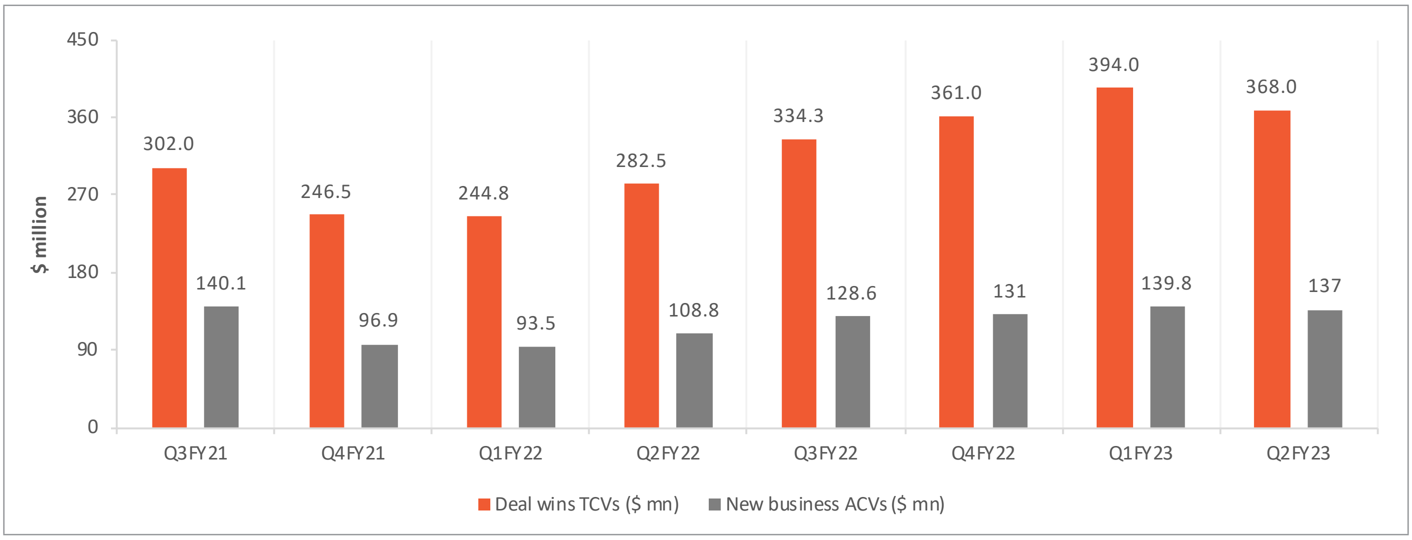
Source: Company; Sharekhan Research

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



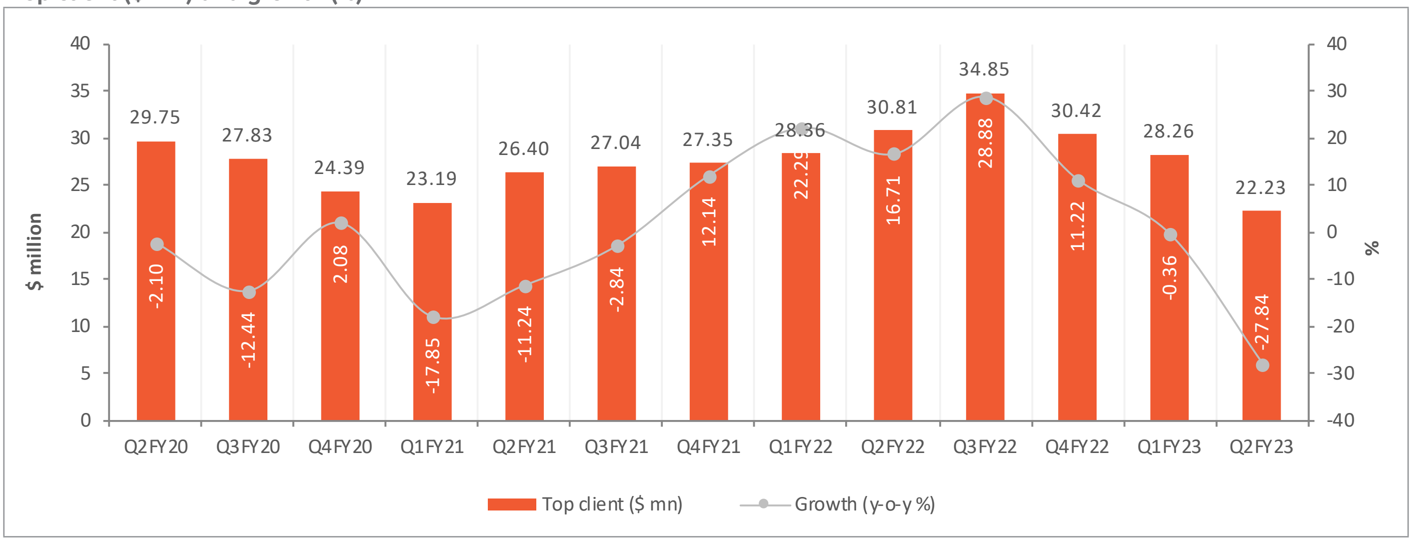
Source: Company; Sharekhan Research

Total deal TCV and new business ACV trend



Source: Company; Sharekhan Research

Top client ($ mn) and growth (%)



Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Expect acceleration in technology spending going forward

We believe that 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.

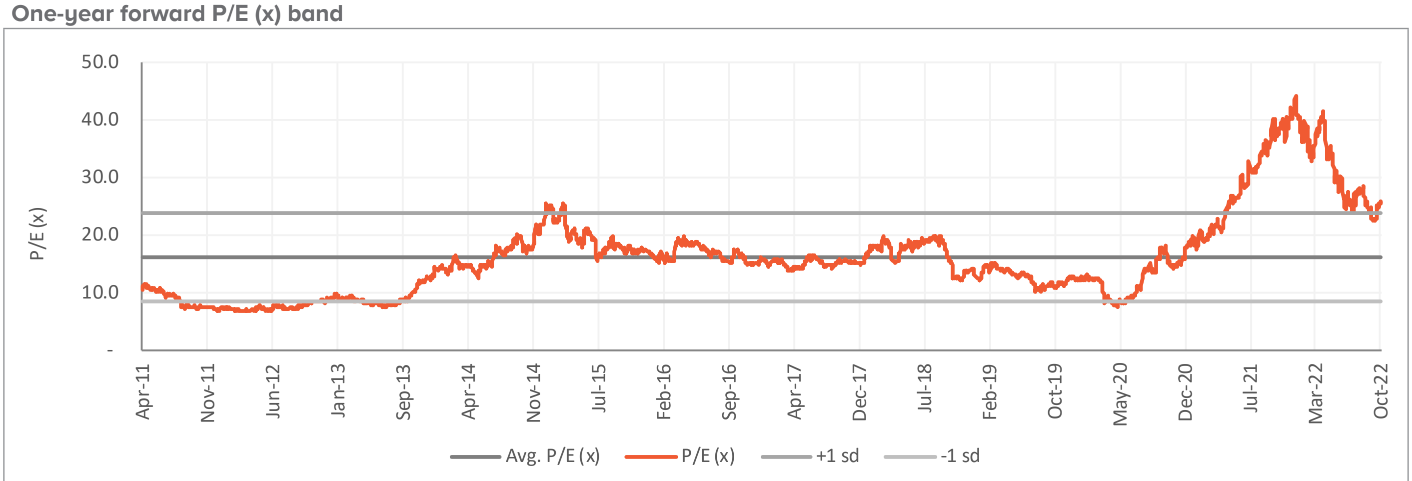
■ Company Outlook – Well positioned to capture immense growth opportunity

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. The 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 Q2, Maintain Buy

We expect margin headwinds to moderate and be offset by higher utilization, reduction in subcontracting costs and currency tailwinds. Given strong bookings, sustained acceleration in deal TCVs, strong execution capabilities PSL is likely to continue to deliver decent performance in the quarters ahead. We retain a Buy on PSL with an unchanged PT of Rs. 4,300.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
				FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Persistent	3707	7.6	28,333	30.9	25.4	19.2	15.8	7.1	6.1	24.7	25.7
Coforge	3,850	6.08	23,420	27.7	24.1	15.9	14.0	7.0	5.9	27.7	26.6
LTI	4,758	17.5	83,418	30.5	27.3	21.4	19.5	9.0	7.1	31.1	34.8

Source: Company, Sharekhan estimates

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) Rupee appreciation and/or adverse cross-currency movements,

2) constraint in local talent supply in the US would have an adverse impact on its earnings and

3) macro headwinds and possible recession in the US are likely to moderate the pace of technology spending.

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 Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Kotak Mahindra Asset Management Company Limited	5.07
2	Kotak Mahindra Trustee	5.01
3	HDFC Asset Management Company Limited	3.89
4	PSPL ESOP Management Trust	3.14
5	Axis Asset Management Company Limited	2.83
6	Vanguard Group Inc	2.41
7	FundRock Management Co SA	1.81
8	L&T Mutual Fund Trustee Ltd	1.62
9	Nippon Life India Asset Management	1.62
10	Dimensional Fund Advisors	1.49

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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